

**Republic of Slovenia: Detailed Assessment of Observance of Basel Core Principles for
Effective Banking Supervision**

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FINANCIAL SECTOR ASSESSMENT PROGRAM

REPUBLIC OF SLOVENIA

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING
SUPERVISION

DETAILED ASSESSMENT OF OBSERVANCE

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I. SUMMARY, KEY FINDINGS AND RECOMMENDATIONS

1. **Banking sector regulation and supervision is generally in line with international standards.** Regulations are up to date, as BOS (BOS) has duly transposed EU banking directives and has incorporated many guidelines from the EBA and its predecessor organization into its legal framework. This has served to strengthen and expand the banking supervisory regime by harmonizing banking regulation in Slovenia with EU standards. A large amount of information is gathered and analyzed through on-site and off-site supervision, and the authorities generally demand prompt correction of routine deficiencies detected in supervised institutions. Nevertheless, there has been a failure in implementation of these standards and the supervisory process. Their implementation has not been fully effective, as reflected in the development of a real estate bubble and asset quality problems in the corporate sector.

A. Introduction

2. **The original FSAP took place in 2001 and the update was conducted in 2003.** The 2003 update undertook an assessment of compliance with the Basel Core Principles for Effective banking supervision based on the 1999 methodology. Based on that methodology, the assessment reflected good compliance overall, but identified weaknesses in several important areas, and a few principles were rated as materially non-compliant. The principle recommendations contained in the 2003 assessment were: (a) increase the risk focus of banking supervision; (b) strengthen supervisory capacity for consolidated supervision and monitoring of transfer risk and connected lending; and (c) considerably expand supervisory resources. The Principles assessed as materially non-compliant included those dealing with legal protection of the BOS and its staff, the definition of connected lending, and consolidated supervision.

3. **Since then, the Slovenian banking system and the financial system more generally has been transformed by Slovenia's accession to the European Union.** In combination with the global economic crisis, which has adversely affected Slovenia's economy, this FSAP update is warranted.

4. **This Detailed Assessment of Observance Report was prepared as part of the FSAP Update mission to Slovenia, which took place April 2 – 16, 2012.** The assessors were Bruno Estecahandy (Banque de France) and Joel Shapiro (formerly of the U.S. Federal Reserve). The FSAP Update also conducted a qualitative analysis of insurance supervision without making a comprehensive IAIS assessment and of securities market regulation without making a comprehensive IOSCO assessment. In addition, the FSAP Update reviewed the adequacy of the bank resolution and crisis management framework and updated implementation of recommendations from the 2009 Moneyval report on Slovenia's anti-money laundering and counter-terrorist financing system. Extensive analysis was undertaken of vulnerabilities of the Slovenian financial system following the 2008-09 global crises and

the uncertain global environment at the time of the assessment; the development of macro-prudential oversight and policies; and the crisis management system.

B. Information and Methodology Used for the Assessment

5. **The assessment is based on several sources:** (i) a comprehensive and critical self-assessment, received in March 2012; (ii) detailed interviews with staff from BOS and other government agencies on the current practice for on-and off-site supervision; (iii) reading of laws, regulations, and other documentation on the supervisory framework and on the structure and development of the Slovenian financial sector, including a questionnaire response prepared by the authorities; (iv) reading of anonymous supervisory materials provided to the assessors during the fieldwork in Slovenia; (v) meetings with other authorities; and (vi) meetings with the banking industry as well as others such as academics and representatives of the accounting and audit profession. Specifically, the assessment team held extensive discussions with: staff from the BOS and in particular its Banking Supervision Department (BSD), the Ministry of Finance, other government agencies including the Insurance Supervisory Agency (AZN), the Securities Market Regulatory Agency (ATVP), and with private sector participants in the banking and financial markets.

6. **The assessor had the full cooperation from the Slovenian authorities and received all information necessary for the assessment.** The team extends its thanks to the staff of the authorities for their participation in the process, their openness, and their hospitality, and to the private sector representatives with whom they had a chance to meet.

7. **The assessment has been conducted in accordance with the guidelines described in the Core Principles (CP) Methodology published in October 2006 by the Basel Committee on Banking Supervision (BCBS).** It assessed compliance with both the Essential and the Additional Criteria, but the ratings assigned were based on compliance with the Essential criteria only. The methodology requires that the assessment be based on (i) the legal and other documentary evidence; (ii) the work of the supervisory authority; and (iii) its implementation in the banking sector. Full compliance requires that all these three prerequisites are met. The guidelines allow that a country may fulfill the compliance criteria in a different manner from those suggested as long as it can prove that the overriding objectives of each CP are achieved. Conversely, countries may sometimes be required to fulfill more than the minimum standards, e.g., due to structural weaknesses in that country. The Methodology also states that the assessment is to be made on the factual situation of the date when the assessment is completed. However, where applicable, the assessors made note of regulatory initiatives, which have yet to be completed or implemented.

8. **The assessment of compliance of each Principle should be made based on the following four-grade scale: Compliant, Largely Compliant, Materially Noncompliant, and Noncompliant.** A “not applicable” grading can be used under certain circumstances.

- **Compliant** – A country will be considered compliant with a Principle when all essential criteria applicable for this country are met without any significant deficiencies. There may be instances, of course, where a country can demonstrate that the Principle has been achieved by other means. Conversely, due to the specific conditions in individual countries, the essential criteria may not always be sufficient to achieve the objective of the Principle, and therefore other measures may also be needed in order for that aspect of banking supervision addressed by the Principle to be considered effective.
- **Largely compliant** – A country will be considered largely compliant with a Principle whenever only minor shortcomings are observed which do not raise any concerns about the authority’s ability and clear intent to achieve full compliance with the Principle within a prescribed period of time. The assessment “Largely Compliant” can be used when the system does not meet all essential criteria, but the overall effectiveness is sufficiently good, and no material risks are left unaddressed.
- **Materially noncompliant** – A country will be considered materially noncompliant with a principle whenever there are severe shortcomings, despite the existence of formal rules, regulations and procedures, and there is evidence that supervision has clearly not been effective, that practical implementation is weak, or that the shortcomings are sufficient to raise doubts about the authority’s ability to achieve compliance. It is acknowledged that the “gap” between “Largely Compliant” and “Materially Noncompliant” is wide, and that the choice may be difficult. On the other hand, the intention has been to force the assessors to make a clear statement.
- **Noncompliant** – A country will be considered noncompliant with a Principle whenever there has been no substantive implementation of the Principle, several essential criteria are not complied with or supervision is manifestly ineffective.
- In addition, a Principle will be considered **not applicable** when, in the view of the assessor, the Principle does not apply given the structural, legal and institutional features of a country.

9. **An assessment of compliance with the BCPs is not, and is not intended to be, an exact science; reaching conclusions require judgments by the assessment team.** Banking systems differ from one country to another, as do domestic circumstances. Also, banking activities are changing rapidly around the world after the crisis and theories, policies, and best practices are rapidly evolving. Nevertheless, by adhering to a common agreed methodology, the assessment should provide the Slovenian authorities with an internationally consistent measure of quality of their banking supervision in relation to the 2006 Revision of the BCPs, which are internationally recognized as minimum standards.

10. **For the sake of completeness, it should be noted that the ratings assigned during this assessment are not necessarily directly comparable to the ones assigned in terms of the FSAP performed using the pre-2006 BCP Methodology.** Differences may stem from the fact that the bar to measure the effectiveness of a supervisory framework was raised by the 2006 update of the BCP Methodology, as well as by lessons drawn from the financial crisis that may have a bearing on supervisory practices.

C. Institutional and Macro-Prudential Setting and Market Structure

11. **The main financial institutions are banks and insurance companies.** There is a small securities market, but its size and importance relative to the economy has been declining, especially in the aftermath of the economic crisis. Banks remain the most important financial institutions in Slovenia, accounting for more than 75 percent of the assets of the financial system. A slight increase in the share of assets of non-bank financial institutions in 2011 was mainly due to deleveraging in the banking system and better relative performance of the insurance sector. Government controlled financial institutions dominate the system. The two largest banks and the largest insurance company belong to financial groups that are at least 50 percent directly or indirectly owned by the government. Government controlled banks account for around 55 percent of the financial system in terms of assets or capital. The overseas activities of Slovenian banks are located principally in other Balkan countries. Several foreign institutions have operations in Slovenia, mostly from France, Italy and Austria, but their overall market share is comparatively small.

12. **Financial supervision responsibilities in Slovenia are shared among several agencies.** The BOS and specifically its Banking Supervision Department supervises banks. BOS is responsible also for payments system oversight. ATVP oversees the securities sector, while AZN mainly deals with the insurance sector.

13. **Cooperation among the supervisors occurs at various levels, from the top management level to more operational coordination among the supervisory agencies.** At the top management level, the MOF participates with the supervisory agencies on approaches to macro-level issues. At the operational level, cooperation between the three supervisory agencies appears productive and effective relative to planning for on-site examinations and routine supervisory issues. Cooperative efforts between the agencies are governed by a series of multilateral and bilateral MOUs.

Recent Developments

14. **The global crisis affected Slovenia's economy significantly, and most banks in the system were affected adversely by the economic downturn.** The performance of banks deteriorated markedly as a result of higher levels of non-performing loans in the corporate and real estate sector, particularly construction industry. As a result, the banking system reported operating losses in both 2010 and 2011. Since a significant amount of asset growth prior to the economic crisis was fueled by wholesale funding from abroad, both capital

adequacy and liquidity came under some strain. Leasing companies, several of which are owned by banks, have been affected by economic conditions as well. As a group they reported operating losses attributable to high non-performing loans and lower levels of activity. Insurance companies have remained profitable.

15. **The authorities have attempted to reduce the effects of the financial crisis with several counter-cyclical fiscal policy measures and a program to provide liquidity to the financial sector.** Automatic stabilizers were allowed to work and a frontloaded 2.1 percent of GDP package of discretionary measures was implemented. The authorities supported liquidity to the financial sector by enhancing the deposit insurance scheme, placing government deposits with banks, and providing guarantees for bank's bond issuances. Banks have also benefitted from access to ECB funding through the 3-year LTRO.

16. **Strengthening the financial condition of the banking system is a key priority of the authorities at present.** The 3 year LTROs have eased immediate liquidity pressures, but a structural adjustment is needed to reduce dependence on wholesale funding and to restructure bank balance sheets overall. Toward this end, a stronger capitalization of some banks would help avoid severe deleveraging and enable banks to provide credit for sound lending opportunities. Further write-downs of non-performing loans will have to be recognized in connection with bank restructuring. The operations of the government controlled banks will have to become more commercially oriented as well.

D. Preconditions for Effective Banking Supervision

Sound and sustainable macroeconomic policies

17. **Slovenia has a solid institutional framework supporting the conduct of sound macro-economic policies.** Monetary policy is conducted by the bank of Slovenia within the ESCB framework. Budgetary policy is conducted within a fiscal framework based on the requirements of the EU's Stability and Growth Pact. The recent financial crisis has put pressure on financial stability and the budgetary situation in Slovenia. Measures have been taken to ensure that the budget remains on a sustainable path. However, considerable adjustment still needs to be made.

A well-developed public infrastructure

18. **The Slovenian legal framework for the financial sector is comprehensive and regularly updated.** The EU's compendium of laws and regulations have been fully adopted and implemented relative to the financial sector. For banks, these are reflected in the major legislation affecting these institutions, including the Banking Act and attendant regulations, and the Companies Act.

19. **Auditing and accounting rules applicable to financial institutions comply with international standards.** All banks, insurance companies and listed companies have

implemented IFRS. Disclosure and reporting requirements also are strict, and adhere to EU requirements as well.

20. **The Slovenian legislative framework with regard to the audit profession requires internal and external auditors to be independent in both fact and appearance.** The Banking Act requires the appointment of an internal auditor and an external auditor in a bank, and stipulates the governance of these auditors, who are subject to specific sections of the Audit Act relative to professional standards. The Agency for Public Oversight of Audit assures the independence of external auditors, including qualification requirements. The Agency also serves as a self-regulating body for the audit profession.

21. **The judicial system, including that for bankruptcy and the enforcement of property rights, is well developed.** However, the legal background and regulatory and institutional framework dealing with banks in a weak or deteriorating financial condition, as stipulated in the Banking Act, is inadequate. BOS needs a more effective set of bank resolution regulations and tools.

22. **BOS participates in the Trans European Automated Real-Time Gross Settlement Express Transfer 2 (TARGET2), the Real Time Gross Settlement of the Eurosystem.** BOS operates the national component of TARGET2, which is the most important payment system in Slovenia. It enables the settlement of transactions between members of the system, and cross-border transactions with members of TARGET2 system outside Slovenia. The number and value accounted for by the latter are relatively small.

Effective market discipline

23. **Competition is encouraged and the market is open to foreign participants.** There are no significant non-prudential barriers to entry by domestic or foreign firms. Indeed, accession to the EU has encouraged and facilitated market openness.

24. **Financial reporting and disclosure requirements for financial institutions listed on capital market indices in Slovenia or other member states of the EU that operate in Slovenia are very strict.** BOS requires detailed disclosures to the public in annual and quarterly financial statements, and in the management review (business report), the supervisory board's report, and statements or opinions from the directors, management or the external auditor.

25. **The corporate governance of financial institutions in Slovenia is governed by the Companies Act and the Audit Act.** In addition, sectoral legislation has been introduced to regulate the operation of each financial sector. For example, the Banking Act and accompanying regulations have provisions addressing corporate governance requirements for the banking system. Similar legislation addresses certain requirements in this regard for the insurance industry, the securities market and pension funds.

Public safety nets

26. **Slovenia has a deposit guaranty scheme that in effect insures depositors with funds on account in a bank aggregating Euro 100,000.** The scheme is administered by BOS, and can be utilized in the event a bank is declared bankrupt in accordance with current bankruptcy laws contained in the Banking Act. To date, the scheme has not been utilized.

Legal framework for supervision

27. **The Slovenian legal framework for banking supervision is comprised principally of the Banking Act and attendant defining regulations.** Other legislation of importance includes the Companies Act, the Conglomerates Act and the Audit Act, each of which contains provisions that round out and provide a comprehensive regulatory and supervisory structure. To implement prudential requirements, BOS employs defining regulations on specific areas ranging from capital adequacy to risk management practices.

E. Main Findings¹

28. **Objectives, independence, powers, transparency and cooperation (CP1):** There is a generally comprehensive set of laws and regulations governing the supervision of the banking industry. BOS is autonomous both from a *de jure* and *de facto* perspective, although government policies and priorities act as an impediment to the robust supervision of the government controlled banks. The legal framework does not indemnify bank supervisors against damages resulting from the discharge of their responsibilities, nor does it provide protection against the costs of defending acts of commission or omission of their duties in good faith. Banking supervision is understaffed, and this problem could inhibit the ability of the BSD to achieve its mission and perform its responsibilities in a satisfactory manner.

29. **Licensing and structure (CPs 2-5):** The legal framework is clear relative to the types of banking and non-banking activities in which banks may engage. While there are few license applications, the legal framework, policies and processes are in place to evaluate the application of a bank license. The transfer of ownership is well defined in the law, and there are explicit definitions for controlling interests. The conditions for the acquisition of non-bank financial institutions are not contained in the law, and in fact, banks are permitted to acquire such institutions without regard to review or approval by BOS at present. The authorities are contemplating legislation to correct this gap in the legal framework.

30. **Prudential regulation and requirements (CPs 6-18):** The capital adequacy framework is based on international standards in accordance with EU directives. The entire Basel II regimen has been introduced into the legal framework in this manner. While BOS has established minimum capital requirements and has the capacity to require additional

¹ Table 1 provides an overview of the assessment on a principle by principle basis.

capital as warranted, the legal framework enables the shareholders of an institution to forestall the raising of additional capital. Virtually all major banking risks are subject to close scrutiny. The evaluation of risk management practices is generally adequate, but many banks have not yet fully developed satisfactory risk management systems in all aspects of their operations. Areas for improvement include certain aspects of credit risk management, particularly with respect to the reporting of problem assets and loan loss reserves. The reporting of problem assets lacks granularity, and the provisioning on NPLs stands at only 41 percent. As a result, there is a strong possibility that impaired assets are under-reserved. Other risks warranting some improvement include internal controls, liquidity risk, operational risks and monitoring of related parties exposures.

31. **Methods of ongoing banking supervision (CPs19-21):** BOS has implemented a risk-based approach to supervision. BSD has built a robust supervisory approach featuring a strong ICAAP-SREP program and RAS methodology. There also is a good mix of on-site and off-site supervision, with an extensive level of communication and cooperation between the two groups. There is an extensive set of reporting requirements for banks that provides a wide range of data and risk management information, both on a consolidated and unconsolidated basis. Appropriately, the information is used in the supervision process to evaluate risk and for other objectives. However, there are gaps in the information collected. Non-bank financial institutions are not required to file financial information on a solo basis, and the data collected on related parties is incomplete.

32. **Accounting and disclosure (CP22):** Disclosure requirements are very strict, and external auditors are employed to ensure that disclosure rules are adhered to. The auditing profession is held to high standards in law and practice by BOS, but it is self-regulating. BOS is not empowered to approve the external auditing firm that is retained by a bank. The banking system prepares its accounting records and reports financial information in accordance with IFRS.

33. **Corrective and remedial powers (CP23):** BOS has a satisfactory range of enforcement tools at its disposal to address supervisory issues. However, these may be impeded by shareholder rights relative to requirements to increase capital, and lack of power in the law to remove unqualified members of a supervisory board. The powers and strategies concerning the resolution of a problem bank are in need of strengthening.

34. **Consolidated and cross-border banking supervision (CPs24-25):** BOS has developed an overall satisfactory program of consolidated supervision. Supervisors are aware of the organizational structure of banking groups, have identified areas of risk, and maintain contact with other foreign bank supervisors and domestic authorities, principally through supervisory colleges. The program can be strengthened by focusing additional supervisory attention on non-bank financial companies, enhancing the understanding of related party interests throughout a banking group, and monitoring transactions with affiliated companies in a mixed activity company.

Table 1. Slovenia: Summary Compliance with the Basel Core Principles

Core Principle	Grading	Comments
1. Objectives, independence, powers, transparency, and cooperation	Largely Compliant	The laws and regulations governing the supervision of the banking industry are relatively comprehensive. The legal framework provides sufficient supervisory tools to require banking corporations to comply with laws and regulations, and there are adequate provisions in the law to facilitate consolidated and cross-border supervision. Nevertheless, certain provisions of the law should be strengthened or added to the regulatory framework to enable BOS to respond in an appropriate manner. In particular, provisions in the law need to be strengthened to enable the supervisors to prohibit potentially unqualified candidates from being appointed to the supervisory board, and to remove unqualified board members as well. The power to require banks to raise capital should be made more effective and an appropriate and effective bank resolution framework is necessary.
1.1 Responsibilities and objectives	Compliant	The set of laws and regulations is relatively comprehensive. BOS has clear responsibility for banking supervision, and its powers in that regard are stipulated in the Banking Act. To implement provisions of the Act, BOS has issued regulations that complement and interpret provisions of the law. The Banking Act has been amended several times since Slovenia's accession to the EU to incorporate EBA guidelines.
1.2 Independence, accountability and transparency	Largely Compliant	BOS has a great deal of <i>de jure</i> and <i>de facto</i> independence and accountability mechanisms are in place. No other government agency appears to influence its decisions. However, the State's policies or priorities may act as an impediment to the fully effective supervision of the Government controlled banks. One such issue in this regard is the adequate capitalization of these institutions.
1.3 Legal framework	Largely Compliant	The Banking Act provides an overall satisfactory legal framework for the supervision of banks, and is complemented with a compendium of detailed regulations. Provisions of the law regarding the supervision of members of the supervisory board, the requirement to raise capital and the tools to resolve a problem bank should be strengthened.
1.4 Legal powers	Largely Compliant	BOS has sufficient powers in the law, and an appropriate range of tools, to require banks to comply with banking laws and regulations in most cases. Bank shareholders can impede the supervisor's requirement to raise capital, and the manner in which supervisors are authorized to deal with unqualified members of the supervisory board must be strengthened.
1.5 Legal protection	Non-compliant	Protections in the law to indemnify bank supervisors against litigation in the proper conduct and execution of their responsibilities as bank supervisors are inadequate.

Core Principle	Grading	Comments
1.6 Cooperation	Compliant	A satisfactory framework for cooperation on supervisory issues and the exchange of information exists between BOS and other financial regulators both in Slovenia and abroad. Cooperative efforts and the exchange of information with other Slovenian financial regulators are maturing, as reflected in the establishment of interagency committees. Such efforts with foreign bank supervisors have a longer history and have been carried out successfully.
2. Permissible activities	Compliant	The legal framework is clear relative to the use of the word “bank” and the types of banking and non-banking financial activities in which banking groups may engage.
3. Licensing criteria	Largely Compliant	The infrastructure is in place in terms of the legal framework, policies and processes to evaluate licensing applications, and the program is effective. However, BOS lacks the power to evaluate and license members of the supervisory board.
4. Transfer of significant ownership	Largely Compliant	The transfer of ownership is well defined in the law, and there are explicit definitions for qualifying holders. However, the sanctions applied to qualifying holders who obtain their ownership interest in a bank without authorization of BOS are weak. Banks are not required to inform BOS of a material adverse event that would affect the suitability of a qualifying holder.
5. Major acquisitions	Non-compliant	BOS does not authorize the establishment of non-bank financial companies for Slovenian banks. Slovenian banks are free to acquire such companies in Slovenia or the EU without authorization and an evaluation of the financial capacity of the bank to acquire such an organization, or its plans relative to the establishment of appropriate risk management practices in the company.
6. Capital adequacy	Materially Non-compliant	The regulatory framework for capital adequacy is aligned with the amendments to the Basel international standards, and the supervisors are proactively preparing for the implementation of Basel III. BOS’s authority in requiring banks to increase capital is clear, but there are provisions in the law that enables a bank’s shareholders to frustrate the supervisor’s efforts in this regard. The supervisors are not aggressively requiring banks to employ more enhanced capital measurement techniques, such as IRB relative to credit risk. The supervisors prefer to require banks to improve their risk management practices. While this is commendable, it is not a substitute for adequate capitalization. Employment of enhanced techniques is expected to result in capital shortfalls for many banks. With respect to the Government controlled institutions. BOS’s powers to ensure that additional capital is raised are limited.

Core Principle	Grading	Comments
7. Risk management process	Largely Compliant	<p>The internal RAS/POT methodology for off-site and on-site supervision provides BOS examiners and analysts with generally adequate guidance for assessing a bank's risk management process. However the regulatory guidance on banks internal control framework and on risk control functions organization, missions and resources could be more precise and prescriptive.</p> <p>BOS duly made use of its power to require banks to strengthen their risk management process and culture but has not been fully successful in obtaining the expected improvements in a timely manner.</p>
8. Credit risk	Largely Compliant	<p>The regulatory framework on credit risk is relevant as well as is the guidance given to the on-site or off-site examiners/analysts in the internal part of BOS's RAS/POT methodology. Credit risk is well identified by the BOS as the prominent risk in the Slovenian banking system. However the Supervisor's ability to keep under control banks credit policies and practices has not been demonstrated taking into account the rise in NPLs and their impact at present on bank profitability. Moreover there is some evidence that credit risk might have been underestimated and that at least some banks have not followed a prudent approach to the degree that was suggested by the supervisor during the years of prosperity supported by high lending growth.</p> <p>The number of banks using the IRB-F approach is very limited and the ones who use it are not the country's biggest credit institutions. Banks have indeed few incentives to shift to IRB in the absence of a regulatory constraint to use it and since it would very likely result in additional capital requirements.</p>
9. Problem assets, provisions, and reserves	Largely Compliant	<p>Banks report monthly on exposures to debtors using a 5 grade classification system. This regulatory reporting provides the supervisor with valuable data on credit risk and is a useful tool for conducting macro-prudential surveys. However the credit classification lacks granularity and the intermediate class C, which accounts for about 10 percent of the classified assets, is not homogenous.</p> <p>Impairment on NPLs is only 40 percent which is rather low to every standard including BOS ICAS methodology for evaluating expected losses (53 percent), which reflects in part the need for greater granularity.</p>

Core Principle	Grading	Comments
10. Large exposure limits	Largely Compliant	BOS is compliant with BCBS and EU guidelines on large exposure limits and on the definition of connected counterparties. BOS's on-site examiners as well as off-site analysts perform regularly controls to make sure that banks comply with LE rules. Furthermore BOS monitors concentration risks and requires that banks put in place limits to concentration risks. In particular BOS has defined measurement methodologies for sectoral risk that banks must comply with. However supervisor's action to prevent sectoral concentration risk to emerge as a major issue has not been fully successful. Many banks indeed have high exposure on the construction and housing sector and on the financial intermediation sector.
11. Exposure to related parties	Largely Compliant	Law and regulations provide a comprehensive definition of related parties and provides regulatory basis for preventing abuses arising from exposures to related party and for addressing conflicts of interest. Furthermore BOS requires from banks quarterly reports on large exposures and semi-annually for related parties and assesses these reports as a part of off-site supervision. However. Related party exposures are not gauged adequately on a consolidated basis through the supervisory returns process or by other means. It is as much a matter of concern that the small size and structure of the Slovenian economy itself induces multiple interrelations between firms.
12. Country and transfer risks	Compliant	No specific rules for country and transfer risk are determined in Slovenian legislation or regulations. Nevertheless the RAS/POT methodology provides BOS's examiners and analysts with some useful guidance. Moreover banks must report monthly to the BOS on their overall country exposure. This light framework is proportionate to the issue as banks foreign countries exposure is limited.
13. Market risks	Compliant	BOS regulatory prescriptions in the market risk field sometimes lacks precision or stringency but BOS's RAS/POT methodology gives more guidance to supervisor's examiners and indirectly to banks. Furthermore, market activities of banks are in most cases very limited and receding. Thus capital requirement for market risk is only 2 percent of the overall capital needs according to ICAAP/SREP estimates. In such a context, regulatory environment and BOS's supervisory practices can be regarded as adequate.

Core Principle	Grading	Comments
14. Liquidity risk	Largely Compliant	<p>BOS has set a comprehensive and pertinent liquidity risk supervision framework, both qualitative and quantitative. It encompasses daily banks reporting on liquidity ratio and the compliance with a liquidity ratio. As liquidity strains in European markets were continuing BOS opportunely encouraged banks to deleverage, to sell assets when possible and to make a large use of ECB facilities, including 3 years LTRO.</p> <p>However, like in many other countries, funding issues were not given timely and sufficient attention by banks and by the Supervisor in advance of the crisis.</p>
15. Operational risk	Largely Compliant	<p>BOS's OR reporting requirements are aligned with COREP reporting requirement on loss events. Collection of loss event data on an aggregate basis (OPR Loss COREP template) is required on a quarterly basis. Collection of loss event details is on request only. Off-site investigations have been limited in number and depth due to the lack of skilled human resources; it is not apparent that the Supervisor has put enough emphasis on this category of risk. Moreover BOS may have not paid adequate attention to some specific OR the Slovenian banking industry is exposed to, such as OR linked to market activities, (rogue trading); and suitability in trading activities like CHF denominated loans. Even if such types of OR have not materialized to date they shouldn't be considered negligible. However there is no evidence that OR is not adequately covered by capital (OR accounts for 15 percent of the capital needs according to ICAAP and SREP).</p>
16. Interest-rate risk in the banking book	Largely Compliant	<p>BOS's regulatory requirements are not very specific on different aspects of the interest rate risk management, including assumptions and stress-tests. In such an environment it does not seem that Slovenian banks have implemented sophisticated methodologies and a large variety of scenarios for measuring impact of interest rate, basis and spreads changes on their banking book.</p> <p>However the need for comprehensive and sophisticated methodologies is limited as the balance sheet structure of Slovenian banks does not reflect very significant interest rate exposure. Indeed a large portion of loans to corporate or households including mortgages are granted with variable rates while most liabilities are also indexed on BOR indices. Further disclosure by banks on ALM issues would be desirable nevertheless.</p>

Core Principle	Grading	Comments
17. Internal control and audit	Largely Compliant	<p>The Banking Law and BOS regulations set general principles as regards the banks' internal control framework. Going further the RAS/POT methodology provides the banks with some more guidance on the Supervisor's expectations and offers to BOS examiners a more comprehensive toolkit for assessing banks' internal controls and the internal audit function.</p> <p>However the credit risk problems and the liquidity strains that the Slovenian banking system is now facing cast some doubt on the adequacy of banks' internal controls and on the skills and/or independence of the control functions including the internal audit). It also tends to demonstrate that even if the Supervisor is now very active in prescribing remedial, correcting measures it may have not been in the recent past proactive enough in this regard and/or unable to enforce in a timely manner the prescribed improvements in banks internal controls.</p>
18. Abuse of financial services	Largely Compliant	<p>Slovenian law and regulations as well as the BOS's "Guidance for the implementation of measures regarding the prevention of money laundering and terrorist financing for the banking sector" have set the legal framework for promoting high ethical standards and preventing the banks from being used for criminal activities.</p> <p>However, as already noticed in the March 2012 MONEYVAL follow-up report, the efficiency of this framework is in practice hampered by two major shortcomings :</p> <ul style="list-style-type: none"> -the relatively low number and severity of administrative sanctions -the still inadequate on-site examination resources devoted to AML/CFT.
19. Supervisory approach	Largely Compliant	<p>BOS has implemented a risk-based approach to supervision. Through SREP-ICAAP dialog, RAS/POT methodology and some other tools (e.g., ICAS) BOS has built a robust and well designed supervisory approach. Moreover BOS can also rely on the high quality of its supervisory staff for understanding the operations and for assessing the individual banks' risk.</p> <p>Nevertheless the crisis revealed some serious weaknesses in the past approach and implementation practices of the BOS. It appears quite obvious that the Supervisor has been overconfident in the banks' ability to master and command their risks and has failed to identify or to address in a timely manner the development of a credit bubble, the rise of sectoral concentration risks and the dependence of Slovenian banks to foreign wholesale funding. Then there is a strong need for more in-depth reviews and ongoing monitoring by the off-site supervision and overall for a more forward looking, a more proactive rather than reactive approach and a somewhat more intensive and demanding implementation of banking supervision.</p>

Core Principle	Grading	Comments
20. Supervisory techniques	Largely Compliant	<p>There is a good mix of on-site and off-site supervision, with a high level of communication and cooperation between the two groups.</p> <p>Whereas supervisory resources have been expanded by 25 percent globally since the last FSAP in 2003 the off-site supervision section is still understaffed. A significant increase in resources would allow the off-site section to developed meetings with the banks both at the higher level and at more operational level. It would also permit the staff to better capitalize on the results of banks' internal audit functions whose reports are not yet systematically used and evaluated. An increase in the off-site staff along with targeted hiring of on-site resources (which presently is short on AML, IT and OR experts), and better leveraging of internal controls and audits would result in a more proactive, more intensive, more forward looking and hopefully more efficient banking supervision.</p>
21. Supervisory reporting	Largely Compliant	<p>BOS receives an abundance of information from banks that the supervisors utilize in ongoing supervision. There are, nevertheless, gaps in the data collected. Non-bank financial companies are not required to file information on a solo basis, and the data collected on related party transactions is incomplete.</p>
22. Accounting and disclosure	Compliant	<p>Disclosure requirements are very strict, and external auditors are employed to ensure that disclosure rules are adhered to. Banks are required to account for and report financial information in accordance with IFRS. Auditing firms are licensed by a public agency and are held to international best practice in their professionalism and expertise.</p>
23. Corrective and remedial powers of supervisors	Largely Compliant	<p>BOS has a satisfactory range of enforcement tools at its disposal to address supervisory issues. However, these may be impeded by shareholder rights relative to requirements to increase capital, and lack of power in the law to remove unqualified members of a supervisory board. The powers and strategies concerning the resolution of a problem bank are in need of strengthening.</p>
24. Consolidated supervision	Largely Compliant	<p>BOS has developed an overall satisfactory program of consolidated supervision. Supervisors are aware of the organizational structure of banking groups, have identified areas of risk, and maintain contact with other foreign bank supervisors and domestic authorities, principally through supervisory colleges. The program can be strengthened by focusing additional supervisory attention on non-bank financial companies, enhancing the understanding of related party interests throughout a banking group, monitoring transactions with affiliated companies in a mixed activity company, and more aggressively monitoring the results of supervisory actions imposed on subsidiaries.</p>

Core Principle	Grading	Comments
25. Home-host relationships	Compliant	BOS engages in host-home country relationships commensurate with the size and complexity of the operations of Slovenian banks operating abroad. Formal written agreements governing cooperation and information exchange are in effect between BOS and ten European bank supervisors. BOS participates in several supervisory colleges, and acts as the coordinator of such colleges relative to the foreign operations of two Slovenian banks.
<i>Aggregate:</i> Compliant (C) – 7, Largely compliant (LC) – 21, Materially noncompliant (MNC) – 1, Noncompliant (NC) – 2, Not applicable (N/A) – 0		

Recommended action plan and authorities' response

Recommended action plan

35. **Table 2 summarizes the recommendations formulated in the course of the assessment.** Some recommendations are included under core principles that are rated as fully compliant.

Table 2. Slovenia: Recommended Action Plan to Improve Compliance with the Basel Core Principles

Reference Principle	Recommended Action
1 (2) Independence, accountability and transparency	It is time to reassess the staffing needs of the Banking Supervision Department. The implementation of the Risk Assessment System, monitoring of industries systemic to the Slovenian economy, the challenges in fully implementing operations risk and Basel III have all strained the Department's resources. Optimally, the current ceiling on the number of professional staff should be raised so that further staff additions can be made as appropriate.
1 (3) Legal framework	To further improve the comprehensiveness of banking laws and regulations, provisions should be added or amended to the Banking Act. Such changes should address the supervisor's power to license or remove supervisory board members, the ability of shareholders to impede the supervisor's power to require a capital increase, and the introduction of an appropriate bank resolution regime.
1 (5) Legal Protection	Slovenian law should be amended to provide indemnification against legal action for employees of BOS in the discharge of their duties and responsibilities.

Reference Principle	Recommended Action
1 (6) Cooperation	The authorities should consider strengthening the communications link between the Commission and the Coordinating (Steering) Committee. For example, the Commission could provide the Coordinating Committee its views relative to issues or supervisory concerns manifesting themselves in the financial system. The Commission could establish ad hoc working groups with representatives from each supervisory agency to propose policies or practices that would be implemented in each agency.
3 Licensing activities	A provision should be added to the Banking Law that would enable BOS to license supervisory board members. With the weight of the prospective EBA Guidelines on Internal Governance set to be introduced, it is an appropriate time to introduce such legislation.
4. Transfer of significant ownership	The sanctions applied to a qualifying holder in the event the shares in a bank are acquired without gaining the approval of BOS should be strengthened. It is recommended that, at a minimum, the qualifying holder should be restricted from voting any shares, or prohibited from benefiting from other advantages of ownership, such as receiving dividends or gaining the appreciation in the market value of the shares. At present, qualifying holders who have acquired their shares illegally are restricted from voting, receiving dividends and required to pay a penalty.
5. Major Acquisitions	It is recommended that the authorities require banks to obtain a license prior to acquiring a non-bank financial company. The criteria applied should be similar to acquiring a controlling interest in a bank.
6. Capital adequacy	<p>BOS should be empowered to require a bank to increase capital, as a special capital charge or for other reasons, without potential impediments raised by the bank's shareholders.</p> <p>While requiring banks to improve their risk management practices is commendable, and ultimately is the correct solution, this frequently is a more protracted affair and is not a substitute for the appropriate level of capital that is needed. In keeping with best practice, it should prod the larger systemically important banks in the system towards gaining the expertise and employing modeling techniques. Use of IRB for credit risk, for example, is expected to reflect a need for capital contributions in these institutions.</p> <p>With the full implementation of Basel III scheduled for January 2013, the supervisors should consider monitoring closely through required written capital plans or other communications the manner in which banks plan to meet the capital adequacy requirements, and the progress made toward this goal.</p>

Reference Principle	Recommended Action
7. Risk management process	<p>Guidance to banks on internal control framework and on risk control functions organization, missions and resources should be more precise and prescriptive. In particular the risk management function should have more power in the decision making process.</p> <p>BOS should be more proactive in identifying risk management issues and be more demanding that banks take remedial actions in a timely manner.</p>
8. Credit risk	<p>The supervisor should intervene timely and forcefully when identifying a rise in credit risk and should put more pressure on banks for classifying more appropriately their claims on individual debtors and requiring additional provisioning when needed even if it can result in a deteriorated capital ratio.</p> <p>BOS should also encourage a wider use of IRB approaches.</p>
9. Problem assets, provisions, and reserves	<p>BOS should consider shifting to a more granular claims classification with more homogenous credit categories. It should encourage external auditors to review with a more critical bias the banks' loan portfolios and require from banks to maintain or increase accordingly their external audit budgeted/fees.</p> <p>It should develop on-site examinations of loan portfolios on larger samples and induce the banks to take a more conservative stance on collateral valuation.</p>
10. Large exposure limits	<p>BOS should pay more attention to the development of sectoral concentration risks and intervene on a more preemptively and in a more directive way as soon as they are detected.</p>
11. Exposure to related parties	<p>BOS should improve its internal RAS/POT methodology on this issue in providing its examiners and analysts. More explicit language could be added to the law relative to the prohibition of related parties receiving credit on more favorable terms.</p>
12. Country and transfer risk	<p>BOS should be ready to take a closer look on country risk exposure and its adequate provisioning if and when it becomes a material risk.</p>
13. Market risks	<p>BOS should stand ready for establishing more demanding requirements and expectations in the market risk field if and when it becomes a material risk for Slovenian banks.</p>
14. Liquidity risk	<p>BOS should encourage domestic banks to reduce their dependence to external borrowings and the wholesale market and should require them to reduce their loan-to-deposit ratio by any available measure when needed.</p> <p>BOS should encouraged banks to monitor closely their progress for being less dependent of the Euro system's financing.</p>

Reference Principle	Recommended Action
15. Operational risk	<p>BOS' OR reporting requirements should be enhanced and the number of on-site investigations should be increased; on-site supervision expertise and resources should be increased accordingly.</p> <p>More emphasis should be put on some specific OR the Slovenian banking industry is exposed to (e.g. OR linked to marked activities and suitability in lending activities).</p>
16. Interest-rate risk in the banking book	<p>BOS should be more specific as regards its expectations on different aspects of the interest rate risk management including assumptions and should encourage the largest banks to develop more sophisticated methodologies for evaluating their interest rate risk on their banking book under normal circumstances as well as in stressed circumstances. Further disclosure from banks on ALM issues would also be desirable.</p>
17. Internal control and audit	<p>BOS should encourage banks to have a more powerful risk management function.</p> <p>It should also monitor more closely, on an ongoing basis, the quality and comprehensiveness of internal reports, including audit reports. BOS should have some licensing or veto power for the appointment to the supervisory board and the audit committee.</p>
18. Abuse of financial services	<p>BOS should increase the number and severity of administrative sanctions and fines issued for AML/CFT non compliance. It also should consider that such measures are made public.</p> <p>BOS should increase significantly its on-site examination resources devoted to AML/CFT so that it could increase the number of on-site inspections.</p>
19. Supervisory approach	<p>There is a strong need for more in-depth reviews and ongoing monitoring by off-site supervision (which will require additional staff) and overall for a more forward looking, a more proactive rather than reactive approach and a somewhat more intensive implementation of banking supervision.</p>
20. Supervisory techniques	<p>Off-site staff and to a lesser extent on-site staff should be expanded. A significant increase in resources would allow the off-site section to developed meetings with the banks both at the higher level and at more operational level. It would also permit staff to better capitalize on banks' internal audit function production whose reports are not yet systematically used and evaluated. Some more targeted hiring of on-site resource (which presently is short of IT and OR experts), is also highly desirable.</p>
21. Supervisory reporting	<p>The authorities should consider expanding the amount of data collected through the supervisory reporting process. More complete information on related party transactions should be required. To improve the level of consolidated supervision, data on non-bank financial companies should be collected from banks on a solo basis.</p>

Reference Principle	Recommended Action
22. Accounting and disclosure	<p>Notwithstanding the high standards of professionalism and expertise established in the auditing profession, it is recommended that the authorities obtain the power to reject the appointment of an auditor by a bank. With this power, the supervisors can ensure that all banks select auditors of the highest quality that have been licensed by the governing agency, would not be compromised by conflicts of interest, or would be objectionable for other reasons.</p> <p>The rotation of external auditing firms could have the benefit of creating some competition in the industry, as there are a minimal number of firms providing these services at present.</p> <p>Consideration should be given to having a formal meeting with the external auditor subsequent to the completion of the audit to discuss at length the auditor's evaluation of risk management practices and the internal control system.</p>
23. Corrective and remedial powers of supervisors	<p>The Banking Law should be amended to enable BOS to remove a member of the supervisory board for the same or similar reasons for which a member of the management board may be removed. Such powers exist in connection with the remedial powers the supervisors have in improving the quality of the management board.</p> <p>All impediments to BOS's powers to require corrective measures relative to ensuring that a bank has adequate capital should be removed from the law.</p> <p>The authority granted under the Banking Act relative to the resolution of a problem bank needs to be revised and strengthened to afford the Supervisor of Banks with the flexibility to apply an appropriate strategy in the event intervention in a problem bank is warranted. The entire existing regulatory structure, including special administration, liquidation and bankruptcy needs to be revised and strengthened in this regard.</p>
24. Consolidated supervision	<p>Enhancements to the program of consolidated supervision should be considered. Among such enhancements is a greater supervisory attention to the non-bank financial subsidiaries and monitoring of intercompany transactions in mixed activity companies. With respect to the non-bank financial companies, collecting supervisory information and including them in the SREP process more fully would provide insights into the risks undertaken by these institutions.</p> <p>In addition, greater focus on related party interests within a banking group is warranted both in a banking group and a mixed activity company.</p>

Authorities' response

36. **BOS generally agrees with the key findings and recommendations from the BCP Assessment.** However, the assessed consequences of identified weaknesses in implementation of BCP in Slovenia are in our view disproportionate to a certain extent. Even highly effective banking supervision could not prevent the consequences of the financial crisis the Slovenian banking sector and corporate sector are facing. Additionally, we have reservations towards those recommendations requiring regulatory or other activities in areas which are immaterial for Slovenian banks (e.g. requirement to collect data from non-bank financial companies on a solo-basis). As the principle of proportionality is one of the core principles in banking supervision, it should also be reflected in the recommendations.

37. **BOS has already prepared an action plan for the implementation of recommendations to improve compliance with the BCP and, at the same time, proposed to the Ministry of finance several amendments of the Banking Act, including provisions on:**

- legal protection of the Banking Supervision staff,
- BOS's authority to licence supervisory board members and the acquisition of non-financial institutions,
- broader BOS's powers to require a bank to increase its capital, while at the same time not allowing bank's shareholders to impede this procedure, and
- introduction of new resolution tools as the basis for the future resolution regime.

38. **Legislative power however lies with the Parliament which is empowered to endorse the abovementioned proposed amendments to the legal acts in the area of banking which are a necessary precondition for more effective banking supervision.**

39. **BOS is committed to implement the aforementioned action plan, also in cooperation with other relevant authorities, and will strive for an even more proactive and forward looking approach to banking supervision in the future.** Nevertheless, strengthening the financial condition of the banking system is a key priority of all Slovenian authorities at present.

DETAILED ASSESSMENT OF COMPLIANCE WITH THE BASEL CORE PRINCIPLES

Principle 1	<p>Objectives, autonomy, powers, and resources. An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks. Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.</p>
Assessment	<p>BOS has clear responsibility for bank supervision under the Banking Act. The law explicitly empowers BOS to be the bank supervisor, with authority over commercial banks and savings banks. The law is complemented by a series of regulations under which BOS provides guidance for banks in adhering to the law. The Banking Act empowers BOS with the power to carry out most supervisory functions. Under the Act, BOS is empowered to carry out all banking supervision activities, including on-site and off-site supervision, effecting corrective measures when appropriate, collecting financial and supervisory information through prudential returns, managing problem bank situations, and sanctioning banks for unsafe and unsound banking practices. The Act also authorizes BOS to license banks and revoke such licenses when appropriate, identifies permissible activities and governs the transfer of significant ownership. A gap in BOS's powers is the ability to require banks to obtain authorization prior to acquiring non-bank financial companies, regardless of their size or impact on a bank's financial condition or risk profile. However, BOS is empowered to supervise such companies.</p> <p>The legal framework provides supervisory tools that would require banks to comply with laws and regulations relating to safety and soundness issues. The tools range from routine measures requiring that corrective measures be taken to resolve deficiencies to the suspension or removal of members of the management board and the revocation of a banking license. Weaknesses in the legal framework include the ability of the supervisors to deal with unqualified members of the supervisory board, including their appointment as directors, and the potential impediment shareholders may pose to the adequate capitalization of a bank.</p> <p>Under the law, BOS is autonomous, but the policies and priorities of the government have influenced the risk management practices and financial condition of government controlled banks. Banking supervision is clearly understaffed, and this problem could inhibit the ability of the Banking Supervision Department to achieve its mission and perform its responsibilities in a satisfactory manner. At present, the number of staff in the Banking Supervision Department is already insufficient to carry out all of its bank supervision responsibilities, especially relative to operations risk, anti-money laundering and other areas.</p> <p>The legal framework does not indemnify bank supervisors against damages resulting from the discharge of their responsibilities, nor does it provide protection against the costs of defending acts of commission or omission in the discharge of their duties in good faith. In practice it is likely that BOS would be sued rather than a bank supervisor.</p>

	<p>The Banking Act mandates confidentiality of information obtained by BOS while carrying out its responsibilities, and provides exceptions in case of criminal proceedings or when authorized by the bank in question. There are exceptions for the exchange of information between Slovenian authorities engaged in the supervision of the financial system, and for supervisory authorities overseas. Supervisory information may be sent to these authorities when such authorities need the information in carrying out their supervisory responsibilities, and there is certainty that the information will be treated in a confidential manner. BOS has established written protocols with ten foreign bank supervisors to facilitate the sharing of information for supervisory purposes. Protocols also are in place with domestic bank supervisors, although the level and amount of information and cooperation are not at as high a level. These relationships need more maturing.</p>
Principle 1(1)	<p>Responsibilities and objectives. An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks.</p>
Essential criteria	
EC1	<p>Laws are in place for banking, and for the authority (each of the authorities) involved in banking supervision. The responsibilities and objectives of each of the authorities are clearly defined and publicly disclosed.</p>
Description and findings re EC1	<p>BOS has clear responsibility for banking supervision in accordance with Article 23 of the BOS Act. This law explicitly empowers BOS to be the bank supervisor, with authority over banks and savings banks. The Act states that BOS has the power to supervise such institutions, and in doing so, is authorized to develop standards of safety and soundness by “defining and implementing rules for the safe operations of banks and savings banks.” The Act, through various Articles therein, empowers BOS with the power to carry out virtually all supervisory functions, such as conducting on-site examinations, licensing banks, and collecting information for supervisory purposes. These powers are further reinforced by Article 217, which charges BOS with the responsibility to supervise banks relative to all services and transactions performed.</p> <p>The Financial Conglomerate Act addresses the issue of banks as members of a conglomerate. The Act states that a bank, as a member of a conglomerate, is in effect subject to supplementary supervision where a supervisory agency is responsible for the supervisory overview and assessment of the financial condition of a financial conglomerate.</p> <p>The responsibilities and objectives of the bank supervisory process are not explicitly stated in the law but are contained in BOS’s Strategic Plan for the years 2009 – 2012, which has been updated through 2013. The Strategic Plan, inclusive of BSD objectives, is found on BOS’s website.</p>
EC 2	<p>The laws and supporting regulations provide a framework of minimum prudential standards that banks must meet.</p>
Description and findings re EC2	<p>BOS communicates minimum prudential requirements through a series of regulations and the Banking Act. Many of the regulations represent EU directives that have been incorporated into the Slovenian legal framework, and may be modified to some degree to reflect Slovenian conditions; they nevertheless are compatible with, and adhere to</p>

	<p>the EU directives. Examples of these regulations include a series of prescriptions on capital adequacy (Basel II) and processes regarding implementation of modeling techniques such as the calculation of capital requirements for credit risk under the IRB approach; and consolidated supervision, large exposures and disclosure requirements. The regulations are sometimes supported by sub-regulations, which provide technical instructions. Chapter IV of the Banking Act sets prudential standards for risk management in credit, market, operational and other risks.</p> <p>BOS has extensive rule making power that it may use to introduce new prudential rules and regulations as warranted. These are established in Articles 12 and 43 of the BOS Act. In practice, however, most prudential requirements today are driven by EU directives. There are several important exceptions. For example, as a complement to EU directives, BOS has issued a regulation addressing the responsibilities of the management and supervisory boards of banks. The regulation establishes ethical values and standards of appropriate professional diligence, including organizational culture, professional qualifications and conflicts of interest. Another exception is the regulation on loan loss provisioning, under which banks are required to allocate reserves in accordance solely with IFRS.</p>
EC3	Banking laws and regulations are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices.
Description and findings re EC3	Banking laws and regulations are updated frequently, and carry annotations reflecting the dates of the most recent amendments. The Banking Act alone has been amended or updated six times between 2006 and 2010, and an additional four times in 2011 to reflect changes necessitated by EU directives or other EU legislation and changes in international best practice. One of the units in BSD has as its chief responsibility the monitoring of EU legislation and international best practice. In cooperation with other departments and the Legal Department in BOS, they are tasked with the responsibility of developing drafts of laws and regulations when such a need is identified.
EC4	The supervisor confirms that information on the financial strength and performance of the industry under its jurisdiction is publicly available.
Description and findings re EC4	<p>Information on the financial strength and performance of the banking industry is available to the public. There are several publications that provide information and analysis of the banking system holistically. The <i>Monthly Bulletin</i> is the source for a listing of all banks and foreign branches operating in Slovenia, together with contact information. The Bulletin provides information on the financial services each institution is licensed to offer.</p> <p><i>The Stability of the Banking System</i> is an annual publication that analyzes the performance, strengths and weaknesses of the industry. <i>The Financial Stability Review</i> provides information and analysis on the structure of the banking sector, the risks in the industry, and individual discussions of specific risks, such as credit and liquidity risk. All of these publications can be found on BOS's public website.</p>
Additional criteria	
AC1	In determining supervisory programs and allocating resources, supervisors take into account the risks posed by individual banks and banking groups and the different approaches available to mitigate those risks.
Description and findings re AC1	The Banking Supervision Department is organized so as to conduct a rigorous program of risk based supervision on a solo and consolidated basis. There are robust policies and programs in place, and supervisory staff participates in supervisory colleges and on working groups to effect satisfactory supervisory programs in banking groups.

Assessment of Principle 1(1)	Compliant
Comments	Since accession to the EU, Slovenia has been gradually incorporating EU directives into the Banking Act, complementing regulations and other laws that affect the banking sector. Many of the amendments to the Banking Act, of which there have been a number over the past few years, address areas that have strengthened the legislation overall.
Principle 1(2).	Independence, accountability and transparency. Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties.
Essential criteria	
EC1	The operational independence, accountability and governance structures of each supervisory authority are prescribed by law and publicly disclosed. There is, in practice, no evidence of government or industry interference which compromises the operational independence of each authority, or in each authority's ability to obtain and deploy the resources needed to carry out its mandate. The head(s) of the supervisory authority can be removed from office during his (their) term only for reasons specified in law. The reason(s) for removal should be publicly disclosed.
Description and findings re EC1	<p>Article 152 of the Constitution of the Republic of Slovenia states that BOS is an independent body relative to its operations, and accountable to the National Assembly. In this connection, BOS is required to report solely to the National Assembly at least bi-annually on its operations. Moreover, Article 2 of the BOS Act states that the Bank and members of its decision-making bodies shall be independent, and not bound by decisions of the government. An operational agreement with the MOF relative to the Bank's role as a fiscal and payments agent for the State and its role as the depository for the funds of the State do not appear to compromise this legislated independence. (BOS Act, Article 27). The MOF also has the authority to attend meetings of the Bank's Governing Board, but has no voting right.</p> <p>In the execution of its rule-making powers and processes, there does not appear to be outside influence exerted by any government agencies, although they may provide input into proposed regulations during the comment period.</p> <p>Government priorities relative to the management of government controlled banks do not necessarily align with the goals of the supervisory process. As a result, the State's policies or priorities may act as an impediment to the fully effective supervision of these institutions. A plan contemplated by the MOF to reduce its stake in and possible influence over the Government controlled banks could serve as a means to ease, but not fully eliminate the problem.</p>
EC2	The supervisor publishes objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives.
Description and findings re EC2	<p>The Banking Supervision Department develops an annual working plan that states the objectives outlined for the Department for the year. The plan, together with the annual budget for banking supervision, is presented to the Governing Board for approval and is benchmarked to monitor execution of the plan during the year.</p> <p>Broader objectives for the supervisors are published on BOS's website in the Bank's Strategic Plan. The Plan describes the Bank's core objectives, of which one is to design and introduce conditions for a stable and efficient banking system. For the</p>

	<p>supervisors, these are translated into specific objectives, including the preparation and introduction of regulations, recommendations and standards for the secure and prudent operation of the banking system, development of appropriate tools and methodologies for monitoring institutions subject to supervision, and allocation of supervisory activities and capacities in accordance with the risks assumed by these institutions.</p>
EC3	<p>The supervisory authority and its staff have credibility based on their professionalism and integrity.</p>
Description and findings re EC3	<p>The Banking Supervision Department has adopted a policy of recruiting staff possessing university degrees, preferably with specializations or advanced degrees in accounting, auditing, law, information technology and other relevant fields. The Department also prefers to recruit candidates with several years of experience in their area of expertise. It is rare for an individual to be recruited immediately after completing his/her university studies.</p> <p>BOS's staff must comply with a Code of Ethics addressing such issues as conflicts of interest and receiving gratuities.</p>
EC4	<p>The supervisor is financed in a manner that does not undermine its autonomy or independence and permits it to conduct effective supervision and oversight. This includes:</p> <ul style="list-style-type: none"> • A budget that provides for staff in sufficient numbers and with skills commensurate with the size and complexity of the institutions supervised. • Salary scales that allow it to attract and retain qualified staff • The ability to commission outside experts with the necessary professional skills and independence and subject to necessary confidentiality restrictions to conduct supervisory tasks • A training budget and program that provides regular training opportunities for staff • A budget for computers and other equipment sufficient to equip its staff with the tools needed to review the banking industry and assess individual banks and banking groups; and • A travel budget that allows appropriate on-site work.
Description and findings re EC4	<p>Banking Supervision Department is financed by a mix of fees charged to banks and budgeted funds from BOS. Roughly 50 percent of the supervisory function's operating funds are derived from fees incurred by the banking system for routine prudential supervision, including on-site examinations. The fees are derived from a mix of fixed and variable charges. The fixed charges are allocated on a cost accounting basis derived from labor and material costs applied to supervisory tasks such as on-site examinations, off-site analysis and licensing activities. The variable charge is risk-based, as the fee is based on a bank's capital adequacy. A higher charge is allocated to banks with lower capital. Over the next five years, revenue from banking fees is expected to rise gradually to 60 percent of the Department's operating costs.</p> <p>Recognizing the need for additional staff in connection with the pending accession to the EU, the target level for the number of employees in the Banking Supervision Department was set at 64 in 2006, but was cut to 63 in 2012. At present, banking supervision has 62 staff members, up from 50 approximately five years ago. The increase is attributable principally to the demand for additional staff emanating from</p>

	<p>increased level of supervisory responsibilities in connection with implementation of risk-based supervision, and the introduction of Basel II and IFRS. Almost one-half of the staff is engaged in on- and off-site supervision. The balance of the staff is engaged in systemic risk analysis, licensing activities, and development of policies, laws and regulations resulting from EU directives. The staff overall possesses a high degree of experience, with many supervisors having in excess of ten years in banking supervision. Virtually the entire staff has a university degree, many in economics. Turnover has not been a serious concern. The turnover ratio is generally 10 percent or less per year, notwithstanding the fact that the private sector offers higher salaries. In recent years, principally because of the financial crisis, turnover has been lower and the Department has been able to attract former bankers and accountants from the private sector. It is rare for a new recruit to be brought in directly upon graduating from college; the authorities desire that a degree of experience in the work force be attained prior to consideration for employment.</p> <p>The Department rarely retains outside experts to complement the expertise of the staff. In certain cases, external auditors or consultants have been commissioned to conduct a forensic review or perform a study when the level of knowledge or experience in-house is considered insufficient. Such authority is granted to the Governor of the BOS under Article 235 of the Banking Act. The external experts are governed by the confidentiality clause contained in Article 228 of the Act. There is no such outsourcing of tasks at present, and none is contemplated, as there is no budget allocated for it. In the event a need was identified, special permission from the Governor would need to be sought.</p> <p>Each year, the Banking Supervision Department proposes a budgeted line item for equipment, including computers, and training. Each member of the staff is proposed for some form of training based on the need for skill enhancement, experience and other factors. The proposed budget for these items is reviewed by the IT Division and the Human Resources Division respectively, which has the option to reduce the proposed budget for these items. However, the overall funding available for these necessities is considered to be reasonable.</p> <p>The Department has sole control over the amount proposed for the travel budget. Included in this segment of the budget is travel for on-site examinations, both in Slovenia and in EU Member States; travel for conferences, working groups and committees in connection with the work of the EBA and other EU organizations; and travel for training. The amount allocated for travel costs also are deemed to be reasonable.</p>
Additional criteria	
AC1	The head(s) of the supervisory authority is (are) appointed for a minimum term.
Description and findings re AC1	The Governor of BOS is nominated by the President of the Republic of Slovenia and appointed by the National Assembly for a six year term, and may be reappointed. Vice Governors also are appointed for a six year term by the National Assembly after being nominated by the President. The Head of the Banking Supervision Department is appointed by the Governor to a four year term, and also may be reappointed; he reports directly to the Governor, but works closely with the Vice Governor responsible for banking supervision matters. Prior to expiration of his term, the head of Banking Supervision Department may be removed for cause, such as conflict of interest.

Assessment of Principle 1(2)	Largely Compliant
Comments	<p>The government's role and goals as a majority stakeholder in two of the largest banks in the Slovenian banking system may not align with the goals of BOS as an independent supervisor and principles of sound prudential supervision.</p> <p>It may be time to reassess the staffing needs of the Banking Supervision Department inasmuch as the staffing level is now set at 63. The strain on staff is most acutely felt in off-site supervision, as the off-site staff is frequently deployed to assist in the completion of the workload of the on-site function. Of the 29 staff assigned to on- and off-site supervision, only five staff is devoted to the off-site function, whose responsibilities are not limited to the analysis of individual banks. The implementation of the RAS program, monitoring of industries systemic to the Slovenian economy, AML/CFT supervisory responsibilities, and the challenges in fully implementing operations risk have all stretched the overall resources of the Department. At a minimum, it is recommended that the reduction in staff be reinstated so that a full complement of 64 staff members would be available to perform the responsibilities of the Department. Optimally, the ceiling on the number of staff should be raised so that further staff additions can be made as appropriate.</p>
Principle 1(3)	Legal framework. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.
Essential criteria	
EC1	The law identifies the authority (or authorities) responsible for granting and withdrawing banking licenses.
Description and findings re EC1	<p>The Banking Act contains provisions throughout various Chapters of the law empowering BOS to grant licenses to banks and for other licensing activities. In addition to approving the licensing of <i>de novo</i> banking institutions and for mergers or acquisitions involving banks, the Act empowers BOS to approve qualifying holdings in a bank at various levels of ownership (the equivalent of a change in control). The criteria for approval are more stringent as the ownership interest in the bank becomes higher. BOS also is empowered to license members of the management board of a bank provided they pass a suitability test, and to grant licenses to foreign banks from countries that are not EU-Member States. Finally, a bank must obtain a license to conduct the banking services described under the law.</p> <p>The Bank also is empowered to revoke a banking license for eight different reasons, including gaining the license by providing false information. Most reasons for revocation are related to inaction relative to safety and soundness issues or implementation of safety and soundness regulations. A license also may be revoked or terminated in the event a bank does not establish operations within one year of obtaining the license. The Act provides detailed revocation procedures (Articles 363 – 368).</p>
EC2	The law empowers the supervisor to set prudential rules (without changing laws). The supervisor consults publicly and in a timely way on proposed changes, as appropriate.

Description and findings re EC2	<p>Articles 12 and 43 of the BOS Act provide the overarching powers to BOS for developing prudential standards. These are established through a series of prudential regulations, all of which have the force of secondary law. The standards address safety and soundness issues and the conduct and responsibilities of members of the management or supervisory board. Since accession to the EU, these regulations are reflective of EU standards, as they borrow heavily from EU directives.</p> <p>The regulations require consultation with the banking industry and other stakeholders via a comment period subsequent to approval by the Governing board of the circulation of a draft of the prospective regulation. The Bankers Association of Slovenia frequently acts as spokesperson for the industry in providing comments on the prospective regulation. The Board also grants final approval to the regulation subsequent to the redraft, which may reflect recommendations and concerns expressed by the banking industry or other relevant stakeholders.</p>
EC3	The law or regulations empower the supervisor to obtain information from the banks and banking groups in the form and frequency it deems necessary.
Description and findings re EC3	The Banking Act, Articles 194, 195, and 234, empowers BOS to require banks to submit reports and information on all matters of importance for the conduct of banking supervision. Article 129 of the Banking Act prescribes the content of reports, the reporting frequency and the method of reporting. Reports or information also may be collected from employees and the management board. There are no exceptions contained in the law, and as a matter of course, the banking industry has been cooperative in providing information as requested.
Assessment of Principle 1(3)	Largely Compliant
Comments	To further strengthen the provisions of Article 234 of the Banking Act relative to its powers to obtain information, supervisory boards should be added to the bodies that are subject to compliance with this provision of the Act. At present, only the management board and employees are subject to these provisions of the Act.
Principle 1(4)	Legal powers. A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws as well as safety and soundness concerns.
Essential criteria	
EC1	The law and regulations enable the supervisor to address compliance with laws and the safety and soundness of the banks under its supervision. The law and regulations permit the supervisor to apply qualitative judgment in safeguarding the safety and soundness of the banks within its jurisdiction.
Description and findings re EC1	The legal framework provides BOS with an appropriate range of tools to address issues in banks. It is at the discretion of the Governing Board to decide which tools to use in a particular case. The Banking Act is the principle law that underpins the ability to act relative to safety and soundness issues, as it prescribes fundamental powers with respect to compliance issues. Under the law, which is contained in Articles 242 and 244 of the Act, BOS is empowered to require remedial actions for identified supervisory concerns, and to impose various sanctions in the event of non-compliance.

	<p>The Banking Act and attendant prudential regulations establish certain safety and soundness standards. As an example, Chapter IV of the Banking Act sets fundamental risk management rules, and Articles in the Act establish prudential standards for management and supervisory boards relative to corporate governance. These are complemented by a series of regulations pertaining to the management of risk. Within this framework the supervisors can employ their supervisory tools for a desired outcome. The supervisors may use their Risk Assessment System to identify such issues as risk management weaknesses and prescribe appropriate remedial actions commensurate with the weaknesses.</p>
EC2	<p>The supervisor has full access to banks' board, management, staff and records in order to review compliance with internal rules and limits as well as external laws and regulations.</p>
Description and findings re EC2	<p>By virtue of Articles 217 and 236 of the Banking Act, the supervisors have full access to all relevant information from a bank and its subsidiaries, affiliates and other related interests. The law is direct and complete and provides legal sanctions in the event of non-compliance. Such sanctions may include fines or other penalties leading up to the revocation of the license. The experience of the supervisors is that they have free access to the information they require to supervise the bank.</p>
EC3	<p>When, in a supervisor's judgment, a bank is not complying with laws or regulations or it is or is likely to be engaged in unsafe and unsound practices, the supervisor has the power to:</p> <ul style="list-style-type: none"> • take (and/or require a bank to take) prompt remedial action; and • Impose a range of sanctions (including the revocation of the banking license).
Description and findings re EC3	<p>Articles 242 and 244 of the Banking Act prescribe a full spectrum of supervisory tools to apply in the event remedial action is warranted and also provides the flexibility to apply them to fit the supervisory issue. These tools range from a Recommendation, which addresses routine technical problems, to an Order with Additional Measures which carries the full force of the law. The law is sufficiently broad and flexible to enable the Bank to address most supervisory issue ranging from inaccurate reporting of regulatory returns to the need to ring fence a bank subsidiary or removing members of a management board. Thus BOS can employ an enforcement action that reflects the severity of the supervisory issues and craft the action to address the problem.</p> <p>BOS has other remedial actions at its disposal to correct supervisory problems, including the imposition of fines on either the bank or members of the management or supervisory board.</p> <p>A potential impediment to fully effective remedial action could be certain actions of a bank's shareholder assembly. In the event a bank is considered to be undercapitalized or BOS requires the bank to increase its capital, the possibility exists for the shareholder assembly to vote against raising the capital to avoid dilution of their equity interest. While there are other ways in which BOS can enforce the requirement, it can become a protracted event. Among other actions, BOS could raise the capital itself,</p> <p>BOS also lacks the authority to remove a member of the supervisory board for due cause. The problem is compounded by the fact that supervisors do not have the</p>

	<p>authority to license board members. The supervisors must obtain shareholder approval for the removal of the board member as well. There have been few cases in which BOS attempted to remove a supervisory board member.</p> <p>BOS ultimately may revoke the license of a bank, principally for safety and soundness issues, in accordance with Article 250 of the Banking Act.</p>
Assessment of Principle 1(4)	Largely Compliant
Comments	BOS has a comprehensive array of supervisory and remedial tools that can be applied effectively in the supervision of a bank. However, the restraint placed on the supervisors to implement necessary supervisory actions relative to capital adequacy and supervisory board member suitability without shareholder authorization represents a significant weakness in the application of remedial action processes. Such cases are very infrequent, but existing law should be modified so as to eliminate the possibility of problems in the future.
Principle 1(5)	Legal protection. A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Essential criteria	
EC1	The law provides protection to the supervisory authority and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith.
Description and findings re EC1	<p>There is no legal protection for the supervisory authority or the staff against lawsuits in the discharge of their duties. In fact, the law as presently structured places the burden of proof on the BOS in the event of a lawsuit while discharging the duties of the office. Under the Code of Obligations, the Bank as a legal entity is responsible for any damage caused by it or its staff, including the Governor and the Bank must prove that the damage was incurred without responsibility by the staff or the Bank.</p> <p>In addition, under a separate Article in the Code of Obligations, BOS is considered liable for damages caused by its staff in the discharge of its duties or in connection with the discharge of its duties, unless it can be proven that the employee acted in good faith under the circumstances.</p>
EC2	The supervisory authority and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith.
Description and findings re EC2	There are no protections in the law nor is there insurance coverage or a reserve fund established by BOS to protect itself in such cases. However, there have been no recent lawsuits initiated where the bank or its employees have been named defendant under such circumstances.
Assessment of Principle 1(5)	Noncompliant
Comments	Legal and financial protection of bank supervisors in civil and criminal court proceedings is inadequate. Arguably, under Slovenian law, the burden of proof is on the supervisors, which renders them vulnerable in litigation also when they have discharged their duties in good faith. Moreover, the legal framework does not ensure in such cases that bank supervisors are indemnified against costs incurred in the

	<p>defense of a legal action. Fortunately, such occurrences are very rare and there have been no such occurrences in the past few years. Moreover, in all likelihood, legal action would most probably be brought against the BOS and not against individual bank supervisors</p> <p>While there have been efforts in the past to introduce legislation that would indemnify the staff and BOS against such legal action, they have been unsuccessful. Further attempts to address this issue in the National Assembly should be pursued so as to preserve the capacity of the Bank and its staff to discharge its duties appropriately without intimidation.</p>
Principle 1(6)	Cooperation. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Essential criteria	
EC1	Arrangements, formal or informal, are in place for cooperation and information sharing between all domestic authorities with responsibility for the soundness of the financial system, and there is evidence that these arrangements work in practice, where necessary.
Description and findings re EC1	<p>BOS has arrangements, both formal and informal, with other Slovenian agencies engaged in the supervision of the financial sector to facilitate cooperation and the exchange of information. Such arrangements are permitted in accordance with Article 230 of the Banking Act. MOUs were exchanged in 2008 by BOS and are in effect with AZN, the insurance supervisor, and ATVP, the regulator of the securities industry. These arrangements facilitate the exchange of information, especially relative to the results of on-site examinations, and have been used principally to promote joint examinations and to plan examinations schedules. In 2010, the KDD, the securities clearing house, became a signatory to a series of MOUs with these agencies to facilitate cooperation and the exchange of supervisory information.</p> <p>Since at least 1999, the supervisory agencies have met quarterly as a Commission to discuss financial sector issues, including the condition of the financial industry. Typically, the officer in charge of supervision represents each agency at these meetings, and the chairmanship is rotated. The initiative to develop a formal method of exchanging supervisory information came from discussions at these meetings, and resulted in development of the MOUs.</p> <p>There also is a Coordinating Committee that meets at least annually for the purpose of discussing systemic issues affecting the financial sector. For BOS, the Governor and the Vice Governor in charge of banking supervision serve as the representatives.</p>
EC2	Arrangements, formal or informal, are in place, where relevant, for cooperation and information sharing with foreign financial sector supervisors of banks and banking groups of material interest to the home or host supervisor, and there is evidence that these arrangements work in practice, where necessary.
Description and findings re EC2	Article 230 also permits cooperative efforts and the exchange of supervisory information with foreign bank supervisors. To facilitate such exchanges, BOS has entered into agreements both on a bilateral basis with EU-Member States and third countries. BOS also has entered into multi-party agreements when supervisory colleges have been established. In aggregate, BOS has signed MOUs with at least

	ten European countries, two of which are bilateral in nature and six are multilateral MOUs where BOS acts as a host country supervisor. BOS has signed or is in the process of negotiating two multi-party agreements under which it will act as the home supervisor and coordinator of supervisory colleges for Slovenian institutions with operation in other Balkan countries.
EC3	The supervisor may provide confidential information to another domestic or foreign financial sector supervisor. The supervisor is required to take reasonable steps to ensure that any confidential information released to another supervisor will be used only for supervisory purposes and will be treated as confidential by the receiving party. The supervisor receiving confidential information from other supervisors is also required to take reasonable steps to ensure that the confidential information will be used only for supervisory purposes and will be treated as confidential.
Description and findings re EC3	<p>The power to exchange information on a confidential basis with other financial sector supervisors in Slovenia and with other EU-Member States or third countries is found in Articles 231 and 294 of the Banking Act. The Act permits BOS to provide such information to supervisory colleges as well. The information may be exchanged provided it is not divulged or shared, although there are explicit exceptions. The receipt of the information carries with it the responsibility to use it only in connection with supervisory responsibilities, and that it must be safeguarded. Each EU-Member State has similar confidentiality requirements.</p> <p>With respect to third country supervisors, the exchange of information may be concluded only if a cooperative agreement has been concluded, and the confidentiality requirements of the EU -- that it must be safeguarded and used only for supervisory purposes -- are followed.</p>
EC4	The supervisor is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information in its possession.
Description and findings re EC4	In addition to providing confidential supervisory information under a court order or to the National Assembly, BOS is obligated by Article 231 of the Banking Act to divulge the information to a number of third parties under circumstances in which they have a need to know. These parties include the MOF, external auditors, the deposit guarantee scheme, the European Central Bank and the EBA. Requests for such information by other parties would be denied.
Assessment of principle 1(6)	Compliant
Comments	The authorities should consider strengthening the communications link between the Commission and the Coordinating Committee. For example, the Commission could provide the Coordinating Committee, through a formal report or a meeting, its views relative to issues or supervisory concerns manifesting themselves in the financial system. The Commission could establish ad hoc working groups with representatives from each agency to propose policies or practices that would be implemented in each supervisory agency. For example, the authorities are contemplating the formation of a group to review and harmonize the treatment of assets for classification purposes, principally loans and investments that are found across financial institutions in Slovenia. This initiative could be directed through the Commission, with the results reported to and deliberated by the Coordinating Committee.

	While the laws governing the exchange of confidentiality of supervisory information are strong, the expanding list of eligible users requires that strict controls be followed in ensuring that the transmission of the information is secure, that users understand the importance of preserving the confidentiality, and that there are appropriate penalties in the event the information is divulged, accidentally or otherwise.
Principle 2	Permissible activities. The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined and the use of the word “bank” in names should be controlled as far as possible.
Essential criteria	
EC1	The term “bank” is clearly defined in laws or regulations.
Description and findings re EC1	The term bank is defined in Article 13 of the Banking Act as a legal person who is permitted to engage in banking services subject to the authorization of a competent supervisory authority, which in this case is BOS. The term savings bank has a similar meaning. Banking services are defined explicitly as the acceptance of deposits from the public and the granting of loans. The term credit institution is used interchangeable in the law to mean either a bank or savings bank.
EC2	The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined either by supervisors, or in laws or regulations.
Description and findings re EC2	In addition to traditional lending and deposit taking activities (Article 6 of the Banking Act), banks are permitted to engage in a litany of business activities, including leasing, trading for own account, portfolio management and advice, custodian services, and management or operation of data processing systems employed for its own use or for other credit institutions. Article 40 and 41 of the Banking Act serves as the linchpin in identifying permissible activities. Permissible activities are grouped into one of three categories: (a) mutually recognized financial services, such as lending and trading; (b) additional financial services, such as custodian services; and (c) ancillary services, such as operating data centers. There is some flexibility in the law that enables BOS to expand the scope of permissible activities depending on products the market may offer. The expansion of permissible activities in this manner is restricted to “additional financial services” which at present also includes payment system administration and the sale of insurance.
EC3	The use of the word “bank” and any derivations such as “banking” in a name is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.
Description and findings re EC3	In accordance with Article 40 of the Banking Act, the terms bank, savings bank and credit institution cannot be used by an organization unless it is registered as such in the court register of companies and it satisfies the conditions for providing banking services. To satisfy these conditions, the institution must have received a license from BOS to engage in banking services (defined as accepting deposits and extending credit), and thus will have fulfilled the criteria to engage in these activities. Thus, only institutions deemed by BOS to be a bank, savings bank or credit institution can use the term “bank.”
EC4	The taking of deposits from the public is generally reserved for institutions that are licensed and subject to supervision as banks.
Description and	Article 35 of the Banking Act, in concert with Article 33, restricts the acceptance of

findings re EC4	<p>deposits to banks and foreign branches of banks located in either an EU Member State or a third country. In all three cases, BOS will have approved the establishment of operations. For the Slovenian bank or the branch of the bank located in a third country jurisdiction approval is granted through the licensing process. For the branch of a bank located in an EU Member State, notification by the bank of its intention to establish a branch is sufficient.</p> <p>BOS has the power to suspend and ultimately to close the operations of an institution – typically within 8 to 15 days – by requiring the institution to show evidence that it has suspended its deposit gathering activities if it considered not to be a bank. BOS also may conduct an on-site inspection of the institution so as to gather evidence that it is accepting deposits.</p>
EC5	The supervisory or licensing authority publishes, and keeps current, a list of licensed banks and branches of foreign banks operating within its jurisdiction.
Description and findings re EC5	BOS maintains a listing of all banks, savings banks and foreign branches engaged in banking activities in the Republic of Slovenia. The listing is located on the Bank's website, and also contains information on the permissible activities in which each may engage, together with contact information for each institution.
Assessment of Principle 2	Compliant
Comments	The legal framework for permissible activities is clear and provides the flexibility to expand the products and services offered by banks upon review of the proposed activity. Banks would be required to have the appropriate infrastructure and management in place prior to offering the product.
Principle 3	Licensing criteria. The licensing authority must have the power to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the ownership structure and governance of the bank and its wider group, including the fitness and propriety of Board members and senior management, its strategic and operating plan, internal controls and risk management, and its projected financial condition, including its capital base. Where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.
Essential criteria	
EC1	The licensing authority could be the banking supervisor or another competent authority. If the licensing authority and the supervisory authority are not the same, the supervisor has the right to have its views considered on each specific application. In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed institution.
Description and findings re EC1	<p>Chapter 3 of the Banking Act establishes the BOS as the licensing authority for banks. Through a series of Articles in that Chapter of the Act, BOS is empowered to grant licenses to institutions to perform banking and other financial services, to establish branches in both EU-Member States and third countries, to merge or acquire other such institutions, and for other similar licensing activities. No other government agency has this authority.</p> <p>A proposed licensing application ultimately is approved by the Governing Board of BOS, which includes the Governor and four Vice Governors in the Bank. Prior to</p>

	<p>presentation to the Governing Board, it is reviewed by the Bank's Licensing Commission, which includes representatives from different departments, and three Vice Governors, including the Vice Governor in charge of banking supervision. At each stage in the process, an analysis of the application is presented with justification for approval/disapproval of the licensing proposal.</p>
EC2	<p>The licensing authority has the power to set criteria for licensing banks. These may be based on criteria set in laws or regulations.</p>
Description and findings re EC2	<p>Within Chapter 3 of the Banking Act, Articles 82, 84 and 86 establish the criteria for licensing a bank. Article 82 states that certain types of information must be filed with BOS in connection with the application for a license. A promulgating regulation, Regulation for the Granting of Authorization to Provide Banking and Financial Services and for Status Transformations, complements the law and describes the requirement for providing certain types of legal documents. More importantly, it provides a definitive statement on information that must be provided in connection with evaluating the application, including the organizational and management structure of the institution and management qualifications, and the plan of risk management and internal controls. Additional information is required in the event of a merger or acquisition and other status transformations and in case of the increase in bank's initial capital with non-cash contribution the subject of which are another bank's shares.</p> <p>Article 84 further enumerates information that is required to be filed, including a three year business plan with projections, and the listing of shareholders and the ownership structure of the institution; the ultimate shareholder(s) must be divulged as a matter of practice.</p> <p>Article 86 reflects, inter alia, the need for prospective members of the management board to meet a "fit and proper" test.</p> <p>In essence, the criteria include the financial strength, quality and reasonableness of strategic and business plans of the applicant, its prospective risk management and internal controls systems, the suitability of prospective executive officers under a fit and proper regimen, and the transparency of the ownership structure.</p> <p>The suitability of supervisory board members is not evaluated.</p>
EC3	<p>The criteria for issuing licenses are consistent with those applied in ongoing supervision.</p>
Description and findings re EC3	<p>The criteria applied in vetting a licensing application are contained in the Banking Act as measures of on-going supervision. For example, Article 222 of the Banking Act charges BOS with the responsibility of ensuring that banks are operating in accordance appropriate risk management practices. Regulations addressing risk management explicitly describe the requirements for banking institutions relative to risk management processes, elements of corporate governance, sound internal control systems and the duties and responsibilities of the management and supervisory board. These are all evaluated in considering the strength of an applicant.</p> <p>In a broader sense, the criteria consider the capacity of the prospective bank to operate in a manner that would not impair the interests of depositors or impact the stability of the banking system.</p>

EC4	The licensing authority has the power to reject an application if the criteria are not fulfilled or if the information provided is inadequate.
Description and findings re EC4	<p>BOS has the power to reject applications. As a first step, the supervisors determine the completeness and accuracy of information provided under the application. The procedural aspects of the process are outlined in Articles 369 – 377 of the Banking Act, and Article 374 explicitly states the application will be rejected in the event of an incomplete or inadequate filing.</p> <p>An application that did not fulfill the criteria could be considered to be an incomplete filing. The criteria include the demonstration of sound financial capacity, a high level of management expertise, appropriate organizational and ownership structure and a well-defined system of risk management and internal controls.</p>
EC5	The licensing authority determines that the proposed legal, managerial, operational and ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis.
Description and findings re EC5	<p>From a legal perspective, a license will be granted only if the institution is organized as a joint stock company in accordance with EU requirements. Article 39 of the Banking Act also states that, as a joint stock company, the bank is subject to the Companies Act, and is therefore required to maintain its financial reports in accordance with IFRS and file audited financial reports annually on a consolidated basis.</p> <p>Applicants may establish a management board with executive and non-executive directors or a two-tier management system where the board of directors is separated from the supervisory board. A bank must have at least two executive directors at all times. The organizational structure of the bank is vetted during the evaluation process both in terms of the management structure of the organization, and the capacity of the structure to facilitate sound risk management and internal control systems.</p> <p>The suitability of major stockholders, the transparency of the ownership structure and the source of initial capital are all examined by the supervisors during the evaluation process. Article 48 of the Banking Act prescribes the criteria for a prospective significant shareholder (a qualifying holder), which is a 10 percent or greater equity interest in the bank, prior to approval as a stockholder. In effect, the prospective shareholder is subjected to a fit and proper standard. Under Article 48 of the Banking Act, there are other reasons for which a prospective qualifying holder may be rejected, such as reasons to suspect the applicant of committing acts of money laundering or terrorist financing. Both the acquisition and sale of a significant ownership is subject to the explicit authorization of BOS in accordance with Article 45 of the Banking Act. Such authorization is withheld in the event the transaction is not transparent or is perceived as an impediment to prudential supervision.</p> <p>BOS also may reject an application of a Slovenian bank to establish a branch or other form of operation in a third country when such operations are located in countries whose legal framework may hinder effective banking supervision (Article 98 of the Banking Act). No authorization is needed for a Slovenian bank to establish a branch in an EU Member State; the establishment or acquisition of other operating entities would require approval.</p>

EC6	The licensing authority identifies and determines the suitability of major shareholders, including the ultimate beneficial owners, and others that may exert significant influence. It also assesses the transparency of the ownership structure and the sources of initial capital.
Description and findings re EC6	<p>Article 86 of the Banking Act requires BOS to grant a license only in the event four conditions are met: (a) the bank's legal organization is a joint stock company and it can be verified; (b) the conditions authorizing the acquisition of a qualifying holding are met; (c) the criteria for being a member of the management board are met; and (d) there is an effective risk management system in place. Towards this end, complex and convoluted organizational structures typically are rejected, prospective stakeholders and management are evaluated, and the possible influence of other parties is assessed. In this connection, applicants must indicate which parties will hold the voting power in the organization and their specific level of ownership. Applicants are required to name the ultimate owners of all shares in the bank. If the ultimate ownership of an institution cannot be determined, the application will be rejected. Article 32 of the Banking Act defines an indirect holder of shares, and is employed in determining ultimate ownership and outside influence. Article 45a sets the criteria for determining the act of exerting significant influence when the shareholder does not own a qualifying holding.</p> <p>Sources of initial capital also are evaluated during the licensing process, together with overall financial capacity and the source of funding for the capital contribution. Article 5 of the Regulation on the Holders of Qualifying Holdings of Banks and Savings Banks provides the criteria that must be satisfied. BOS must be satisfied of the financial strength of the prospective applicant, must be able to assess the source of assets employed to acquire shares and the transparency of the structure of the prospective stakeholder's other equity investments.</p>
EC7	A minimum initial capital amount is stipulated for all banks.
Description and findings re EC7	The Banking Act stipulates that banks must have a minimum initial capital of at least EUR 5 million (Article 42), and savings banks must have a minimum initial capital of at least EUR 1 million (Article 382).
EC8	The licensing authority, at authorization, evaluates proposed directors and senior management as to expertise and integrity (fit and proper test), and any potential for conflicts of interest. The fit and proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the bank; and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to uphold important positions in a bank.
Description and findings re EC8	Article 63 of the Banking Act sets the condition for membership on the bank's management board. To become a member of a bank's management board requires that a prospective senior executive be licensed by BOS. The Banking Act states that a bank's senior management must have adequate qualification, qualities and experience. The licensing process, attendant requirements under Article 63 of the Banking Act, and the Regulation on the Documentation for Demonstrating Fulfillment of the Conditions for Performing the Function of a Member of the Management Board, represent the evaluation of the candidate as a fit and proper person. The candidate's professional qualification, experience and personal qualities are evaluated, and a credit and criminal violations check is performed. In a personal interview with authorities at BOS, the candidate must describe his/her vision of the bank's future operations and management strategy.

	<p>No such powers exist for the licensing of members of a bank's supervisory board or the board of directors. As a result, a fit and proper test is not administered on prospective members of a supervisory board. To promote ethical conduct by both senior executives and board members, BOS has issued the Regulation on the Diligence of the Management and Supervisory Boards of Banks and Savings Banks. This decree introduced explicit rules on the conduct of members of both management and supervisory boards of banks. The standards of professional conduct relate principally to ethical values and the proper conduct of business, and address corporate culture, responsibilities of board members, independence and professional qualifications, conflicts of interest and remuneration.</p>
EC9	<p>The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance, risk management and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank</p>
Description and findings re EC9	<p>Article 84 of the Banking Act requires an applicant to submit a business and strategic plan for the first three years of operations, a description of the banking activities that will be undertaken and products offered, and a discussion or description of the management or organizational structure of the bank, the risk management policies and practices that will be employed in the bank, and the system of internal control. BOS will grant a license to the applicant only if the financial strength and risk management capacity of the institution is deemed satisfactory, its management board meets the fit and proper test, and shareholders meet the conditions of transparency and financial strength for qualifying holders.</p>
EC10	<p>The licensing authority reviews pro forma financial statements and projections for the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholder of the bank.</p>
Description and findings re EC10	<p>The financial statements and projections for the first three years of the operation of the proposed bank are reviewed and analyzed with particular attention focused on the reasonableness of assumptions. Depending upon the case, the supervisors may run their own assumptions as well. Frequently the business plan, projections and financial information provided is discussed at length with the applicant. All qualifying shareholders are assessed as to their financial capacity in terms of their financial strength at the time of the application, and prospective capacity to provide additional capital to the bank in the event it is needed. Each such prospective qualifying shareholder must provide financial information that demonstrates an appropriate level of financial capacity.</p>
EC11	<p>In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For purposes of the licensing process, as well as ongoing supervision of cross-border banking operations in its country, the host supervisor assesses whether the home supervisor practices global consolidated supervision.</p>
Description and findings re EC11	<p>In accordance with Article 103 of the Banking Act, the establishment of branches in Slovenia of a third country bank is subject to approval of BOS. The application for the license must be accompanied by the authorization of the foreign bank's supervisory authority. Such banks may only operate branches in Slovenia.</p>

	<p>Banks of EU-Member states are entitled to provide banking services through branch operations in Slovenia commensurate with the services offered in their home country provided they have permission from the home country supervisor. Such branches are not subject to approval by BOS, but the supervisors must be notified of the bank's intention to open a branch. It must also inform BOS that permission has been granted by its home country supervisor, although an authorization letter or other form of notification is not required from the home country supervisor.</p> <p>Both banks in EU-Member States and in other countries must apply for a banking license to operate a subsidiary in Slovenia, and a no objection or authorization letter must be provided.</p>
EC12	If the licensing, or supervisory, authority determines that the license was based on false information, the license can be revoked.
Description and findings re EC12	Article 250 of the Banking Act outlines the grounds for withdrawal of a license. One such reason for revoking the license, of which there are eight, is obtaining it through false statements or providing false information.
EC13	The board, collectively, must have a sound knowledge of each of the types of activities the bank intends to pursue and the associated risks.
Description and findings re EC13	<p>The responsibilities of the management board and the supervisory board are outlined in Articles 66 and 73 of the Banking Act. In essence, the management board is responsible for managing the bank in a safe and sound manner in accordance with the Banking Act, which contains provisions on operating a bank under sound risk management practices, strong internal controls and corporate governance, and adequate capital and liquidity.</p> <p>The supervisory board is required to determine the bank's business and strategic plan, authorize a sound system of internal controls and audit, verify the bank's annual reports, and provide guidance on risk management practices and corporate governance in accordance with the Banking Act.</p> <p>In connection with its power to evaluate the capabilities of individuals on the management board, BOS is able to evaluate the knowledge skills of management board members employing a suitability test. It cannot do so for the supervisory board, as it lacks the power to license or approve a prospective member of the supervisory board, and hence cannot assess the banking knowledge and skills of members of the board.</p>
Additional criteria	
AC1	The assessment of the application includes the ability of the shareholder to supply additional financial support, if needed.
Description and findings re AC1	The Regulation on the Holders of Qualifying Holdings of Banks and Savings Banks requires BOS to assess the financial capacity of a prospective qualifying shareholder at the time of the acquisition and to evaluate the capacity to provide additional support in the event the bank requires additional capital.
AC2	The licensing or supervisory authority has policies and processes in place to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.

Description and findings re AC2	New entrants to the banking system are subject to a monitoring process similar to well established banks; there is no enhanced monitoring process. However, such institutions are subject to an examination within the first year of its opening.
Assessment of Principle 3	Largely Compliant
Comments	<p>BOS has the power to set conditions and to evaluate prospective candidates for the supervisory board or board of directors of a bank. However, the ability of bank supervisors to prohibit candidates to a supervisory board who would not pass a fit and proper standard is limited. BOS does not have direct power to remove an unqualified candidate from the supervisory board. Only a bank's shareholders, also upon the recommendation of the authorities, can remove a supervisory board member. Indirectly, through its power to evaluate a prospective qualifying holder who may become a director, or those defined as exerting significant influence, it is able to bar unqualified candidates, but the lack of direct power on this issue does not provide sufficient restrictions in this regard. There is a possibility that candidates that do not have the requisite banking knowledge or skills, or are unqualified in other ways, may serve on the supervisory board.</p> <p>To obviate the implications of having an unqualified board member, BOS has established standards related to ethical values and the proper conduct of business required of directors, and through various provisions of the Banking Act, has established a standard of responsibilities for directors to promote the safe and sound operations of the bank.</p> <p>In connection with the adoption of Basel III capital standards under CRD IV in 2013, BOS is represented on the EBA's Subgroup on Internal Governance, which will set higher fit and proper standards for management and supervisory boards. With the weight of the prospective EU directive as support, it is an appropriate time to consider reintroducing a regulation in the National Assembly that would enable BOS to evaluate and license the candidacy of supervisory board members and to gain the power to remove unqualified board members. Such a regulation has been introduced in the National Assembly in the past without success.</p> <p>A more robust monitoring process for new entrants to the banking system could be developed. In recognition that most bank failures occur within 3 – 5 years of their opening, a more frequent examination schedule, or at least frequent on-site visits to the bank to evaluate the quality of risk management and control systems, including credit origination practices, and its capacity to meet its projected business and strategic goals, should be considered in the event there are additional <i>de novo</i> entrants to the banking system. The off-site monitoring process could focus on the success of the business and strategic goals as well.</p>
Principle 4	Transfer of significant ownership. The supervisor has the power to review and reject any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Essential criteria	
EC1	Laws or regulations contain clear definitions of "significant" ownership and "controlling interest."
Description and findings re EC1	Significant ownership and controlling interest are generally used interchangeably but there are distinctions based on the level of ownership interest in a bank. A qualifying holder is a significant owner, and is defined as a shareholder with at least a 10 percent equity interest in the bank, regardless of whether it is held directly or indirectly. Someone whose holding is below 10 percent may still be considered a qualifying

	<p>holder in the event BOS considers the shareholder to exercise significant influence over the bank's management.</p> <p>With a 20 percent equity interest in a bank, either directly or indirectly, a shareholder owns a participation in the bank. For both the qualifying holder and the participant, the level of voting rights held in the institution by the shareholder reflect the proportionate share in the bank's ownership.</p> <p>The definition of control is related to an ownership structure featuring a parent institution and its banking and non-bank subsidiaries. Control is the relationship between the parent institution and its subsidiary. There is no defined level of ownership. While it is typically a majority interest in a bank or subsidiary, its use is flexible and can encompass a qualifying holder. From the perspective of determining a presumption of control, this can be a valuable interpretation.</p> <p>The ability to exert significant influence over the affairs of a bank is defined as having the capacity to influence the membership of the management or supervisory board, including the right to appoint or discharge such individuals from these boards; or having the capacity, through a legal agreement or other legal grounds, to influence the policy or strategic direction of the bank.</p> <p>Articles 23 – 27 of the Banking Act provide the definitions of significant ownership and controlling interest. Article 25 defines significant influence.</p>
EC2	<p>There are requirements to obtain supervisory approval or provide immediate notification of proposed changes that would result in a change in ownership, including beneficial ownership, or the exercise of voting rights over a particular threshold or change in controlling interest.</p>
Description and findings re EC2	<p>BOS authorizes an ownership interest in a bank through the granting of a license at the qualifying holder and participation level, when acquiring an equity interest of 10 percent, 20 percent, and 33 percent of the bank's shares or when acquiring a majority interest (50 percent or more). A shareholder who over time may acquire additional shares of the bank must apply for a new license when an interest at the 20 percent, 33 percent, and 50 percent threshold is attained. At each level, in view of the level of ownership held by the shareholder, the criteria become more stringent. At 10 percent, the prospective owner is usually subjected only to a fit and proper test. At succeeding higher ownership levels, the owner must provide strategic and financial plans. For a majority owner, corporate governance and the management structure is assessed, together with evaluation of the supervisor's ability to conduct effective consolidated supervision.</p> <p>In the event a shareholder at the qualifying holder level or above intends to sell shares such that the equity interest in the bank is reduced to a lower level, BOS must be informed at least one day prior to the sale. A report must be filed with BOS within five days after the transaction is consummated.</p>
EC3	<p>The supervisor has the power to reject any proposal for a change in significant ownership, including beneficial ownership, or controlling interest, or prevent the exercise of voting rights in respect of such investments, if they do not meet criteria comparable to those used for approving new banks.</p>

Description and findings re EC3	A change or transfer of significant ownership may be rejected by BOS for a number of reasons. As stipulated in Articles 48 and 49 of the Banking Act, the criteria are similar to the establishment of a <i>de novo</i> bank, and include an assessment of financial strength, the application of a suitability test, the identification of the source of funding for the acquisition, the identification of the ownership structure, and whether the acquisition could impede effective supervision depending upon the locus of the acquirer. As part of the suitability test, BOS takes special care to evaluate the likelihood that the prospective shareholder would engage in money laundering operations or terrorist financing activities. Article 49 authorizes BOS to reject the application.
EC4	The supervisor obtains from banks, through periodic reporting or on-site examinations, the names and holdings of all significant shareholders or those that exert controlling influence, including the identities of beneficial owners of shares being held by nominees, custodians and through vehicles which might be used to disguise ownership.
Description and findings re EC4	Article 195 of the Banking Act requires banks to report the names and holdings of shareholders with at least a qualifying holding. The Regulation on the Reporting of Individual Facts and Circumstances of Banks and Savings banks is the implementing regulations. On an annual basis subsequent to the shareholder meeting, banks must file a report that reflects the names and ownership interests of shareholders, the amount of voting rights, and in the manner held, whether held directly or indirectly, so as to identify the ultimate or beneficial owner and the structure of ownership, including holdings through a trustee or nominee. Notification of changes in the amount of shares held by a qualifying holder must be filed with BOS five days subsequent to the transaction. The supervisors proactively trace and investigate changes in ownership interests and ultimate indirect holdings using the company register and other official documents.
EC5	The supervisor has the power to take appropriate action to modify, reverse or otherwise address a change of control that has taken place without the necessary notification to or approval from the supervisor.
Description and findings re EC5	Under Article 52 of the Banking Act, a qualifying holder who acquires shares of a bank without obtaining the appropriate license is restricted to voting only 10 percent of the acquired shares. Within a month after BOS has determined that a shareholder has acquired an unauthorized qualifying interest in a bank, and the shareholder has not filed an application to obtain a license to continue holding the shares, BOS will issue an enforcement action requiring the owner of the shares to dispose of them. Typically, the shareholder is required to file a plan describing the manner in which the shares will be disposed; BOS will require that the shares be sold within a prescribed period of time.
Additional criteria	
AC1	Laws and regulations provide, or the supervisor ensures, that banks must notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder.
Description and findings re AC1	There is no requirement in the law that requires a bank to report to BOS adverse changes in the suitability of a qualifying holder, such as a material decline in financial

	capacity or a civil or criminal judgment rendered by the court system. Notifications are required only in the event of changes in the ownership interests of qualifying holders, including a change in control, which in most of these cases triggers implementation of the licensing process.
Assessment of Principle 4	Largely Compliant
Comments	<p>The sanctions applied to a qualifying holder in the event the shares in a bank are acquired without gaining the approval of BOS should be strengthened. It is recommended that, at a minimum, the qualifying holder should be restricted from voting any shares held without prior approval of the BOS and prohibited from receiving dividends or other remuneration such as benefitting from an appreciation in the market value of the shares. The qualifying holder is required to pay a fine. These restrictions should be applied in the event an application for a license to hold the shares is not filed within the one month "grace period." If the application for acquiring the shares is rejected by BOS, the restrictions and penalties should be applied until such time as the owner disposes of the shares.</p> <p>The authorities should consider an amendment to the Banking Act that would require a bank to notify BOS of material adverse changes in the suitability of a qualifying holder, just as is required in the event there are material adverse events that affect the financial condition of the bank. For that matter, notification should be required in the event there are material adverse changes in the suitability of a member of the management board and the supervisory board.</p>
Principle 5	Major acquisitions. The supervisor has the power to review major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and confirming that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Essential criteria	
EC1	Laws or regulations clearly define what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need prior supervisory approval.
Description and findings re EC1	<p>Articles 45 -- 49 of the Banking Act governs the acquisition of investments in banks by a qualifying holder. The Act establishes criteria considered in the assessment of the application, including the financial soundness of the applicant, suitability standards and an evaluation of potential impediments relative to the supervision of the institution in a satisfactory manner.</p> <p>There are no powers explicitly granted to BOS for the licensing of non-bank financial companies by Slovenian banks regardless of their intended locus. A number of Slovenian banks have acquired or established such subsidiaries. Many of these are leasing subsidiaries owned directly by the banks and are wholly or majority owned.</p> <p>Articles 169 and 170 govern the acquisition of investments in non-financial companies. The law parallels EU CRD directive 2006/48, limiting the exposure of a bank for each investment to 15 percent of capital; in aggregate a bank's investment in non-financial sector investments is limited to 60 percent of capital, although there are some exceptions. Banks may exceed the 60 percent exposure rule, but must deduct the gross balance of the excess against the capital base in calculating capital adequacy ratios.</p>

EC2	Laws or regulations provide criteria by which to judge individual proposals.
Description and findings re EC2	The criteria applied to the establishment of a <i>de novo</i> bank or of a bank gaining a majority interest would be employed in evaluating such proposals. Non-bank non-financial companies are evaluated as portfolio investments inasmuch as there are strict limits on the bank's exposure.
EC3	Consistent with licensing requirements, among the objective criteria that the supervisor uses is that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. The supervisor can prohibit banks from making major acquisitions / investments (including the establishment of foreign branches or subsidiaries) in countries with secrecy laws or other regulations prohibiting information flows deemed necessary for adequate consolidated supervision
Description and findings re EC3	Article 96 of the Banking Act establishes the power of BOS to reject an application of a bank to establish branch operations in a foreign country on the grounds that a fully effective program of consolidated supervision would be impeded based on the regulatory framework and/or the approach to banking supervision practiced by the home country supervisor.
EC4	The supervisor determines that the bank has, from the outset, adequate financial and organizational resources to handle the acquisition/investment.
Description and findings re EC4	Under the legal framework governing the acquisition of a qualifying holding in a bank, the financial strength of the applicant is a fundamental criterion. It is established in Articles 48 of the Banking Act. All qualifying shareholders are assessed as to their financial capacity in terms of their financial strength at the time of the application, and prospective capacity to provide additional capital to the bank in the event it is needed. Each such prospective qualifying shareholder must provide financial information that demonstrates an appropriate level of financial capacity.
EC5	Laws and regulations clearly define for which cases notification after the acquisition or investment is sufficient. Such cases should primarily refer to activities closely related to banking and the investment being small relative to the bank's capital.
Description and findings re EC5	Notification is required in connection with the establishment of such operations in Slovenia and EU-Member States.
EC6	The supervisor is aware of the risks that non-banking activities can pose to a banking group, and has the means to take action to mitigate those risks.
Description and findings re EC6	BOS is aware of the risks of operating non-bank financial activities. Its program of ongoing supervision includes the non-bank financial companies operated by Slovenian banks, as many of them are subjected to on-site examinations. There also is a ring fencing mechanism to protect banks from potentially abusive practices. However, the lack of a licensing process is a gap in the legal and supervisory framework. While the non-bank financial subsidiaries are subject to an ongoing supervision regimen, aside from the on-site examinations there is very little direct focus on these entities.
Additional criteria	
AC1	When a bank wishes to acquire a significant holding in a financial institution in another country, the supervisor should take into consideration the quality of supervision in that

	country and its own ability to exercise supervision on a consolidated basis.
Description and findings re AC1	As a matter of practice, and grounded in the Banking Act, is the requirement to assess the quality of the home country supervisor. The provisions of the Banking Act addressing the acquisition of a qualifying holder and of consolidated supervision contain articles requiring BOS to evaluate foreign bank supervisors, and to ensure the legal framework and supervisory practices do not impede the ability of BOS to supervise the institution on a consolidated basis.
Assessment re Principle 5	Noncompliant
Comments	The Banking Act empowers BOS to, inter alia, license banks, qualifying holders of shares, management boards of banks, and foreign branches that may be established in third countries. The Act is silent on providing BOS with the authority to grant licenses to non-bank financial companies owned by Slovenian banks. This represents a weakness in the regulatory and supervisory framework. Non-bank financial companies can expose banks to significant risks, potentially affecting the future viability of the acquiring institution, and the authorities should have the power to review and approve material acquisitions and investments. It is recommended that the authorities amend the Banking Act or develop a regulation that empowers BOS to authorize the licensing of such entities when operated by a bank, and to develop a notification process in the event the size and scope of such operations may be considered to be immaterial relative to the total operations of the banking group. Better yet, the authorization process should be employed for such acquisitions in view of the risks they can pose to the institution.
Principle 6	Capital adequacy. Supervisors must set prudent and appropriate minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. At least for internationally active banks, these requirements must not be less than those established in the applicable Basel requirement.
Essential criteria	
EC1	Laws and regulations require all banks to calculate and consistently maintain a minimum capital adequacy ratio. Laws, regulations or the supervisor define the components of capital, ensuring that emphasis is given to those elements of capital available to absorb losses.
Description and findings re EC1	<p>BOS has virtually transposed EU Directives 2006/48 and 2006/49, commonly referred to as Capital Requirements Directives (CRD) into Slovenian regulations. The entire Basel II regimen has been introduced into the legal framework in this manner.</p> <p>The CRDs establish minimum capital requirements for several types of risk. BOS requires that these capital requirements are adhered to by each bank. In accordance with Article 136 of the Banking Act, a bank's capital must equal or exceed the sum of capital requirements for credit, market and operational risks. There are regulations addressing the methodologies for calculating capital adequacy for each of these risks. Banks may select the methodologies contained in the regulations, such as the Basic Indicator approach for operational risk, or a more advanced approach provided they are granted approval to do so by BOS.</p> <p>The internal capital requirements of Basel II are addressed in the Guidelines on Internal Capital and the SREP-ICAAP process for Banks. The methodologies for calculating these capital requirements, such as for interest rate risk in the banking</p>

	<p>book, and securitization and concentration risk are contained in a separate Regulation on the Calculation of Minimum Internal Capital Requirements.</p> <p>The regulations apply to banking groups on a consolidated basis, but there are exemptions for immaterial subsidiaries or for other reasons, and BOS must authorize these exemptions. Branches of foreign banks also are exempt.</p> <p>The rules for calculating the various components of supervisory capital – Tiers I, II and III – together with deductions from capital are precisely defined in accordance with Basel II in Chapter 4.4 of the Banking Act and the Regulation on the Calculation of Own Funds for Banks and Savings Banks. In addition, the Guidelines on Internal Capital require that 80 percent of Tier I capital be comprised of core capital components such as common shares and retained earnings.</p> <p>With the impending introduction of the EU version of Basel III (CRD IV) in Slovenia in January 2013, BOS is considering its implications. The current minimum capital adequacy established in the law will increase, and banks have been notified of the need to plan for additional capital, especially in light of the capital buffers that may be imposed.</p>
EC2	At least for internationally active bank, the definition of capital, the method of calculation and the ratio required are not lower than those established in the applicable Basel requirement.
Description and findings re EC2	The minimum capital requirements expressed in the Banking Act apply to all banks and banking groups at the consolidated level. Within a banking group, they apply to the banks individually in the few cases where there are multiple banks in the group. These are based on the CRDs. There is no distinction between banks whose operations are confined to Slovenia and those who operate internationally in this regard, and the capital adequacy measurements are the same as stipulated in the CRD.
EC3	The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures.
Description and findings re EC3	<p>BOS may require banks to add additional capital based on Article 248 of the Banking Act. Broadly speaking this provision of the law would be employed in the event a bank requires additional capital based on its risk profile as assessed by the supervisors.</p> <p>BOS typically requires individual banks to limit its exposure or enhance its risk management practices for specific risks that are identified as requiring more capital protection rather than requiring a capital increase. This analysis is based on the results of the SREP/ICAAP process. The supervisors, using a series of scorecards to measure the level of risk in individual banks determines the amount of capital in aggregate a bank may need based on its overall risk profile, which flows from the assessment of the individual risks.</p> <p>Specific limitations on risk exposures are prescribed for material exposures such as borrowers and borrower group indebtedness, but BOS has not proactively establish stricter capital requirements systemically for risk exposures that may be identified as potential systemic threats.</p>

EC4	The required capital ratio reflects the risk profile of individual banks. Both on-balance sheet and off-balance sheet risks are included.
Description and findings re EC4	<p>Several regulations cover capital measurement and adequacy, and they all are based on the Basel II framework. There are regulations covering credit risk, market risk and operational risk, and they incorporate both on- and off-balance sheet items.</p> <p>Other regulations deal with the assessment of other banking risks. These principles-based regulations describe general capital requirements in support of all risks and guidelines to require all banks to develop and use enhanced risk management techniques. The defining regulation in this regard is the Regulation on Risk Management and Implementation of the Internal Capital Adequacy Assessment Process for Banks and Savings Banks. In accordance with the CRDs, the regulation relates to risks that were included in an earlier version of Basel II but were not fully treated within that framework, such as credit concentration risk, and risks not taken into account at that time, such as interest rate risk in the banking book, and reputation and strategic risk.</p> <p>The evaluation of the adequacy of capital tailored to an individual bank is a practice that has taken shape in connection with the development of BOS's Risk Assessment System, which includes the SREP and ICAAP process. This process includes a comprehensive evaluation of the risk profile of each bank. All banks in the system are subjected to the process annually.</p> <p>In the implementation of the Risk Assessment System, risk scoring cards are derived that reflect the evaluation of the inherent risk and the quality of risk management practices. The inherent risk is that derived specifically from individual risks, such as credit and market risk.</p> <p>The scores derived for each risk are evaluated against the level and quality of capital derived from ICAAP. The System is a supervisory tool that assists the supervisors in identifying which banks may have a capital shortfall, and which risk areas may be the most culpable. A capital shortfall based on this analysis does not automatically trigger a call for additional capital. The typical supervisory strategy would be to require a bank to develop a plan to address the weaknesses in the area of risk management that have been identified, based on the risk scorecards. With better risk management practices, the capital issue is expected to be resolved over time. However, additional capital ultimately may be required by the supervisors.</p> <p>While such a supervisory strategy is necessary and ultimately is the solution that will resolve the underlying problem, it does not provide the level of capital that is needed in the bank at the time of the evaluation, and enables a bank to continue operating with an amount of capital that does not reflect its risk profile.</p>
EC5	Capital adequacy requirements take into account the conditions under which the banking system operates. Consequently, laws and regulations in a particular jurisdiction may set higher capital adequacy standards than the applicable Basel requirements.
Description and findings re EC5	BOS's regulations concerning capital measurement and adequacy are based on the EU's CRDs, and there has been virtually no deviation from these requirements. BOS retains the capacity to adjust factors such as the risk weightings for certain localized asset classes to reflect local statutory and economic conditions but has not done so.

EC6	Laws or regulations clearly give the supervisor authority to take measures should a bank fall below the minimum capital ratio.
Description and findings re EC6	<p>BOS is empowered to require banks to establish and maintain capital at the minimum as defined in the Banking Act. Article 248 enables BOS to require banks to raise additional capital as is required to at least meet the minimum required level. This can be accomplished by requiring the management board to develop a plan for meeting the minimum capital requirement. BOS also can resort to having the bank's management and supervisory board call a general meeting of shareholders and pass a resolution to increase capital to the minimum required by law. There is no guaranty that the shareholders will pass such a resolution, and may not do so to avoid dilution of their shares or for other reasons. In that case, BOS could resort to other measures contained in the law, which could be used to require additional capital.</p> <p>To raise the required capital, BOS could resort to one of two options: a) BOS could itself sell shares or convert debt into equity, or 2) the bank could be placed under special administration. Both of these options are viewed as a last resort and neither is palatable.</p> <p>As a matter of practice, BOS takes preemptive measures to prevent a bank from reaching the point where its capital adequacy slips below the minimum requirement, insofar as possible. These measures usually include heightened monitoring of the bank based on a capital restoration plan that is acceptable to BOS, and may include deleveraging through the sale of assets, restricting dividend payments or other elements of a sound supervisory strategy. A supervisory strategy of this nature typically emanates for the ICAAP/SREP process. However, the power of shareholders in this matter could act as an impediment.</p> <p>With the introduction of increased capital requirements arising from Basel III, there is recognition that several banks in the system will need to add capital to maintain capital at least at the minimum required by law. BOS has been active in communicating to the industry that many of these institutions must raise additional capital.</p>
EC7	Where the supervisor permits banks to use internal assessments of risk as inputs to the calculation of regulatory capital, such assessments must adhere to rigorous qualifying standards and be subject to the approval of the supervisor. If banks do not continue to meet these qualifying standards on an ongoing basis, the supervisor may revoke its approval of the internal assessments.
Description and findings re EC7	<p>Banks are permitted to use internal assessments of risk as inputs for the calculation of capital requirements only upon gaining authorization from BOS. The authorization is required for credit, market and operational risk modeling. There are regulations that prescribe in detail the requirements that would enable BOS to grant authorization for each of these risks. The conditions under which such authorization is granted are fully compliant with the CRD requirements. As a result, the regulations also incorporate the provisions of the CRD that address the use of internal models when a bank is supervised through a supervisory college such that a joint decision by the supervising bodies to permit internal assessments would enable the bank to employ modeling techniques in its operations in its cross border operations. For Slovenia this is important because there are several banks whose home country supervisor is an EU-Member State.</p> <p>BOS grants authorizations for banks to employ the IRB approach for credit risk, the AMA approach for operational risk, and internal models for position risk, foreign</p>

	<p>exchange risk or commodity risk relative to market risk, either as an IMM or mark-to-market model. Some combination of the more sophisticated and complex modeling techniques may be combined with other measurement systems upon approval of BOS.</p> <p>Prior to granting authorization, BOS examiners conduct on-site pre-validation, validation and post-validation reviews of modeling processes. During the pre-validation examination, the examiners evaluate the bank's preparation for implementation of the modeling, and the bank's risk assessment policies and processes. In the validation examination, examiners assess corrective measures taken to resolve problems. In one such examination, the examiners assessed the bank's net systems processing policies, its collection loss data events system, scenario analysis and key risk indicators for managing operations risk. In the post-validation examination process, BOS tests the modeling system to ensure that the bank has not lowered its standards; this exercise occurs at least once every three years. The authorization to employ these internal models can be revoked by BOS or through the Joint Decision process of a supervisory college if the examiners determine the qualifying standards have been eroded.</p> <p>BOS has on its examination staff a computer engineer, a statistician, and mathematicians who participate in these examinations. At present, there are two banks operating in Slovenia that have been approved to employ internal models for credit and operational risks. Both of these institutions are supervised through a supervisory college with the coordinator (consolidated supervisor) located in another EU-Member State.</p>
Additional criteria	
AC1	For non-internationally active banks, the definition of capital, the method of calculation and the capital required are broadly consistent with the principles of applicable Basel requirements relevant to internationally active banks.
Description and findings re AC1	BOS's regulations for defining capital or the method of calculation are the same for local Slovenian banks and are for those with operations in other countries.
AC2	For non-internationally active banks and their holding companies, capital adequacy ratios are calculated and applied in a manner generally consistent with the applicable Basel requirement, as set forth in the footnote to the Principle.
Description and findings re AC2	Capital adequacy regulations are applied uniformly to all banks and banking groups that operate in Slovenia.
AC3	The supervisor has the power to require banks to adopt a forward-looking approach to capital management and set capital levels in anticipation of possible events or changes in market conditions that could have an adverse effect. There is no distinction between internationally active banks and non-internationally active ones, including in the definition of capital, the computation methods and the minimum capital requirements.
Description and findings re AC3	In the context of the ICAAP process, banks are required to examine their capital adequacy under other macroeconomic and internal conditions and make sure that appropriate capital for the support of banking activities is available. More specifically, these requirements are directed at two main processes, capital planning as a component of strategic planning and strict forward-looking stress tests.

	As it analyzes a bank's ICAAP report, BOS reviews the bank's capital planning deliberations and the results of the stress tests and factors them into the overall assessment of capital adequacy.
AC4	The supervisor requires adequate distribution of capital within different entities of the banking group according to the allocation of risks.
Description and findings re AC4	The prudential requirements relative to capital adequacy apply both at the solo and consolidated level. Articles 130 and 131 of the Banking Act requires that a banking group or a bank be capitalized adequately at each level of the organization. In practice, BOS gauges only the targeted capital of the subsidiary banks in a banking group. Other organizations in the group or that are held directly by the bank as subsidiaries are evaluated only at the consolidated level. The investment in such subsidiaries are treated as an investment and evaluated from a risk management perspective as a line item asset. The rationale for approaching the evaluation of capital in this manner is that banks are considered the only material institutions.
AC5	The supervisor may require an individual bank or banking group to maintain capital above the minimum to ensure that individual banks or banking groups are operating with the appropriate level of capital.
Description and findings re AC5	BOS conveys its expectations in the course of the dialogue that follows the ICAAP-SREP process. A bank may be deemed to need capital above the minimum requirement based on the supervisor's evaluation, and the expectation normally is that the bank will resolve the risk management issues that lead to the supervisor's assessment. In addition, BOS expresses its expectations relative to the amount of capital above the required minimum that an institution is expected to have. The expectation is transmitted in the form of a decree.
Assessment re principle 6	Materially Noncompliant
Comments	<p>The regulatory framework for capital adequacy is aligned with the amendments to the Basel international standards, but there is a provision of the law that should be strengthened nonetheless. There is a clear and direct power in the law to require a bank to maintain capital at a prescribed minimum level, and that BOS has the authority to require banks to raise additional capital, either as a special capital charge or for other supervisory reasons. However, a potential impediment to a desired goal of requiring a bank to raise additional capital is the provision in the law that requires a shareholder meeting be called so that a resolution can be voted upon to raise the capital. Not only can this result in a protracted affair, but there is a possibility that such a resolution could fail. Under such circumstances, BOS must resort to selling the capital itself or placing the bank under special administration. Neither is a desirable option. This provision of the law should be eliminated. The rights of shareholders are an important economic consideration, but cannot supersede the protection of depositors and the need for banks to be adequately capitalized.</p> <p>The supervisors are not aggressively demanding that banks increase capital based on the results of the ICAAP/SREP process in a persistent manner, or moving banks to employ more enhanced capital measurement techniques, such as IRB relative to credit risk. The supervisors prefer to require banks to improve their risk management practices. While this is commendable, it is not a substitute for adequate capitalization</p>

	<p>and enables a bank to operate without a satisfactory level of capital. Employment of enhanced techniques, particularly for the larger more systemically important institutions in Slovenia, would be appropriate. The supervisors should prod these banks into gaining the necessary expertise and applying it to their capital calculations. However, it is recognized that application of these modeling techniques is likely to identify even higher levels of required capital, especially for credit risk.</p> <p>In accordance with CRD IV established by the EBA, Basel III will be implemented in January 2013 throughout the EU. In Slovenia, Basel III will be incorporated into BOS's regulations without any modifications. The direct supervisory responsibility aspects of Basel III will be implemented through a series of rules and regulations developed by a series of working groups operating under EU auspices. Representatives of BOS participate on many of these working groups. In preparation for implementation of Pillars I and II, supervisory staff have performed a series of quantitative studies both on individual banks and systemically relative to capital adequacy and liquidity requirements. With respect to capital adequacy, the quantitative impact studies were conducted using in-house data for institutions on both a solo and consolidated basis. The results of the study indicated that capital ratios would fall for virtually all banks, but would remain above the required levels systemically. Several banks will have to add capital or in other ways conform to the capital adequacy guidelines. In connection with implementation of Basel III, the authorities should consider requiring a capital plan from individual banks so that they will be able to monitor formally the strategy that banks pursue and the progress made in meeting the capital guidelines.</p>
Principle 7	<p>Risk management process. Supervisors must be satisfied that banks and banking groups have in place a comprehensive risk management process (including Board and senior management oversight) to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile. These processes should be commensurate with the size and complexity of the institution.</p>
Essential criteria	
EC1	<p>Individual banks and banking groups are required to have in place comprehensive risk management policies and processes to identify, evaluate, monitor and control or mitigate material risks. The supervisor determines that these processes are adequate for the size and nature of the activities of the bank and the banking group and are periodically adjusted in the light of the changing risk profile of the bank or banking group and external market developments. If the supervisor determines that the risk management processes are inadequate, it has the power to require a bank or banking group to strengthen them.</p>
Description and findings re EC1	<p>Article 124 of ZBan-1 (Banking Act) requires that banks have a robust and reliable risk management system which include clear organizational structure, effective processes for risk identification, assessment/measurement, mitigation and control, appropriate internal control system and remuneration system. In addition and based on Article 126 of ZBan-1 banks must implement a comprehensive internal capital adequacy assessment process (ICAAP) which include various techniques for assessment of risk profile and stress tests. These legislative requirements are further in-depth elaborated in Decree on Risk Management and ICAAP in the form detailed regulatory requirements on risk management system, including internal control system of the bank. (Articles 3, 7 to 28 of Decree on Risk management and ICAAP). Principle of</p>

	<p>proportionality applies for all cases (Article 124(2) of ZBan-1 and Article 7(2) of Decree on Risk management and ICAAP).</p> <ul style="list-style-type: none"> - Regarding risk management and policies, a bank must implement appropriate, effective and comprehensive strategies and policies for taking-up and managing risks (Article 3 of Decree on Risk management and ICAAP). - Regarding the risk management processes, a bank must implement effective procedures for identifying, measuring/assessing, mitigating and monitoring risks and system for internal risk reporting. These requirements cover also new products and outsourcing regime - Regarding the internal control system, a bank must fulfill various requirements on Internal control issues (i.e. internal control structure, reporting, working procedures, limits, physical controls, internal controls for information systems, personnel issues) and Internal Audit. <p>Banks must fulfill abovementioned requirements on risk management system also on consolidated (group) level (Article 4 of Decree on Risk Management and ICAAP). BOS has the legal power to impose measures which could improve risk management system and process ICAAP (i.e. Article 248(6) of ZBan-1).</p> <p>Though it does exist some regulatory basis for imposing standards to banks in the field of risk management policies and processes Slovenian regulation is more principle based than specific as regards banks' internal control frameworks.</p> <p>On the side of supervisory methodologies a large part of BOS Risk Based Approach methodology (RAS/POT) covers evaluation of internal control environment of individual bank. This methodology follows CEBS Guidelines on Supervisory Review Process. For each bank and every type of risk the BOS has an ongoing assessment process. Internal controls is viewed as a risk mitigant, therefore the quality of internal control is closely monitored and rated through a scoring process whose principles have been made public in October 2006 (public part of the RAS/POT methodology), so that banks are aware of what are the supervisor's expectations. Emphasis is thus given to several aspects of internal controls : framework of risk management (risk identification, measurement and control), quality of internal and external reporting, existence and consistent implementation of internal procedures, independence and effectiveness of the audit function, compliance controls, effectiveness and integrity of the IT support, adequacy of the human resources.</p> <p>There have been many occasions where banks were given measures (admonishments, orders, and recommendations) due to poor or inadequate risk management processes.</p>
EC2	<p>The supervisor confirms that banks and banking groups have appropriate risk management strategies that have been approved by the board. The supervisor also confirms that the board ensures that policies and processes for risk-taking are developed, appropriate limits are established, and senior management takes steps necessary to monitor and control all material risks consistent with the approved strategies.</p>
Description and findings re EC2	<p>Issues are addressed in BOS's RAS methodology where the involvement of management and supervisory board in daily business and also in risk management is evaluated. This document follows the Supervisory Review Process under pillar 2 (CEBS June 2005).</p> <p>The obligations of board, including the approval and review of risk management strategies and policies are defined also in article 12 (responsibilities of the Board in the</p>

	<p>area of risk management) and obligations of senior management, including the establishment and control of limits for limiting exposure to risks are defined in article 13 (responsibilities of the bank's senior management) of Regulation on Risk Management and implementation of Internal Capital Adequacy Assessment process. This regulation transposes the European Directive 2006/48/EC and its amendments.</p>
EC3	<p>The supervisor determines that risk management strategies, policies, processes and limits are properly documented, reviewed and updated, communicated within the bank and banking group, and adhered to in practice. The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of and authorization by the appropriate level of management and the Board where necessary.</p>
Description and findings re EC3	<p>A bank must follow detailed requirements on appropriate documentation on every level of risk management process (Article 37 of Decree on Risk Management and ICAAP). In this regard bank must provide systematic documentation of important elements of the management system and the process of assessing adequate internal capital (i.e. risk strategies and policies, instructions and guidelines, material measures and decisions of the Management body.</p> <p>Implementation of risk management procedures across bank is evaluated by the BOS when performing on site supervision. Knowledge of people involved and usage of manuals and internal procedures in practice is evaluated. Regulation on Risk Management and implementation of Internal Capital Adequacy Assessment process in article 12 (see above) determines the roles of management and supervisory board also in the area of reviewing and updating the risk strategies and policies if bank's internal and external environment change. Regulation of the diligence of the members of the board and supervisory board for banks and saving banks also determines the role in risk management process.</p>
EC4	<p>The supervisor determines that senior management and the board understand the nature and level of risk being taken by the bank and how this risk relates to adequate capital levels. The supervisor also determines that senior management ensure that the risk management policies and processes are appropriate in the light of the bank's risk profile and business plan and that they are implemented effectively. This includes a requirement that senior management regularly reviews and understand the implications (and limitations) of the risk management information that it receives. The same requirement applies to the board in relation to risk management information presented to it in a format suitable for board oversight.</p>
Description and findings re EC4	<p>A bank must ensure that the appropriate knowledge and experience, regarding risks which the bank takes-up in the scope of its operations, are available to the management board and senior management (Article 14 of Decree on Risk Management and ICAAP). This is the prerequisite for the bank that its material risks are covered by risk bearing capacity at all times (Article 6 of Decree on Risk Management and ICAAP). To appropriately inform the board on risks, a bank must ensure internal reporting framework that would make possible the taking of management decisions with regard to measures for mitigating risks and for monitoring the results of said measures. The extent and detail of internal risk reports shall take into account the needs of intended users, including all management levels of the bank (Article 19 of Decree on Risk Management and ICAAP).</p> <p>The RAS/POT methodology encompasses the assessment of "culture of risk management" which is extensively defined. Furthermore the RAS/POT methodology describes the BOS's expectations on the involvement of bank management and</p>

	<p>supervisory board in risk management. The issue of suitability of the risk management information reported to the board is somehow covered by two specific chapters of the RAS/POT methodology, namely “reporting” and “decision making process.”</p> <p>From a more practical standpoint, one of the purposes of the on-site examinations is to review the internal reports regarding risks and risk management that management and supervisory board approve on their regular meeting.</p>
EC5	<p>The supervisor determines that the banks have an internal process for assessing their overall capital adequacy in relation to their risk profile, and reviews and evaluates bank’s internal capital adequacy assessments and strategies. The nature of the specific methodology used for this assessment will depend on the size, complexity and business strategy of a bank. Non-complex banks may opt for a more qualitative approach to capital planning.</p>
Description and findings re EC5	<p>According to the BOS’s ICAAP Guideline (February 2010), article 126 of the Banking Act (ZBan-1), and Chapter 4 of Decree on Risk Management and ICAAP) the banks must implement ICAAP methodology while the BOS uses its own RAS/POT methodology as a key element of its Supervisory Review and Evaluation Process (SREP). Comparison of the results of both internal calculations of ICAAP and supervisor’s RAS /SREP scoring is the basis of a “dialog” between each bank and the BOS. Through this dialog the BOS can challenge the banks ICAAP evaluations. Moreover in case of issues discovered in on site examinations or off site reporting proper additional capital could be required from the bank.</p> <p>The SREP dialog takes place every year; the intensity of dialog depends on size and complexity of the bank.</p>
EC6	<p>Where banks and banking groups use models to measure components of risk, the supervisor determines that banks perform periodic and independent validation and testing of the models and systems.</p>
Description and findings re EC6	<p>When banks want to use internal models to measure certain components of risk (IRB approach for credit risk and AMA for operational risk) they have to request the permission to use such model from the BOS (articles 143 and 159 of Z-Ban1/Banking Law). In this regard a bank must fulfill prescribed minimum standards (for IRB) or qualification criteria (for AMA) that are in detailed described in Decree on IRB approach and Decree on Operational risk. To obtain such an authorization a bank must first have done an internal validation performed by the internal audit and then to get the approval of the BOS. On site examination checks that presumptions and structure of the model are valid and properly tested. Furthermore the BOS has developed an In house Credit Assessment System (ICAS) designed to estimate probabilities of default (PDs) and then is able to challenge the results of banks internal models. The BOS ICAS is in the course of validation by the ECB for valuation of collateral.</p> <p>Besides IRB and AMA (which are currently use by a very limited number of Slovenian banks), banks using models for the purpose of valuation of unlisted capital shares or listed but illiquid equities must get an approval of an external auditor and of their own supervisory board. Regular monitoring of such models is performed by on site examinations.</p>
EC7	<p>The supervisor determines that bank and banking groups have adequate information systems for measuring, assessing and reporting on the size, composition and quality of exposures. It is satisfied that these reports are provided on a timely basis to the board or senior management and reflect the bank’s risk profile and capital needs.</p>
Description and findings re EC7	<p>BOS makes its opinion on the quality and adequacy of the banking groups ’IS through different channels. First the timing, correctness, reliability of the external reporting</p>

	required and received by the supervisor is evaluated by the BOS on an ongoing basis. Second the quality of the internal reporting is a key element of the evaluation of a bank when conducting an on-site examination. Third the quality of management information system is evaluated specially under Operational risk where information system of the bank is evaluated. The BOS expectations on IS are expressed in the RAS/POT Methodology in different chapter 10 "Elements of internal controls", bullet point 2 (reporting) and bullet point 6 (information technology).
EC8	The supervisor determines that banks have policies and processes in place to ensure that new products and major risk management initiatives are approved by the board or a specific committee of the board.
Description and findings re EC8	According to BOS Regulation on risk management and ICAAP, article 17, when introducing new products the banks shall provide an analysis of associated risks prior to the introduction of a new product or system. All risk management procedures (identification, measurement, mitigation, control) valid for introducing new products or systems also (Article 15 of Decree on Risk Management and ICAAP). Moreover "Significant risks arising from a new product or system shall be treated comprehensively and in a timely manner in the risk management process". Additionally, according to Article 13 of the Regulation on reporting of individual facts and circumstances of bank and savings bank, banks are obliged that new products or activity are approved by the board or a specific committee and have to inform BOS thereof. Bank should also report on introducing new product, characteristics of the product, major risks, period of introduction, test phase etc. On site examinations usually covers the new products/new activities process and e guidance to on-site examiners is given in the RAS/POT internal handbook.
EC9	The supervisor determines that banks and banking groups have risk evaluation, monitoring and control or mitigation functions with duties clearly segregated from risk-taking functions in the bank, and which report on risk exposures directly to senior management and the board.
Description and findings re EC9	Article 124 of the ZBan-1/Banking Act states that banks should have in place sound and reliable management system with clear organizational structure and with precisely defined, transparent and consistent internal relationship. Article 9 of the Regulation on risk management and ICAAP states that banks shall have appropriate segregation of competencies and duties amongst all employees, including all management levels. Segregation between the risk taking functions (front office) and the risk control function is made more explicit in the annexes of this document, for instance the annex 1 on credit risk states that a bank shall ensure clear separation of competencies and duties between the commercial unit and the risk management functions. The internal RAS/POT methodology put special emphasize on distinction between front office and risk management functions when performing on-site examinations.
EC10	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk.
Description and findings re EC10	Regulation on risk management and ICAAP defines in its annexes (1 to 5) minimal standards for credit risk, market risk, liquidity risk, interest rate risk and operational risk that banks must comply to. These standards are derived from EU CRD Directive and are obligatory for EU Member States.
Additional criteria	
AC1	The supervisor requires larger and more complex banks to have a dedicated unit(s) responsible for risk evaluation, monitoring and control or mitigation for material risk

	areas. The supervisor confirms that this unit (these units) is (are) subject to periodic review by the internal audit function.
Description and findings re AC1	Even if it is not absolutely explicit in regulation, in practice all banks under BOS supervision have risk management department as independent sector or function and larger bank have divided risk management departments for credit risk, market risks and other risks. The risk control function is usually under direct jurisdiction of the bank management and is under regular review from internal audit function as well as external auditors including BOS.
AC2	The supervisor requires banks to conduct rigorous, forward-looking testing that identifies possible events or changes in market conditions that could adversely impact on the bank.
Description and findings re AC2	Banks are required to conduct regular stress test on their portfolios. Some tests are predesigned by the BOS (liquidity tests) itself while banks use their own stress tests as part of ICAAP process and as part of risk management process. The results of tests are taken into account during the ICAAP/SREP dialog when setting the capital needs of each individual bank (Pillar 2).
AC3	The supervisor requires banks and banking groups to have in place appropriate policies and processes for assessing other material risks not directly addressed in the subsequent CPs, such as reputational and strategic risks.
Description and findings re AC3	<p>In general a bank shall ensure that it is, at all times, capable of managing all significant risks (in addition to credit, market, interest rate, operational and liquidity risk) to which is exposed in the scope of its operations. This includes risks to which the bank has been or could be exposed, internal and external risks, measurable and non-measurable risks and risks which can and cannot be controlled. For measurable risks, the bank shall establish methodologies for measuring risks; for non-measurable risks methodologies for assessing risks shall be established (Article 5 of Decree on Risk Management). A bank shall ensure that significant risks, taken-up in the scope of its operations, are identified early, comprehensively treated, monitored in the scope of the bank's activities and presented to the appropriate management levels in a timely manner. Effective risk management reduces the possibility of unexpected losses and consequently prevents reputation risk arising from such losses (Article 15 of Decree on Risk Management).</p> <p>The public part of RAS/POT methodology (Chapters B.6 and B.7) describes briefly the general expectation of BOS as far as reputational and strategic risks are concerned. There is a more detailed description of strategic risk and reputational risk in the internal (non public) RAS/POT Methodology. These risks, among others, are also periodically subject to on site examinations thus examination reports contain usually some assessment of reputational and strategic risks of the audited banks when risks are material.</p>
Assessment of Principle 7	Largely Compliant.
Comments	The regulations and internal RAS/POT methodology for off-site and on-site supervision provides BOS examiners with generally adequate guidance for assessing a bank's risk management process. However the regulatory guidance on risk control functions organization, missions and resources –including the public part of RAS/POT methodology- could be more precise and prescriptive as it seems that there is still some room for improvement in the banks management's risk culture. In particular it is a widely shared view in the financial industry (external auditors and bankers themselves) that the risk management function has not always enough power in the decision making process.

	<p>BOS has identified in some of the country's largest banks –including some large state-owned bank- highly inefficient corporate management and poor internal control environment and has recently put additional pressure on them to take remedial, corrective action. BOS duly made use of its power to require these banks to strengthen their risk management process and culture but has not been fully successful in obtaining the expected improvements in a timely manner.</p>
Principle 8	<p>Credit risk. Supervisors must be satisfied that banks have a credit risk management process that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control credit risk (including counterparty risk). This would include the granting of loans and making of investments, the evaluation of the quality of such loans and investments, and the ongoing management of the loan and investment portfolios.</p>
Essential criteria	
EC1	<p>The supervisor determines, and periodically confirms, that a bank's Board approves, and periodically reviews, the credit risk management strategy and significant policies and processes for assuming, identifying, measuring, controlling and reporting on credit risk (including counterparty risk). The supervisor also determines, and periodically confirms, that senior management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes.</p>
Description and findings re EC1	<p>Article 177 of ZBan-1 (Banking Act) is about of banks credit risk management and procedures and states that :</p> <ul style="list-style-type: none"> - banks shall establish and implement appropriate policies and procedures of measuring and managing all material credit risk factors and effects bank shall establish and implement appropriate policies and procedures of measuring and managing all material credit risk factors and effects. -bank's decision to grant loans shall be based on appropriate and well-defined criteria. -bank shall clearly define its procedures for loan approval, change, renewal and refinancing of a loan. -prior to approving any credit or prior to concluding any other contract that is the basis for occurrence of exposure, the bank shall assess the obligor's ability to meet his obligations to the bank and the quality of the collateral according to the type and extent of such collateral. <p>The bank shall monitor the obligor's operations and the quality of collateral throughout the duration of the legal relationship that is the basis for occurrence of the exposure.</p> <p>Article 178 of ZBan-1 (Portfolios monitoring systems) states that : the bank shall set up effective systems for regular managing and monitoring of various portfolios associated with the credit risk and of the bank's exposure, which include: identifying and managing problem exposures and creation of appropriate impairments and provisions. Diversification of the bank's credit portfolios shall be in line with its target markets and general credit policies.</p> <p>Last, according to Article 173 (Responsibility of the Management Body) bank's Board has to approve and periodically review the bank's strategies and policies for identifying, measuring, managing and monitoring risks to which the bank is exposed in its operations.</p> <p>More detailed description of the responsibilities of the Board and Senior management in the area of risk management is also available in Regulation on risk management and ICAAP (generally in Article 12, Article 13, Article 14 and specifically in Annex I:General credit risk management standards).</p>

	<p>On-site and off-site supervision of credit risk is extensively detailed in internal RAS/POT Methodology. Emphasize is put on culture of risk taking and objectives of credit strategy, credit policies, accordance of the entire credit function with credit strategy, attitude of the Board with respect to credit risk management, role of Board and Supervisory Board at determining of credit strategy, decisions and measures of the Board, etc). Supervisors shall also assess credit risk management framework of the bank, internal and external reporting, credit process and procedures, internal and external audit reviews, compliance, IT support and human resources management at credit function. This usually includes assessing how well the Board sets, monitors and controls risk appetite and delegation of powers to senior management.</p> <p>On-site examination reports made available in English for the needs of the BCP assessment shows that RAS/POT methodology is effectively and extensively used in practice by BOS examiners and that a special attention is given to every aspects of credit risk management as credit risk is the prominent risk in most if not all the Slovenian banks.</p>
EC2	<p>The supervisor requires, and periodically confirms, that such policies and processes establish an appropriate and properly controlled credit risk environment, including:</p> <ul style="list-style-type: none"> • a well documented strategy and sound policies and processes for assuming credit risk; • well defined criteria and policies and processes for approving new exposures as well as renewing and refinancing of existing exposures, identifying the appropriate approval authority for the size and complexity of the exposures; • effective credit administration policies and processes, including continued analysis of a borrower's ability and willingness to repay under the terms of the debt, monitoring of documentation, legal covenants, contractual requirements and collateral, and a classification system that is consistent with the nature, size and complexity of the bank's activities or, at the least, with the asset grading system prescribed by the supervisor; • comprehensive policies and processes for reporting exposures on an ongoing basis; • comprehensive policies and processes for identifying problem assets; and • prudent lending controls and limits, including policies and processes for monitoring exposures in relation to limits, approvals and exceptions to limits.
Description and findings re EC2	<p>Bank's obligation regarding credit risk management policies and procedures is detailed in ZBan-1/Banking Law (Article 177) and in Regulation on risk management and ICAAP (articles 15 and 16). Furthermore annex I (General credit risk management standards) in aforementioned regulation contains rules concerning organizational requirements with regard to credit risk, credit approval process, credit monitoring process, analysis of credit portfolio, detailed credit monitoring and treatment of problem loans, process of early detection of increased credit risk, process of assigning an obligor and exposure to grades and pools, process of value adjustments, treatment of concentration risk, treatment of securitization risks.</p> <p>The assessment of banks' compliance to these regulations is mostly carried out through regular on-site examinations which are based on POT methodology and special on-site pre-examinations or examinations of credit risk models at IRB banks. Emphases of on-site examination on the framework of credit risk management are on credit policy (standards and manners for approval of new exposures, renewing and refinancing of existing exposures, limit system, exceptions to limits, authorization), classification of debtors and exposures (structure of rating model, correctness of</p>

	<p>rating, borrower's ability to repay the obligation), monitoring of credit exposures and debtors throughout entire period of crediting, collateral management, legal covenants management, problem assets treatment, recoverability of problem assets, early warning system, impairment policy. The quality of internal and external reporting system and implemented procedures throughout the entire credit process are also important subjects of regular on-site examinations. Examination team selects the sample of credit files which are fully reviewed during examination in bank.</p> <p>Moreover BOS Banking Supervision Department has developed an ICAS (in house credit assessment system, statistical PD estimation model) which is used for calculation of bank's expected loss and comparison with individual and collective impairments and as a benchmark for estimation of corporate borrowers' PD. LGD is estimated from data of collaterals in monthly external reporting (RAZ-1). On this basis expected loss of each debtor and on the aggregate level can be estimated. Calculated expected loss is compared to impairments of the bank. At the end of February 2012, the average provisioning rate for exposures of NPLs-corporates in the banking system was 41,2 percent while the expected losses on NPL calculated by BOS was around 53,9 percent.</p> <p>Additionally monitoring of individual systemically important debtors with large exposure in the banking system is also carried out by the BOS Banking Supervision Dpt. Estimations from the in-house model (see above) for non-market shares valuation are frequently used for valuation of financial collateral.</p> <p>Values of real estate collateral used for credit risk mitigation shall be regularly monitored by banks. Banks valuation of real estate is challenged by BOS with publicly available information (e.g. quarterly reports on the average selling prices of real estate property in the Slovenian market of Surveying and Mapping Authority in the Republic of Slovenia).</p>
EC3	The supervisor requires, and periodically confirms, that banks make credit decisions free of conflicts of interest and on an arm's length basis.
Description and findings re EC3	<p>See above Principle 7 EC9.</p> <p>The BOS requires that credit decisions are subject to strict regulatory rules, providing the equal treatment of all cases (Annex 1 of Risk Management Decree).</p> <p>Conflicts of interests are matter of regular on-site credit reviews based on RAS/POT methodology. Special emphasis is put by this internal methodology on treatment of subordinated companies and employees with special relation to the bank.</p>
EC4	The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling and reporting on credit risk.
Description and findings re EC4	Provisions in ZBan-1/Banking Act (Articles 234 – 240) gives to the BOS full access to information in the credit and investment portfolio and to the bank officers involved in assuming, managing, controlling and reporting on credit risk is assured with. At the request of the BOS's authorized person, the audited bank shall allow this person to conduct an on-site examination at the bank's head office or on other bank's premises.
Additional criteria	
AC1	The supervisor requires that the credit policy prescribes that major credit risk exposures exceeding a certain amount or percentage of the bank's capital are to be decided by the bank's senior management. The same applies to credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities.
Description and findings re AC1	<p>See above EC3.</p> <p>Moreover article 167 of ZBan-1/Banking Act requires from banks that conclusion of</p>

	<p>any legal transactions, which, in respect of the bank's overall exposure, would result in a large exposure to a single counterparty or a group of connected counterparties, is subject to an approval from the bank's supervisory board. This approval is also required for the conclusion of legal transactions on account of which the bank's large exposure to a single counterparty or a group of connected counterparties might increase so that it exceeds 15 percent or 20 percent of the bank's own funds, and every subsequent 5 percent of its own funds.</p> <p>On-site and off-site supervision RAS/POT methodology prescribes that examinations shall involve reviews of credit policy with reference to credit exposures to a single debtor.</p>
AC2	The supervisor determines that banks have in place policies and processes to identify, measure, monitor and control counterparty credit risk exposure, including potential future exposure sufficient to capture the material risks inherent in individual products or transactions. These processes should be commensurate with the size or complexity of the individual bank.
Description and findings re AC2	<p>In accordance with Article 154 of the ZBan-1 banks are obliged to calculate its counterparty credit risk in the event of OTC derivatives, credit derivatives, securities financing transactions (repurchase agreements, securities or commodities lending or borrowing transactions, margin lending transactions based on securities or commodities and) and long settlement transactions. Banks are obliged to identify, measure, monitor and control counterparty credit risk according to the Regulation on the calculation of capital requirements for market risks for banks and savings banks (hereinafter: The regulation on market risk) and The regulation on credit protection (only in the case of SFT). The regulation on credit protection and The regulation on market risk provide different methods for calculating the exposure values of these transactions. The methods are consistent with the CRD.</p> <p>The adequacy of such processes and models are part of review according to POT methodology.</p>
AC3	The supervisor determines that banks have policies and processes to monitor the total indebtedness of entities to which they extend credit.
Description and findings re AC3	<p>Regulation on large exposures of banks and savings banks (see Principle 10) sets rules which require banks to monitor total exposure on an entity and its connected parties.</p> <p>According to the POT methodology bank's policies, systems and processes are regularly reviewed in view of total exposure and inherent risk, as well as in view of compliance with Regulation on large exposures of banks and savings banks. POT methodology prescribes that examiner shall pay attention to direct and indirect exposure to the individual debtor or connected parties such as pledge of shares in company which is a debtor of the bank.</p>
Assessment of Principle 8	Largely –Compliant
Comments	<p>BOS's regulations on credit risk are both relevant and detailed as well as is guidance given to the on-site or off-site examiners/analysts in the internal part of BOS's RAS/POT methodology. Credit risk is well identified by the BOS as the prominent risk in the Slovenian banking system; the Supervisor henceforth pays a lot of attention to it. However the Supervisor's past ability to keep under control banks credit policies and practices is questionable taking into account the rise in NPLs (6 percent of the outstanding "classified assets" are in default and 11.5 percent are claims more than 90 days in arrears) and their impact on bank profitability. Moreover there are some evidences that banks credit risks might have been underestimated and that at least</p>

	<p>some banks have not followed a prudent approach to the extent which was suggested by the Supervisor in the years of prosperity. Then the somewhat hazardous past banks' credit risk strategies or laxity in the loan granting process is now resulting in large provisioning needs. To this regard it is revealing to notice that the country largest banking group -whose total asset is 16.5 bios EUR- had to created in 2011 nearly 0.5 bios EUR or additional impairments and provisions and made a loss of 233 mios EUR. It is quite obvious that some root causes of the present banking crisis were beyond the control of the Supervisor itself (recession in the country, recession or very slow growth in the neighboring countries, political interferences in the management of state-owned banks); nevertheless more timely or more forceful supervisory action could have been desirable.</p> <p>Last, the number of banks using the IRB-F approach is very limited and the ones who use it are not the country's biggest credit institutions. Banks have indeed few incentives to shift to IRB in the absence of a regulatory constraint to use it and since it would very likely result in additional capital requirements.</p>
Principle 9	Problem assets, provisions and reserves. Supervisors must be satisfied that banks establish and adhere to adequate policies and processes for managing problem assets and evaluating the adequacy of provisions and reserves.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to formulate specific policies and processes for identifying and managing problem assets. In addition, laws, regulations or the supervisor require periodic review by banks of their problem assets (at an individual level or at a portfolio level for credits with homogenous characteristics) and asset classification, provisioning and write-offs.
Description and findings re EC1	<p>BOS has put in place a very comprehensive regulatory corpus on provisions and reserves which encompasses :</p> <ul style="list-style-type: none"> - Article 177 of the Banking Act, states banks are obliged to establish and implement appropriate policies and procedures of measuring and managing all material credit risk factors and effects - Article 178 stipulates that banks are obliged to set up effective systems for regular managing and monitoring of various portfolios associated with the credit risk and of the bank's exposure, including identifying and managing problem exposures and creation of appropriate impairments and provisions - Regulation on Risk Management and ICAAP prescribes process of risk management in detail. Especially Article 3 includes directive for establishing strategies and policies for taking-up and managing risks. Annex I is dedicated to general credit risk management standard, where organizational requirements, treatment of credit risk, analysis of credit portfolio, treatment of concentration risk and securitization risk are further elaborated, including detailed credit monitoring and treatment of problem credits. - Regulation on the Assessment of Credit Risk Losses of Banks and Saving Banks prescribes more detailed criteria for asset classification and calculation of impairments and provisions. In accordance with this regulation, IFRS and other regulation banks has to classify balance and off-balance sheet exposures into categories according to risk, and estimate the level of credit risk losses. Bank has to monthly assess whether there exists objective evidence that a financial asset or group of financial of financial assets should be subject to impairment, or whether there exists the possibility of a loss from contingencies and commitments including off-balance sheet items. If such evidence for balance and off-balance sheet exposures exists, banks shall estimate impairments for a financial assets and provisions for contingencies and commitments. Impairment and provisions shall be measured for each balance and off-balance sheet exposures that are individually significant. Impairment of balance and off-balance

	sheet exposures that are not individually significant may be measured individually or collectively.
EC2	The supervisor confirms the adequacy of the classification and provisioning policies and processes of a bank and their implementation; the reviews supporting this opinion may be conducted by external experts.
Description and findings re EC2	<p>According to the Regulation on the Assessment of credit losses Banks must classified their balance sheet and off-balance sheet exposures into credit risk categories ranging from A (the best) to E (the worse) or P for individuals. Categories D and E are in default. Category C is more ambiguous as according to article 13 (4) of the above-mentioned regulation it encompasses financial assets, contingencies and commitments including off-balance sheet items of the following debtors:</p> <ul style="list-style-type: none"> (a) those whose cash flows are estimated to be insufficient for the regular settlement of due liabilities; (b) those that pay their liabilities up to 90 days in arrears, and occasionally 91 to 180 days in arrears, (c) those that are substantially undercapitalized, (d) those that lack sufficient long-term sources of funds to finance long-term investments, (e) those from whom the bank has not received sufficient up-to-date information or the appropriate documentation in connection with the settlement of liabilities. <p>Banks have an obligation of monthly reporting on the classification of balance and off-balance sheet exposures and the creation of impairments and provisions. Credit risk and the classification and provisioning policies and processes are subject of supervision by the BOS (Article 222 of ZBAN-1/Banking Act) and by external auditors (Article 210 and 211 of Banking Act and Article 8 of Regulation on the Minimum scope and content of the Additional Audits' Review of Compliance With Risk Management Rules at Banks and Saving Banks.</p>
EC3	The system for classification and provisioning takes into account off-balance sheet exposures
Description and findings re EC3	In accordance with Article 1 of the Regulation on the Assessment of Credit Risk Losses banks have to classify off-balance sheet exposures (contingencies and commitments) items into categories according to risk, and estimate the level of credit risk losses. That is starting point for estimating impairments and provisions.
EC4	The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs reflect realistic repayment and recovery expectations.
Description and findings re EC 4	<p>According to Article 178 of ZBan-1 / Banking Act banks shall set up effective systems for regular managing and monitoring of various portfolios associated with the credit risk and of the bank's exposure, including identifying and managing problem exposures and creation of appropriate impairments and provisions.</p> <p>Furthermore Regulation on the Assessment of Credit Risk Losses regulation includes stipulation about objective evidence of impairment or possibility of a loss, consideration of collateral in the calculation of the impairment or provisions etc. Banks have to have analysis and estimates of the cash flows for the settlement of the liabilities when impartial evidence of the impairment of a financial asset is received. Banks' policies and processes which represent the basis for the determining of its potential losses and provisioning are subject to BOS's on-site examinations.</p>
EC5	The supervisor determines that banks have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations.
Description and findings re EC5	According to Article 11 of Regulation on the Assessment of Credit Risk Losses a bank shall assess the debtor's ability to discharge the liabilities to the bank and the quality of collateral prior to approving any loan or off-balance sheet exposure and shall

	<p>monitor the debtor's operations and the quality of the collateral of the balance and off-balance sheet exposures throughout the duration of relationship. Additionally, bank has to monthly assess its exposure and calculate impairments and provisions if necessary (Articles 19, 20 and 21).</p> <p>According to Annex I of The Regulation on Risk Management, banks shall establish a process and define the appropriate qualitative and quantitative indicators for early detection of increased credit risk. Banks shall define criteria for treatment of obligors and deteriorating assets which require more detailed monitoring and regularly review these types of obligors and assets in order to define their further treatment.</p> <p>The BOS's RAS– POT Methodology (Internal part) provides the examiners with useful guidance for building samples and it is supported by different internal IT tools helping them to make a selection of loans/files to be reviewed. POT methodology involves elements of risk which relate to recoverability of NPLs and elements of internal controls which relate to monitoring procedures for the early identification of deteriorating assets, and for collecting on past due obligations that shall be quantitatively and qualitatively evaluated during on-site or off-site supervisions.</p>
EC6	The supervisor is informed on a periodic basis, and in relevant detail, or has access to information concerning the classification of credits and assets and provisioning.
Description and findings re EC6	<p>According to Article 27 of Regulation on the Assessment of Credit Risk Losses banks shall report on the classification of balance and off-balance sheet exposures "regularly and in a timely manner". In practice they shall draw up the reports at the final day of each month in the form and in the manner prescribed by of the BOS in its Instructions for implementing the regulation on the assessment of credit risk losses of banks, September 2010. For each debtor (where companies with identification number are meant, for natural persons only aggregate information are received) bank has to report amount of balance sheet assets (distinguishing between financial assets at amortized costs and financial assets at fair value), off-balance sheet liabilities and total exposure. Banks shall also report the amount of items for classification and category designation (A, B, C, D, E). Banks should also report percent of impairments or losses pursuant to the IFRS, the amounts of necessary and created impairment or provisions pursuant to the IFRS or during collective assessment pursuant to the regulation. Additionally they have to report category designation from A to E, to which a debtor has been classified if the bank has not received prime and adequate insurance. Banks have to report also the amount of non-collateralized exposures and amount of collateral by different types of collateral (banking deposits, irrevocable guarantees of Republic of Slovenia, equity instruments, securities, mortgages, and collateral from insurance companies and other collaterals) and number of days in arrears.</p> <p>However it must be stressed that the rating scale in use has only 5 notches ranging from A to E and thus lacks of granularity. Furthermore, if class D and class E are clear-cut default, class C is more ambiguous as it is designed notably for "debtors that pay their liabilities up to 90 days in arrears and occasionally 91 to 180 days in arrears". Now C class represents around 10 percent of banks credit exposures.</p> <p>Additional to category designation banks report also days in arrears. The bank has to start to count number of days in arrears when the amount of overdue liabilities of individual customer exceed EUR 1.000 and the entire exposure to the customer has to be assigned as non-performing (not only the overdue part and not only obligations form the agreement, which is in arrears). Calculating NPLs with days in arrears, non-performing loans includes the classified claims with the number of delays over 90 days. Additionally, combination of both criteria is also an option. In that case NPLs are defined as union of classified claims with the number of delays over 90 days and class D and E.</p>
EC7	The supervisor has the power to require a bank to increase its levels of provisions and reserves and/or overall financial strength if it deems the level of problem assets to be of concern.

Description and findings re EC7	<p>According to Article 124 of ZBan-1 (Banking Act) banks shall set up and implement a sound and reliable management system, which shall include between others effective procedures of identifying, assessing, measuring or evaluating, mitigating and monitoring of risks to which the banks are or might be exposed during their operations. According to Article 222 the BOS performs bank supervision in order to verify whether banks operate in line with the risk management rules and other rules laid down in Banking Act and regulations issued on the basis thereof. When the BOS establishes violations of regulations it shall according to Article 242 issue an order imposing on the bank the obligation to eliminate such violations. Additionally, BOS may impose measures/recommendations for implementing risk management rules (Article 247) and increasing overall financial strength of bank (Article 248).</p> <p>At the time of this BCP assessment there were a significant number of measures (orders, admonishments...) given by the BCP to banks on credit risk related issues. However it must be stressed that the average provisioning rate in the Slovenian banks is rather low despite the fact the real economy was very badly hit in 2009 by the financial crisis (GDP fell by 8 percent in 2009) and is double dipping (BOS growth forecast for 2012 is -1,2 percent). Thus the global impairment rate on NPLs is roughly 40 percent whereas expected loss calculations made by BOS thanks to its internally developed ICAS methodology is 53 percent. That is a 13 percent gap; however impairments are point in time while EL is forward looking (on one year period). Moreover, the provisions to NPLs ratio in Slovenia are clearly at the low end of the European spectrum (see IMF GFSR April 2011).</p>
EC8	<p>The supervisor assesses whether the classification of the credits and assets and the provisioning is adequate for prudential purposes. If provisions are deemed to be inadequate, the supervisor has the power to require additional provisions or to impose other remedial measures.</p>
Description and findings re EC8	<p>If provisions are deemed to be inadequate or the bank has not set up reliable risk management system, BOS may impose on the basis of Article 248 of Banking Act additional measures for implementing risk management rules. This measures include improving the management system in accordance with Article 124 of this Act, improving strategies and processes of assessing the appropriate internal capital in accordance with Article 126 of this Act, changing the areas of the bank's operations, restricting the granting of loans, improving the procedures of recovering the bank's outstanding claims, proper valuation of asset and off-balance sheet items, improving the accounting information system, improving the procedures of internal control system and internal audit system.</p>
EC9	<p>The supervisor requires banks to have appropriate mechanisms in place for periodically assessing the value of risk mitigants, including guarantees and collateral. The valuation of collateral is required to reflect the net realizable value.</p>
Description and findings re EC9	<p>Article 177 of ZBan-1 (Banking Act states that banks are obliged to assess the quality of the collateral, by type and extent, entering into any agreement representing the basis of their exposure, as well as for entire duration of the credit-borrower relationship. Additional requirements are laid down by the Bo S Regulation on the Assessment of Credit Risk Losses.</p>
EC10	<p>Laws, regulations or the supervisor establish criteria for assets to be identified as impaired, e.g. loans are identified as impaired when there is reason to believe that all amounts due (including principal and interest) will not be collected in accordance with the contractual terms of the loan agreement.</p>
Description and findings re EC10	<p>According to the Article 19 of Regulation on the Assessment of Credit Risk Losses bank has to monthly assess whether there exists objective evidence that a financial asset or group of financial of financial assets should be subject to impairment, or whether there exists the possibility of a loss from contingencies and commitments including off-balance sheet items. Additionally, objective evidence shall include</p>

	information on events obtained by the bank. Which information is convenient for objective evidence is directed in Article 6 of Regulation on the Assessment of Credit Risk Losses.
EC11	The supervisor determines that the Board receives timely and appropriate information on the condition of the bank's asset portfolio, including classification of credits, the level of provisioning and major problem assets.
Description and findings re EC11	In accordance with Article 177 of the Banking Act banks are obliged to establish and implement appropriate policies and procedures of measuring and managing all material credit risk factors and effects. Banks policies and procedures in detail prescribe the role of bank's management bodies and lines of reporting. In Risk Assessment Process – POT Methodology Public part duties of Board and lines of reporting are determinate as well. However, the extent and the timeliness of information and lines of reporting can be verified only during on-site banking supervision.
EC12	The supervisor requires that valuation, classification and provisioning for large exposures are conducted on an individual item basis.
Description and findings re EC12	According to the Article 10 of Regulation on the Assessment of Credit Risk Losses, where an individually significant financial balance and off-balance sheet exposures represents an entire exposure to a single debtor whose value exceeds 0.5 percent of the capital or 650.000 euros, large balance and off-balance sheet exposures shall be assessed individually.
Additional criteria	
AC1	Loans are required to be classified when payments are contractually a minimum number of days in arrears (e.g. 30, 60, 90 days). Refinancing of loans that would otherwise fall into arrears does not lead to improved classification for such loans.
Description and findings re AC1	According to Article 13 of Regulation on the Assessment of Credit Risk Losses banks have to classify balance and off-balance sheet exposures in categories from A to E and category P (individuals). Receivables from borrowers whose liabilities are repeatedly met with a delay ranging from 15 to 30 days are classified B, those with repeated delays of between 30 and 90 days (occasionally 91 to 180 days in arrears) as C, those with repeated delays between 90 to 180 days in as D and loans which are not likely to be repaid in group E. In group P are balance and off-balance sheet exposures that the bank establishes in an individual assessment as requiring impairment or the creation of provisions. Refinancing of such receivables does not lead to improved classification.
Assessment of Principle 9	Largely Compliant.
Comments	Banks shall monthly report on exposures to debtors using a 5 notches classification ranging from A (the best rating) to E (the worse) or P for individuals. This RAZ-1 report (or "credit register") provides the supervisor with valuable data on credit risk and is very useful for conducting macro-prudential surveys or research as the data collection starts from 1993. However this credit classification lacks of granularity and the intermediate class C, which accounts for about 10 percent of the classified assets, is not homogenous. Formerly this credit classification was the basis for determining the provision rate expected by the BOS as each class correspond to a fixed level of provisioning (1 percent on A, 10 percent, 25 percent, 50 percent and 100 percent respectively on groups B to E). From the implementation of IFRS in January 2006 this provisioning system has been abandoned and now banks determine themselves the adequate level of provision on a case by case basis. It seems then that homogeneity of methods

	<p>is not ensured throughout the banking industry.</p> <p>Provision rates come certainly under the scrutiny of external auditors as well as BOS examiners when performing on-site supervision. Nevertheless, impairment on NPLs is only 40 percent which is rather low to every standard including BOS ICAS methodology for evaluating expected losses (53 percent). This is all the more surprising that collateral offers usually relatively poor protection for obligors as debtors under Slovenian law can delay considerably the proceedings. Moreover, in many cases, the collateral consists in company shares or real estate which is non liquid assets that are subject to major valuation uncertainties. However it is worth emphasizing that BOS internally has set rule for the valuation of the real estate collateral, which is followed by on-site examiners and also in the measures given to the banks. Estimations from the in-house model for non-market shares valuation are regularly used for valuation of financial assets during on and off-site examinations. Therefore one can suspect that global (6.5 percent of total “classified claims” at the end of 2011) and in many cases individual provision rates are inadequate. The gap between the aforementioned levels of expected loss and actual impairments is indeed compensated inside the SREP process through higher capital needs. However the capital target required by the BOS is not always met by banks and their shareholders.</p>
Principle 10	Large exposure limits. Supervisors must be satisfied that banks have policies and processes that enable management to identify and manage concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.
Essential criteria	
EC1	Laws or regulations explicitly define, or the supervisor has the power to define, a “group of connected counterparties” to reflect actual risk exposure. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC1	<p>Regulations which require banks to identify, quantify, control and monitor their exposures to single counterparties and groups of connected counterparties derive from the European CRD and CEBS guideline and are fully compliant with them. BOS made use of only few “national discretions” in the field of large exposures (leeway given to EU members to transpose EU directives) for adopting more stringent rules on certain aspects (see below EC2).</p> <p>Rules are contained within ZBan-1/Banking Act and the Regulation on the large exposure of banks and savings banks (Regulation on LE). The definition of large exposures in Article 163 of ZBan-1 requires banks and savings banks to consider their exposures to individual counterparties and groups of connected counterparties. That means when calculating its exposure, a bank must identify all clients linked so closely that it is prudent to treat them as a single risk and respectively as single counterparty. The concept of connected counterparties as defined in Article 30(1) of ZBan-1 is fully compliant with the definition of connected counterparties in Article 4(45) of the CRD. The requirements to group counterparties are further elaborated in Article 8 of the Regulation on LE, which is compliant with CEBS Guidelines regarding issue of connected clients (Guidelines on the implementation of the revised large exposure regime)².As such it covers the following situations:</p>

² Committee of European Banking Supervisors Guidelines on the implementation of the revised large exposure regime, issued on 11th December 2009.

	<p>(i) "control type of interconnections" - when one client/counterparty has control over the other a bank must automatically consider this counterparties as connected counterparties – i.e. single risk (unless it proves otherwise).</p> <p>(ii) "economic type of interconnections" – when clients are interconnected by some form of material economic dependency, identification of possible connections between counterparties is obligation and responsibility of the bank (case-by-case judgment), which shall use all available information to identify such connections. Concept of "economic interconnectedness" between counterparties is further elaborated in Article 8 of the Regulation on LE). This Article provides a more detailed definition and a list of possible dependencies between counterparties, where a bank should carry out further investigations (case-by-case) regarding the need to group these counterparties</p> <p>In the case of existence of interconnection between counterparties the type of interconnections is unimportant. It is the result that of such interconnection that counts—a bank must group such counterparties in a group of connected counterparties and treat them as single risk.</p> <p>Identification of possible connections between counterparties should be integral part of the bank's credit granting process and banks should in general examine interconnections for all exposures, however BOSI (BS) expects (according to Article 8(6) of the Regulation on LE) that banks intensively investigate possible connections (with all appropriate documentation) at least for exposures that exceed 2 percent of own funds (at solo or consolidated level)—consistent with CEBS Guidelines on the implementation of the revised large exposure regime.</p> <p>In cases of divergence between the opinion of the bank and the opinion of the BOS regarding grouping of counterparties it is the BOS which decides whether counterparty must be regarded as part of the group of connected counterparties. It worth to be noted that Slovenia being a relatively small country most groups are well known and "manual" cross checking of banks reportings allows to detect group of connected counterparties. Furthermore BOS makes use of information given by two local data providers to enhance its controls.</p>
EC2	<p>Laws, regulations or the supervisor set prudent limits on large exposures to a single counterparty or a group of connected counterparties. "Exposures" include all claims and transactions, on-balance sheet as well as off-balance sheet. The supervisor confirms that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis.</p>
Description and findings re EC2	<p>Rules regarding large exposures and limit system are contained within the section 4.5.5. of ZBan-1 and within the regulation on Regulation on LE. The definition of "Large exposure" in Article 163 of ZBan-1 is fully compliant with the definition of "large exposure" in the CRD. The Article states: <i>"A bank's exposure to a single counterparty or a group of connected counterparties shall be considered a large exposure where its value is equal to or exceeds 10 percent of its own funds."</i> Article 9 (maximum allowable exposure) of Regulation on Large exposure of Banks is also clear-cut and in line with EU directive: "A bank's exposure to an individual client or a group of connected clients shall not exceed 25 percent of its own funds".</p> <p>When calculating the exposure value the bank's exposure to a single counterparty (or a group of connected counterparties) is defined in Article 113 of ZBan-1 as <i>" a total of all asset and off-balance sheet items showing: (1) the bank's claims and contingent claims from this person and (2) the bank's investments in financial instruments and equity interests of this person.</i> This definition is further elaborated in Articles 5 (exposure to non-trading book) and 6</p>

	<p>of the Regulation on LE (exposure to trading book and overall exposure) which are compliant with the CRD.</p> <p>Conclusion of any legal transactions, which, in respect of the bank's overall exposure, would result in a large exposure to a single counterparty or a group of connected counterparties, is subject to an approval from the bank's supervisory board (Article 167 of ZBan-1). The same applies for lending to related parties (further described under Principle 11). The value of exposure calculated in accordance with Article 5 and 6 of the Regulation on LE is taken into account. The approval from the supervisory board is also required for the conclusion of legal transactions on account of which the bank's large exposure to a single counterparty or a group of connected counterparties might increase so that it exceeds 15 percent and every subsequent 5 percent of its own funds. When large exposure actually occurs the bank's management board must notify the bank's supervisory board forthwith in writing about this large exposure and circumstances about it (Article 67(1)(4) of ZBan-1).</p> <p>The regulation regarding maximum allowable exposure is fully compliant with CRD. According to Article 127 of ZBan-1 banks must conduct their operations so that the risks to which they are exposed in individual or all types of transactions they perform exceed in no event the restriction of maximum allowable exposures. These are defined in Article 165 of ZBan-1.</p> <p>According to the Article 165(1) of ZBan-1</p> <p><i>"(1) The bank's exposure to an individual counterparty or a group of connected counterparties reduced for exemptions or effects of credit protection (as defined in Articles 13 to 16 of the Regulation on LE) <u>may not exceed 25 percent of its own funds</u>. This limit applies for all counterparties (single counterparty, group of connected counterparties and related parties). When calculating maximum allowable exposure exemptions and effects of credit risk mitigation specified in Section IV of Regulation on LE are taken into account. BS implemented only few national discretions the regarding possible exemptions thus taking a very conservative approach.</i></p> <p>There is however exception from this limit, which applies for exposures to institutions, which is also compliant with the CRD. According to it, the Paragraphs 2 – 4 of the Article 165 of ZBan-1 define that:</p> <p><i>"(2) the bank's exposure to an institution or group of connected counterparties which includes one or more institutions shall not exceed higher of amounts of 25 percent of the bank's own funds or 100 million EUR under condition that the sum of exposure to all connected counterparties in the group which are not institutions may not exceed 25 percent of bank's own funds.</i></p> <p><i>(3) Exposure referred to in Paragraph (2) exceeding 25 percent of bank's own funds may not exceed 100 percent of bank's own funds or a smaller per cent which is determined by the bank with the purpose of dealing with, monitoring and controlling the concentration risks while taking into consideration policies and processed referred to in Article 188 of ZBan-1.</i></p> <p><i>(4) In individual cases the bank's exposure referred to in Paragraph (2) may exceed 100 percent of its own funds subject to the approval of the BS but the exposure may not exceed the amount of 100 million EUR.</i></p> <p>Remark: Article 111(1) of the CRD actually defines a higher limit than 100 MEUR - in the amount of 150 MEUR, with the national discretion that member states may set a lower limit than 150 MEUR. Due to the size of the Slovenian banking sector the prudential analyses made by BS showed the appropriateness of limit in the amount of 100 MEUR.</p> <p>If a bank in exceptional cases exceeds any of these exposure limits (i.e. because of a merger of two legal entities or other reasons beyond its power) a bank must (in accordance with Article 168 of ZBan-1) immediately notify the BOS thereof. In its notification it must enclose a description of measures to be taken for harmonization</p>
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	<p>with the large exposure limits as well as the time limits within which such measures will be carried out.</p> <p>A bank shall at all times comply with the limits regarding large exposures (Article 127 of ZBan-1) at the solo and at the consolidated level. Requirements regarding compliance with large exposure limits on a consolidated basis are defined in Article 131(1) point (4) of ZBan-1 and Article 17 of the Regulation on LE. Article 131 of ZBan-1 requires that a parent bank in the Republic of Slovenia performs the all obligation concerning large exposures on a consolidated basis at the level of the Republic of Slovenia. The parent bank is responsible for the compliance of the banking group of its obligations connected with the calculation of consolidated levels of exposures and compliance with the large exposure limits.</p> <p>As part of the monitoring process of large exposures banks are obliged to quarterly prepare reports and submit them to the BOS (on a solo and consolidated basis).</p> <p>Diversification policy of the bank shall have a clear determination of objects regarding structure of credit portfolio and limits of exposure to individual clients and groups of connected counterparties. Diversification policy and credit portfolio concentration are components of regular on-site examination, based on RAS/POT (supervisory assessment process).</p> <p>During on-site examinations compliance with aforementioned legislation is regularly checked by examiners in accordance with RAS/POT methodology (internal part).</p>
EC3	The supervisor determines that a bank's management information systems identify and aggregate on a timely basis exposure to individual counterparties and groups of connected counterparties.
Description and findings re EC3	<p>According to Article 175 of ZBan-1 the bank must set up and carry out consistently appropriate administrative and accounting procedures and an appropriate system of internal controls in order to (1) identify and measure the risks to which it is or might be exposed in its operations and in order to calculate and verify the capital requirement compliance relating to such risks and (2) identify and monitor large exposures and their changes and in order to verify their compliance with the bank's policies regarding such exposures.</p> <p>This request is further elaborated in Article 18 of Regulation on LE, according to which a bank must develop an adequate information system and must put in place and consistently implement appropriate administrative and accounting procedures and an appropriate system of internal controls to identify and monitor large exposures (to individual counterparties and groups of connected counterparties). The Regulation on LE also requires banks internal control must check the adequacy of the implementation of its internal policies and procedures.</p> <p>The existence of such systems and their effectiveness are monitored during on-site inspections carried out by BOS. This together with RAS/POT (supervisory risk assessment process) allows BOS to determine whether banks' information systems are adequate and timely.</p>
EC4	The supervisor confirms that a bank's risk management policies and processes establish thresholds for acceptable concentrations of credit and require that all material concentrations be reviewed and reported periodically to the Board.
Description and findings re EC4	<p>In the course of the bank supervision process, BOS' supervisors determine:</p> <ul style="list-style-type: none"> • whether the banks' management information systems enable the identification of counterparties and groups of connected counterparties to which the bank has an exposure reaching or exceeding 10 percent of its own funds (Article 18 of

	<p>Regulation on LE),</p> <ul style="list-style-type: none"> • whether the bank's supervisory board (Article 167 of ZBan-1) has approved conclusion of legal transactions, which result in a large exposure to a single counterparty or a group of connected counterparties, and whether it has approved the conclusion of legal transactions which result in exposures to a single counterparty or a group of connected counterparties that exceed 15 percent and every subsequent 5 percent of its own funds, • whether bank's supervisory board (Article 67(1) point(4) of ZBan-1) is informed about all large exposures to a single counterparty or a group of connected counterparties which actually occurred, • whether the prudentially set limits concerning banks' exposures to single counterparties or groups of related counterparties are observed, • whether a bank has appropriate policies and processes in order to deal with, monitor and control the following concentration risks (Article 188 of ZBan-1): (i) risks based on exposure to a single counterparty, groups of connected counterparties and counterparties connected by common risk factors such as: the same economic sector or geographical area, transactions or goods of the same kind and (ii) risks of using credit protection and particularly risks associated with an indirect large credit exposure (for example, to a single personal collateral issuer) and whether management information systems enable the identification of such concentrations within the portfolio, • whether decision process is consistent with the Regulation on risk management and implementation of ICAAP for banks and savings banks
EC5	<p>The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed. The supervisor has the power to require banks to take remedial actions in cases where concentrations appear to present significant risks.</p>
Description and findings re EC5	<p>Concentration risk in credit portfolios is monitored through regular reporting of banks to BOS and through calculations made by BOS, based on data received from banks within their regular reporting.</p> <p>According to Article 19 of the Regulation on LE banks are obliged to quarterly prepare reports on large exposures and submit them to the BOS (on a solo and consolidated basis) on:</p> <ul style="list-style-type: none"> (a) individual counterparties and groups of connected clients to which the bank has an exposure reaching or exceeding 10 percent of its own funds; (b) the values of the exposures to these counterparties before taking into account the exemptions and the effects of credit risk mitigation; (c) the amount of exemptions and the amount and type of the credit risk mitigation; (d) the exposure values after taking into account the exemptions and the effects of credit risk mitigation; (e) The compliance with the limits and any exceeding of these limits. <p>Banks must also prepare reports on risks of using credit protection and particularly risks associated with an indirect large credit exposure (Article 188 of ZBan-1). The request to analyze the exposures associated with indirect large credit exposure (exposures to collateral issuers, providers of unfunded credit protection and underlying assets – in the case of exposures to "schemes") is compliant with Article 110(3) of the CRD. The request to analyze possible concentrations connected with such exposures and request to reduce such exposure (if appropriate) is further defined in Annex II (Subsection 2.2, Par.3) of The regulation on risk management and implementation of the internal capital adequacy assessment process for banks and savings banks. Reporting requirements are defined in Article 14(3) of The regulation on the reporting</p>

	<p>of individual facts and circumstances of banks and savings banks. A bank must prepare these reports quarterly and submit them to the BOS.</p> <p>Additionally BOS monthly calculates and monitors individual, sectoral, geographical and currency concentration of each bank. The calculations are based on monthly reports received from banks in accordance with Regulation on the assessment of credit risk losses and Regulation on reporting of monetary financial institutions.</p> <p>As regards individual and sectoral concentrations, each bank must calculate it. The calculation is a part of the ICAAP report. A bank must prepare this report at least once a year, and upon any significant change in risk exposure (Appendix 2: Concentration risk of BOS guidelines for banks and savings banks - Instructions for completing and submitting the ICAAP report).</p> <p>In cases where concentrations appear to present significant risks or when the bank's operations exceed limits regarding the bank's exposure or other limits, the BOS is empowered to impose additional measures on the bank (Article 247(4), (5) and article 248(1) of ZBan-1).</p> <p>In recent years BOS has intervened through recommendations both to the banking sector and to several individual banks to alert on risks of excessive exposure to the construction sector. Nevertheless if the Supervisor has identified and attempted to deflate banks' growing exposure once it has reached a critical level it has apparently been less successful in preventing it to happen and in reducing significantly the overall banking sector exposure on the construction and real estate sector.</p>
Additional criteria	
AC1	<p>Banks are required to adhere to the following definitions:</p> <ul style="list-style-type: none"> • 10 percent or more of a bank's capital is defined as a large exposure; and • 25 percent of a bank's capital is the limit for an individual large exposure to private sector non-bank counterparty or a group of connected counterparties. <p>Minor deviations from these limits may be acceptable, especially if explicitly temporary or related to very small or specialized banks.</p>
Description and findings re AC1	<p>Rules regarding large exposures and limit system are contained within the section 4.5.5. of ZBan-1 (definition of large exposures is in Article 163 of ZBan-1, large exposure limits are defined in Article 165), and within the regulation on Regulation on LE(see above EC2).</p>
Assessment of Principle 10	Largely Compliant
Comments	<p>BOS is fully compliant with BCBS and EU guidelines on large exposure limits and on the definition of connected counterparties. BOS's on-site examiners as well as off-site analysts perform regularly controls to make sure that banks comply with LE rules. Furthermore BOS monitors concentration risks and requires that banks put in place limits to concentration risks. In particular BOS has defined measurement methodologies for sectoral risk that banks must comply with.</p> <p>However supervisor's action to prevent sectoral concentration risk to emerge as a major issue has not been fully successful. Thus the December 2011 BOS Financial Stability Report stresses that "Growth in loans to sectors with the lowest quality claims [namely construction, financial intermediation (LBOs and MBOs) and real estate] continues" and rightly mentions that "The banks' exposure to construction corporate is high..." (page 38).</p>

Principle 11	Exposures to related parties. In order to prevent abuses arising from exposures (both on balance sheet and off balance sheet) to related parties and to address conflict of interest, supervisors must have in place requirements that banks extend exposures to related companies and individuals on an arm's length basis; these exposures are effectively monitored; appropriate steps are taken to control or mitigate the risks; and write-offs of such exposures are made according to standard policies and processes.
Essential criteria	
EC 1	Laws or regulations explicitly provide, or the supervisor has the power to provide, a comprehensive definition of "related parties". This should consider the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC1	<p>Definition and requirements about "related parties" are contained in the ZBan-1 (Banking Act) and in a more specific document, namely Regulation on the diligence of members of the management and supervisory boards of banks and saving banks (hereinafter: Regulation on Diligence, August 2011).</p> <p>Related parties are defined in Article 164 of ZBan-1. The definition includes:</p> <ul style="list-style-type: none"> • (1) members of the bank's management board, • (2) members of the bank's supervisory board, • (3) the bank's procurator, • (4-first part) legal persons other than banks and whose management or supervisory board member or procurator is a person from points 1, 2 or 3 of this list, or • (4-second part) legal persons other than banks in which a person from points 1, 2 or 3 of this Article or this person's immediate family member (please see definition at the end of this principle) is a direct or indirect holder of shares granting him/her at least 10 percent of the voting rights or at least a 10 percent participation in capital, • (5) natural persons who are direct or indirect holders of the bank shares granting them at least 5 percent of the voting rights or at least a 5 percent participation in the bank's capital, • (6) legal persons other than banks that are direct or indirect holders of the bank shares granting them at least 10 percent of the voting rights or at least a 10 percent participation in the bank's capital, • (7) immediate family members of persons from points 1., 2., 3. and 5. of this list, • (8) members of the management board, members of the supervisory board or members of other management or supervision bodies of the legal person from point 6 of this list. <p>Bank's subsidiaries and affiliates, and parties that the bank exerts control over or that exert control over the bank are not defined as related counterparties even though footnote 25 of BCP Methodology suggests doing so. However exposures to these counterparties are subject to limits (see above Principle 10 EC1 and EC2).</p> <p>Additionally Article 12(2) (b) of the Regulation on diligence requires that a member of the management or supervisory board or a member of his or her close family member is, as the user of banking or other services provided by a bank or its subsidiary, subject to treatment that is in line with the adopted business policy or usual practices of the bank or its subsidiary. Article 3 of this regulation defines more precisely than the Banking Act the "related parties" :</p>

	<p>Definitions:</p> <p><i>"Immediate family member" of a person is:</i></p> <ol style="list-style-type: none"> 1. <i>His or her spouse or a person with whom he or she lives in a relationship that has the same rights in property as those arising out of matrimonial relationship, or a person with whom he or she lives in a same-sex civil partnership pursuant to the act governing same-sex civil partnership registration.</i> 2. <i>Child or adopted child of such person or person from point 1. of this Paragraph, who lacks full legal capacity,</i> 3. <i>Other persons lacking full legal capacity that are under such person's guardianship.</i> <p><i>"Member of the close family of a member of the management body" (close family member) is:</i></p> <ul style="list-style-type: none"> • <i>immediate family member (as defined above),</i> • <i>a natural or adopted child of the member in question or person referred to in the first indent of this point, with full legal capacity,</i> • <i>the natural or adoptive parent of the member in question or person referred to in the first indent of this point,</i> • <i>the brother or stepbrother or sister or stepsister of the member in question or person referred to in the first indent of this point, and</i> • <i>the grandfather or grandmother of the member in question or person referred to in the first indent of this point.</i>
EC2	<p>Laws, regulations or the supervisor require that exposures to related parties may not be granted on more favorable terms (i.e. for credit assessment, tenor, interest rates, amortization schedules, requirement for collateral) than corresponding exposures to non-related counterparties.</p>
Description and findings re EC2	<p>According to Article 173(1) of ZBan-1/Banking Act the management board of the bank must ensure that the bank operates in accordance with the risk management rules. In particular it must lay down precisely defined, transparent and consistent internal relations regarding responsibility which prevent conflicts of interests.</p> <p>Article 12(2) (b) of the Regulation on Diligence requires that a member of the management or supervisory board or immediate family member should not be "subject to treatment that is not in line with the adopted business policy or usual practices of the bank or its subsidiary". If not, this would be treated as potential conflict of interests and subject to specific regulatory rules and measures of Supervisory board. Although this formulation covers not only credit granting but could cover all products, which is a "plus", this wording leaves room for interpretation then a more straightforward, EC2 type formulation would have been preferable.</p> <p>In addition exposures to all related parties (not only to members of the management or supervisory board or members of his or her immediate family member) are subject to stricter approval process. According to Par. 2 of Article 167 of ZBan-1/Banking Act <i>"Conclusion of legal transactions which are the fundamental reason for the bank's incurrence of exposure to a single individual or a group of connected clients holding the position of an entity in a special relationship with the bank (related counterparty) the approval from the supervisory board shall be required when the bank's exposure to this individual or the group of connected clients exceeds or will exceed 100,000 euros based on this transaction"</i>.</p> <p>An approval from the Supervisory board is also required when such exposure reaches or exceeds 10 percent of the banks own funds and this exposure increases so that it exceeds 15 percent and every subsequent 5 percent of its own funds (Par. 1 of Article 167 of ZBan-1).</p>

	<p>However it is not clear that compliance with aforementioned legislation is a part of regular on-site examinations as BOS's Supervisory manual for risk assessment (internal RAS/POT methodology) does not suggest to include some related parties in the client sample that on-site examiners should review when supervising credit risk whereas it suggests to include some "media covered notorious client".</p>
EC3	<p>The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process.</p>
Description and findings re EC3	<p>Exposures to related parties are subject to stricter approval process. According to Article 167 (2) of ZBan-1/Banking Act "<i>Conclusion of legal transactions which are the fundamental reason for the bank's incurrence of exposure to a single individual or a group of connected clients holding the position of an entity in a special relationship with the bank (related counterparty) the approval from the supervisory board shall be required when the bank's exposure to this individual or the group of connected clients exceeds or will exceed 100,000 euros based on this transaction</i>".</p> <p>The approval from the Supervisory board is also required when this exposure reaches or exceeds 10 percent of the banks own funds and this exposure increases so that it exceeds 15 percent and every subsequent 5 percent of its own funds (Article 167 (1) of ZBan-1/Banking Act).</p> <p>Article 10(6)(b) of the of the Regulation on Diligence requires a member of the management or supervisory board to refrain from voting if there exists a suspicion of a conflict of interest in a matter subject to voting at the meeting of the management or supervisory board. Moreover the management or supervisory board shall ensure that the explanation and statement of the member of the management or supervisory board indicating he or she refrained from voting owing to the conflict of interest is included in the minutes of the meeting of the management or supervisory board. By this the transparency of the process is ensured.</p>
EC4	<p>The supervisor requires that banks have policies and processes in place to prevent persons benefiting from the exposure and/or persons related to such a person from being part of the process of granting and managing the exposure.</p>
Description and findings re EC4	<p>The legal basis for the prevention of such cases is the "professional and ethical standards policy" that every bank must have in accordance with Regulation on Diligence, Article 5.</p> <p>By this regulation it is the obligation of the bank to identify the situations in which conflicts of interest could arise. For this purpose the bank should define the approach for recognizing and handling acts of corruption at all decision-making levels at the bank, methods for detecting and preventing transactions on own account, and other criminal, unethical and contentious acts linked to the bank's operations. In practice this include relationships between different persons (i.e. management body, customers, shareholders, employees, suppliers...) that could result in potential benefiting of particular persons from the exposure or the process of granting/managing the exposure.</p> <p>The management board must notify the supervisory board with regard to implementation and execution of abovementioned policy on yearly basis.</p>
EC5	<p>Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties those are at</p>

	least as strict as those for single counterparties, or groups of connected counterparties.
Description and findings re EC5	<p>Exposures to related parties are subject to general large exposure limits (see above Principle 10). More stringent limits, which were in force until CRD II, were deleted with the amendment of Banking Act (ZBan-1E) after CRD was adopted. Until then the limit on exposure to related party (or group of such counterparties) was set at the 20 percent of own funds, additionally a sum of all bank's exposures to related parties was limited with 200 percent of own funds.</p> <p>CRD allows less stringent treatment of exposures for exposures incurred by a bank to its parent undertaking, to other subsidiaries of that parent undertaking or to its own subsidiaries in so far as those are covered by the supervision on a consolidated basis to which the credit institution itself is subject (Article 113(4) (c) of the CRD), but BOS implemented this discretion in a conservative way. When calculating maximum allowable exposure a bank may exempt only up to 50 percent of the exposure value for exposures to a its parent undertaking, its own subsidiary or other subsidiary of that parent, if the following conditions are met: - the counterparty is a bank, established in the EU member state, - the counterparty is included in the same consolidated supervision as the bank, - the exposures do not constitute own funds of the counterparty. If those counterparties (subsidiaries, etc) are not covered by the supervision on a consolidated basis to which the credit institution itself is subject, they are subject to general limits (no exemption applies).</p>
EC6	The supervisor requires banks to have policies and processes to identify individual exposures to related parties as well as the total amount of such exposures, and to monitor and report on them through an independent credit review process. The supervisor confirms that exceptions to policies, processes and limits are reported to the appropriate level of senior management and, if necessary, to the Board, for timely action. The supervisor also confirms that senior management monitors related party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.
Description and findings re EC6	<p>As exposures to related parties are subject to approval of the supervisory board (Article 167(1&2) of ZBan-1) and additionally subject to separate reporting (Article 14(3) of the Regulation on the reporting of individual facts and circumstances of banks and savings banks). A bank must have policies and processes to identify individual exposures to related parties as well as the total amount of such exposures. For the calculation of exposure values rules from regulation on Large Exposures apply. As regards exposures to subsidiaries and affiliates, and any party that the bank exerts control over or that exerts control over the bank these are subject to approval of the supervisory board (Article 167(1) of ZBan-1) only if the exposure to them exceeds 10 percent of own funds.</p> <p>Regarding the internal reporting system, Articles 19 and 22 of the Regulation on risk management and ICAAP require that banks are expected to provide periodic internal reports on the risks to which they are exposed in the scope of its operations. This refers to both, regular and ad hoc risk reports. Such reports must, among other, provide also information regarding the compliance of the bank's operations with valid internal acts and policies (Article 22-1 (b)).</p>
EC7	The supervisor obtains and reviews information on aggregate exposures to related parties.
Description and findings re EC7	Exposures to related parties as defined in Article 164 of ZBan-1/Banking Act and some other counterparties (i.e. close family members, etc.) are subject to special

	<p>reporting to BOS (on solo basis). According to Article 14(3) of the Regulation on the reporting of individual facts and circumstances of banks and savings banks must report exposures to the following counterparties (or groups of connected counterparties, which include at least one counterparty from the list) that exceed 20.000 EUR. These counterparties are:</p> <ul style="list-style-type: none"> • (a) Members of the bank's management board, • (b) Members of the bank's supervisory board, • (c) The bank's procurator, • (d) Natural persons who are direct or indirect holders of the bank shares granting them at least 5 percent of the voting rights or at least a 5 percent participation in the bank's capital, • (e) close family members of persons from points (a) to (d) of this list, • (f) Legal persons other than banks and whose management board member or procurator is a person from points 1. 2. or 3. of this list, or • (g) Legal persons other than banks in which a person from points 1, 2 or 3 of this list or this person's close family member is a direct or indirect holder of shares granting him/her at least 10 percent of the voting rights or at least a 10 percent participation in capital, • (h) Legal persons other than banks that are direct or indirect holders of the bank shares granting them at least 10 percent of the voting rights or at least a 10 percent participation in the bank's capital, • (i) Members of the management board, members of the supervisory board or members of other management or supervision bodies of the legal person from point (h) of this list. <p>A bank must submit these reports (POR-195/4) the BOS twice a year.</p> <p>Additionally according to Article 19 of the Regulation on Large Exposures banks must submit reports an large exposures (the exempted exposures included) to BOS on a quarterly basis (on a solo and consolidated basis) on individual counterparties and groups of connected counterparties (related counterparties included) to which the bank has an exposure reaching or exceeding 10 percent of its own funds.</p> <p>The BOS reviews and assesses these POR-195/4 and Large Exposure reports as a part of off-site supervision.</p>
Assessment of Principle 11	Largely compliant
Comments	<p>Law and regulations provide a comprehensive definition of related parties and provides regulatory basis for preventing abuses arising from exposures to related party and for addressing conflicts of interest, although more explicit language could be added to the law relative to the prohibition of related parties receiving credit on more favorable terms. Furthermore BOS requires from banks reportings on large exposures (quarterly) and related parties (semi-annually) and assesses these reports as a part of off-site supervision. However, BOS's internal RAS/POT methodology does not provides very specific guidance to its supervisors on the related parties issue; it is therefore questionable that on-site examiners pay adequate attention to this matter. It is as much a matter of concern that the size and structure of the Slovenian economy itself induces multiple interrelations between firms as there is significant number of (sometimes informal) financial holdings run by local "tycoons". As a result, the reporting of business interests of related parties is not robust, particularly in affiliated companies.</p>
Principle 12	Country and transfer risks. Supervisors must be satisfied that banks have adequate policies and processes for identifying, measuring, monitoring and controlling country

	risk and transfer risk in their international lending and investment activities, and for maintaining adequate provisions and reserves against such risks.
Essential criteria	
EC1	The supervisor determines that a bank's policies and processes give due regard to the identification, measurement, monitoring and control of country risk and transfer risk. Exposures are identified and monitored on an individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.
Description and findings re EC1	<p>No specific rules for country and transfer risk are determined in Slovene legislation or regulations.</p> <p>Nevertheless the RAS/POT methodology (internal part) provides BOS's examiners and analysts with some useful guidance the RAS/POT methodology the following topics: Main products and markets and Credit activity in foreign markets. According to RAS/POT Methodology banks shall have properly defined policies and processes for identifying, measuring, monitoring and controlling country risk and transfer risk in their international lending and investment activities due to additional credit risk originated from geographical concentration, currency mismatches of investments, political events, currency conversion and transfer prohibition, expropriation etc. Adequate provisions and reserves shall be built against this additional credit risk.</p> <p>Banks are obliged to identify, monitor exposures on an individual country basis and report them regularly to BOS. In accordance with RAS/POT methodology (Credit risk, Concentration) banks' policy of diversification shall have clear determination of objects regarding structure of credit portfolio and limits to individual geographic regions. In accordance with RAS/POT methodology (Credit risk, Main products and markets, Credit activity in foreign markets) share of exposure in individual countries with regard to the country and transfer risk shall be reviewed in regular on-site examinations. If exposure to the individual country exceeds 10 percent of total classified exposures of the bank, additional analysis shall be done. If a bank is exposed to increased credit risk due to the excessive exposure to one country, special measures can be adopted by BOS.</p> <p>Moreover banks must report monthly to the BOS on their overall country exposure. Thanks to this reporting BOS monitors the banking sector and individual banks' credit exposure ("classified assets") on every country. If necessary on-site examiners are then in a position to further investigate significant exposures detected by off-site supervision. However it must be stressed that the overall banks foreign countries exposure is limited. As a matter of fact 89 percent of Slovenian banks credit exposure is on domestic debtors. Roughly 5 percent is on other ex-Yugoslavia countries (mostly Serbia and Croatia) and 4 percent on other EU member countries. There is no material credit exposure on emerging countries. In addition banks bond portfolios and liquidity buffers consist predominantly in Slovenian Government Bonds with again no significant exposure on emerging market debt or European peripheral countries. Some banks had sizeable exposure on so called PIIGS government bonds but have drastically reduced them in 2011 with moderate losses.</p>
EC2	The supervisor confirms that banks have information systems, risk management systems and internal control systems that accurately monitor and report country

	exposures and ensure adherence to established country exposure limits.
Description and findings re EC2	BOS examiners shall regularly review adequacy of banks' information systems, risk management systems and internal control systems including the ones used to monitor and report country exposure. However in practice it seems that banks' IS are not reviewed as often as desirable because of the BOS limited number of experts available for conducting such investigations (only 2 FTE at the present time).
EC3	There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices which are all acceptable as long as they lead to risk-based results. These include: <ul style="list-style-type: none"> • The supervisor (or some other official authority) decides on appropriate minimum provisioning by setting fixed percentages for exposures to each country. • The supervisor (or some other official authority) sets percentage ranges for each country, and the banks may decide, within these ranges, which provisioning to apply for the individual exposures. • The bank itself (or some other body such as the national bankers' association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The provisioning will then be judged by the external auditor and/or by the supervisor.
Description and findings re EC3	Each bank decides itself for each individual loan on the appropriate provisioning if there is an objective evidence of impairment or possibility of a loss. Collective impairments can also be set for exposures to other countries. According to Article 22 in Regulation on the assessment of credit risk losses of banks, banks shall designate groups for collective assessment of the impairment of financial assets or for collective establishment of the required provisions for contingencies and commitments including off-balance sheet items with regard to similar characteristics of credit risk as indicated by the debtor's ability to settle the liabilities in accordance with the contractual provisions. Groups may be designated with regard to the geographical location. Bank's methodology of provisioning is judged by the external auditor and by the BOS when reviewing loan portfolios. In practice the case for setting collective impairments is very limited as banks exposures are generally small. However it worth mentioning that in many instances the impairment rate on foreign country classified assets exposure is higher than the impairment rate for domestic credit exposure.
EC4	The supervisor obtains and reviews sufficient information on a timely basis on the country risk and transfer risk of individual banks.
Description and findings re EC4	Monthly calculations and monitoring of such exposures at each bank and banking system are done by BOS (see above EC1). These calculations are based on monthly reports received from banks in accordance with Regulation on the assessment of credit risk losses of banks and savings banks (RAZ-1).
Assessment of Principle 12	Compliant
Comment	
Principle 13	Market risk. Supervisors must be satisfied that banks have in place policies and processes that accurately identify, measure, monitor and control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.
Essential criteria	

EC1	The supervisor determines that a bank has suitable policies and processes that clearly articulate roles and responsibilities related to the identification, measuring, monitoring and control of market risk. The supervisor is satisfied that policies and processes are adhered to in practice and are subject to appropriate Board and senior management oversight.
Description and findings re EC1	<p>Law and regulations dealing with market risk derive from EU directive and generally accepted best practices</p> <p>Article 173 of ZBan-1/Banking ACT requires that management board must determine clear, transparent and consistent internal relationship, which provides clear segregation of duties and prevents conflicts of interest. Management board must assure regular verification of strategies and policies for risk measuring, for all risk that the bank is currently exposed or can be exposed. Management board is responsible, that bank operates according to the principles of proper risk management.</p> <p>Article 180 of ZBan-1/Banking Act requires that bank must implement appropriate policies and procedures for measuring and managing of all important factors and end effects of market risk.</p> <p>Article 9 of the Regulation on risks management and ICAAP requires that the organizational structure in banks must be based on appropriate segregation of duties between all employees, including management. Segregation of duties is appropriate if prevents conflict of interest and provides transparent and documented process of decision taking.</p> <p>First paragraph of first point of Annex II on “General market risk management standards” of Regulation on risk management and ICAAP requires that banks must assure clear operational and organizational segregation of front office from back office, including segregation in management. Where it is appropriate, bank must assure organizational segregation of back office from risk management and accounting.</p> <p>Article 16 of Decree on risk management requires that procedures of risk measuring must include comprehensive and timely identification of risks that a bank takes in its operations, and analyze the causes for its appear. Identified risks must be documented.</p> <p>The procedures for measuring or assessing risk must include the creation of quantitative and / or qualitative assessments of measurable and / or non-measurable risks that the bank has identified in the process of risks identification. Risk assessments must be documented.</p> <p>The bank must ensure the regular procedures for identifying and measuring risk.</p> <p>Paragraph 2 of Annex II of Decree on risk management requires that banks shall ensure that risks resulting from trading activities are handled by a department independent of the trading unit and that the measuring from trading involves assessing losses under normal market conditions, and loss under the stress in the market. Bank must compare the results from market risk measuring with the level of capital and bank's income.</p> <p>Last, the BOS RAS/POT Methodology (internal part) gives some guidance to its on-site examiners and off-site analysts on what is expected from banks in terms of organization, governance and risk management in capital market activities.</p> <p>In conclusion regulatory framework on market risk puts relevant emphasis on segregation of duties but is less prescriptive on many other desirable elements of a sound governance and effective internal control environment. This is however</p>

	acceptable in the Slovenian context when banks have very limited and receding trading activity.
EC2	The supervisor determines that the bank has set market risk limits that are commensurate with the institution's size and complexity and that reflect all material market risks. Limits should be approved by the Board or senior management. The supervisor confirms that any limits (either internal or imposed by the supervisor) are adhered to.
Description and findings re EC2	<p>Article 24 of the Regulation on risk management and ICAAP requires that the bank must set up a limit structure for restricting exposure to measurable risks [including market risks].</p> <p>According to the Paragraph 2 of Annex II on the Regulation on risk management and ICAAP, limits for restricting losses must take into account the amount of capital and income of the bank. The structure of limits for restricting losses should be based on the estimated risks and the maximum loss. The bank must provide periodic adjustment of limits according to the results of stress testing. Limits must cover each trading transaction. Exceeded limits must be approved by an authorized person.</p> <p>Article 24 of the Regulation on risk management and ICAAP requires that internal controls should include verification if business transactions are done according to the limits and verification and confirmation of all transactions, which are not according to the limits.</p> <p>Paragraph 1.2 Point of Annex II on Decree on risk management requires that the bank must assure regular monitoring of the process of dealing for the trading unit, including checking:</p> <ul style="list-style-type: none"> (a) the completeness of documentation of transaction, and its timely submission to the back-office, (b) consistency of data on the transaction with the data on the confirmation, printouts of electronic trading systems and other sources, (c) compliance with limits (d) the compliance of transactions with market conditions, (e) deviations from internal trading rules, (f) the consistency of transaction records between the trading unit and units which are independent from the trading unit. <p>Article 173 of ZBan-1/Banking Act requires that management board must assure regular verification of strategies and policies for risk measuring, for all risk that the bank is currently exposed or can be exposed, including risks from macroeconomic environment. Management board is responsible, that bank operates according to the principles of proper risk management.</p> <p>Paragraph 2 of Annex II of the Regulation on risk management and ICAAP requires that all limit exceeds must be reported to the management board.</p> <p>However it is not categorically required that the Board as article 13 (e) of the Regulation on risk management and ICAAP states that "the responsibilities of senior management in the area of risk management include...establishment and control of limits". No minimum periodicity is required by the regulation for the revising market risk limits. Nevertheless RAS/POT methodology identifies more good practices and gives</p>

	<p>more precise guidance to BOS's examiners and analysts. Furthermore it worth be noted that banks exclusively deal on vanilla products, have almost no proprietary trading activities and have very limited market making activities.</p>
EC3	<p>The supervisor is satisfied that there are systems and controls in place to ensure that all transactions are captured on a timely basis, and that the banks' marked to market positions are revalued frequently, using reliable and prudent market data (or, in the absence of market prices, internal or industry-accepted models). The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments/reserves for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions.</p>
Description and findings re EC3	<p>Chapter 2 of Annex II on the regulation on risk management and ICAAP sets standards for the treatment of market risks. In particular it requires that the monitoring of risks resulting from trading activities includes the daily monitoring of both trading positions and trading results as well as utilization and exceeding of limits.</p> <p>Additionally Article 12 of the Regulation on capital requirement for market risk requires that banks shall establish and maintain systems and controls sufficient to provide prudent and reliable valuation of trading book. Banks shall then ensure that each position in its trading book appropriately reflects the current market value. This value includes an appropriate degree of certainty of the dynamic nature of trading, according to the need for careful accuracy (strength rating), and mode of operation and purpose of capital requirements in respect of trading book positions. Systems and controls must include the following elements:</p> <ul style="list-style-type: none"> • policies and procedures for the process of valuation of trading book, which must include clearly defined responsibilities of the all units, involved in the process of valuation, market information and review, frequency of independent valuation, time of closing prices, procedures for adjusting valuations, verification procedures at the end of the month and extraordinary verification procedures; • provides a clear and independent (i.e. independent from the front office) reporting lines for the department, which is responsible for the valuation process; • The trading book items must be valued at current market prices. If this is not possible, items are valued using an internal model. Items must be revaluated at least once a day; <p>Valuation at current market prices means at least daily revaluation of positions to the market prices, obtained from independent sources, such as stock prices, the prices obtained through market makers or quotes from several independent brokers. In the application of valuation at current market prices the prudency principle in relation to buying / selling rates must be in place, unless the bank is a significant market maker for a particular type of financial instrument or commodity and can close out at mid market (between buying and selling). If a bank uses an internal model for valuation of trading book, the model must meet the following requirements:</p> <ul style="list-style-type: none"> • senior management must be aware of the items in trading book, which is valued by internal model, and must understand the uncertainty this creates in the reporting of risk / performance; • market inputs shall, whenever is possible, be in line with the market prices, the adequacy of market inputs for a particular position being valued and the

	<p>parameters of the model must be estimated with sufficient frequency;</p> <ul style="list-style-type: none"> • if available, it is necessary to use valuation methodologies which are accepted by the market participants for particular financial instruments or commodities; • if the bank develops its own internal model, it must be based on appropriate assumptions that are assessed by the specialists, in the development and approval the trading unit must not be involved, the model must be independently tested, including validation of mathematical calculations, assumptions and software; • there shall be procedures for any changes of the model, copy thereof shall be held and • periodically used to check valuations; • risk management needs to know the weaknesses of the model and must include them as much as possible to the results of the evaluation; • the model must be subject to periodic review to determine the accuracy of its operation (E.g. assessing appropriateness of assumptions, analysis of profit / loss according to risk factors, comparison of actual close out values to model outputs). <p>In addition to daily valuation at current market prices or by using the valuation-model an independent review on prices must be carried out. This is the process by which market prices and market inputs are regularly verified for accuracy and independence. Daily valuation at current market prices may be performed by dealers, verification of market prices and input data for the model are performed by the organizational unit that is independent from the front office and done at least monthly (or more frequently, the nature of trading activities). Where independent pricing sources are not available or are subjective, prudent valuation adjustments must be done. Moreover if a bank uses a valuation model, it must inform BOS, according to the letter from 22. 11. 2010, which was sent to all banks. BOS makes then an independent review of models when performing on-site inspections and if deemed necessary discuss with the bank about shortcomings and usage of the model.</p> <p>In practice, Slovenian banks make a limited use of models. It worth mentioning that currently all except one banks in Slovenia use the standard approach and then have not implement VaR models. Valuation models are only used for non listed shares or for listed but non-liquid equities or bonds (which may be in this last case disputable). Nevertheless while the scope for using such models has been increasing in the past few years, amount of positions revalued with having recourse to a model remains subdued. BOS makes sure that external auditors did not raise any reservation about the use of valuation models and that there has been an internal validation process by an independent function (ordinary the Risk control department). When performing on-site inspections BOS's examiners check the characteristics of the model and that valuations are acceptable.</p>
EC4	The supervisor determines that banks perform scenario analysis, stress testing and contingency planning, as appropriate and periodic validation or testing of the systems used to measure market risk. The supervisor confirms that the approaches are integrated into risk management policies and processes, and results are taken into account in the bank's risk-taking strategy.
Description and findings re EC4	Article 16 of the regulation on risk management and ICAAP requires that procedures for identifying risks shall include comprehensive and timely recognition of risks that a bank takes-up in the course of its operations, and analyze the causes for their emergence. Identified risks must be documented. Furthermore procedures for

	<p>measuring or assessing risks shall include the creation of quantitative and/or qualitative assessments for measurable and non-measurable risks which the bank has identified in the risk identification procedure. Risk assessments must be documented.</p> <p>Annex II of the regulation on risk management requires that the measurement of risks arising from trading activities shall include the assessment of losses under normal market circumstances and losses under extraordinary circumstances. Banks shall ensure that the comparison of results of the measurement of risks from trading with their level of capital and revenue. No specific requirements are made on market activities related IT systems and contingency plans.</p> <p>According to the BOS's RAS/POT methodology BOS's examiners shall assess measuring of market risk as well as policies and procedures related to market risk measurement. However, taking into account the very low level of Slovenian banks' market risk exposures, banks have not developed sophisticated stress tests and rely mostly on stressed sensitivities measures and which it is deemed adequate by the BOS.</p>
Additional criteria	
AC1	The supervisor requires that market data used to value trading book positions are verified by a function independent of the lines of business. To the extent that the bank relies on modeling for the purposes of valuation, the bank is required to ensure that the model is independently tested.
Description and findings re AC1	<p>According to Article 12 of the regulation on capital requirement for market risk, daily valuation at current market prices may be performed by dealers, verification of market prices and input data for the model must be performed by the organizational unit that is independent from the front office, and done at least monthly (or more frequently, the nature of trading activities). When making use of models, banks shall also assure that these models are independently tested which includes validation of mathematical calculations, assumptions and software.</p> <p>If a bank uses a valuation model, it must inform BOS, according to the letter from 22. 11. 2010, which was sent to all banks. BOS makes an independent review of models when performing on-site inspections and if deemed necessary discuss with the bank about shortcomings and usage of the model.</p> <p>According to BOS RAS/POT methodology examiners must assess the managing of market risk, which involve the assessment of proper segregation of duties for all activities connected with trading. It must be understood that it encompasses the fact that the valuation of positions is properly segregated from the business line.</p>
Assessment of Principle 13	Compliant.
Comments	BOS regulatory prescriptions in the market risk field sometimes lacks of precision or stringency and even -in a few instances- could be considered as lax compared to generally accepted best practices (setup and revision of limits, contingency plans, use of off-market prices, use of internal valuation models for listed securities...). However it should also be considered that BOS's RAS/POT internal methodology gives more guidance to supervisor's examiners and indirectly to banks. Furthermore, market activities of banks are in most cases very limited and receding. Thus capital requirement for market risk is only 2 percent of the overall capital needs according to ICAAP/SREP estimates. In such a context, regulatory environment and BOS's

	supervisory practices can be regarded as adequate.
Principle 14	Liquidity risk. Supervisors must be satisfied that banks have a liquidity management strategy that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control liquidity risk, and to manage liquidity on a day-to-day basis. Supervisors require banks to have contingency plans for handling liquidity problems.
Essential criteria	
EC1	The supervisor sets liquidity guidelines for banks. These guidelines take into consideration undrawn commitments and other off-balance sheet liabilities, as well as existing on-balance sheet liabilities.
Description and findings re EC1	<p>The BOS has set both qualitative and quantitative guidelines for liquidity management regulations on liquidity risk management by banks.</p> <p>On the qualitative site, liquidity guidelines are given by the Regulation on risk management and implementation of ICAAP in :</p> <ul style="list-style-type: none"> -Article 2-3 (f) and (g) about the definition of “liquidity risk” and “liquidity reserve”, -Article 5-2 (e) that states that banks shall comply with general risk management which are further describe in other articles of the regulation, -last and more specifically in Annex V “General liquidity risk management standards”. Paragraph 1, Article 2.3. (Annex V) prescribes that the methodologies for identifying, measuring, controlling and monitoring shall enable the bank to reconcile current and projected sources of liquidity with the current and projected consumption of liquidity funds in the same period. For this purpose, these methodologies must take into account current and projected material cash flows that arise from assets, liabilities, off-balance sheet items, including contingent liabilities and the possible impact of other risks (reputational). <p>BOS’s qualitative regulation is fully compliant with the BCBS “Principles for sound liquidity risk management and supervision” (September 2008). Additionally the ZBAN-1 (Banking Law) transposes the EU’s CRD Directive. Articles 183, 184 and 185 deal with liquidity risk management.</p> <p>Since there is at this time no EU quantitative requirements for liquidity risk management (LCR/NSFR ratios will not be implemented before 2015), BOS has opportunely set in 1999 and revised in 2007 its own quantitative requirements. Regulation on the minimum requirements for ensuring an adequate liquidity position of banks and saving banks prescribe that the banks are obliged to send to the BOS regular reports on a daily basis inside which they calculate their liquidity position with a liquidity ratio, which is the ratio between the sum of financial assets, including off balance sheet assets in local and foreign currencies and the sum of liabilities, including off balance sheet liabilities with regard to residual maturity. Category one liquidity ratio (financial assets and liabilities with a residual maturity of up to 30 days) should be at least 1 (then a minimum required 100 percent). The aim of the ratio is to assure that institutions have enough liquid assets to meet its short term (30 days) obligations from maturing balance sheet and off balance sheet liabilities. Besides, Report has three maturity buckets: besides 0-30 days, 0-180 days and over 180 days. The second liquidity ratio does not have any limitation, but it is closely monitored by the BOS.</p> <p>Undrawn commitments and other off balance sheet items are duly taken into account for the calculation of the regulatory ratios. Thus on the asset side contractually</p>

	obtained credit lines and undrawn portion of loans are 100 percent weighted. This drawing assumption will be made more stringent soon by an amendment to the Regulation on liquidity as from 1 April 2013 these items will have a 50 percent weighting (75 percent during a transitional period). Sight deposits which were 50 percent weighted till 30 September 2011 are now 40 percent weighted. This slight relaxation was passed to converge somehow with the upcoming LCR assumptions which are definitely less stringent (5 to 10 percent).
EC2	The supervisor confirms that banks have a liquidity management strategy, as well as policies and processes for managing liquidity risk, which have been approved by the Board. The supervisor also confirms that the Board has an oversight role in ensuring that policies and processes for risk-taking are developed to monitor, control and limit liquidity risk, and that management effectively implements such policies and processes.
Description and findings re EC2	<p>Article 12 (1) of the Regulation on risk management and ICAAP sets the responsibilities of the board in the area of risk management, which also includes liquidity risk management. Board's responsibilities encompass approval and review of strategies and policies for taking-up and managing risk, providing up to date strategies and policies for taking-up and managing risks, related to changes in the bank's internal and external environment, ensuring that strategies and policies for taking-up and managing risks are comprehensive and proportionally take into account the risks to which a bank is exposed to in the scope of its operations and monitoring and regular assessment of the management system's effectiveness.</p> <p>Review of compliance with liquidity risk management rules shall be reviewed annually by the accounts auditor. Existence and effectiveness of the liquidity management strategy, policies and processes for managing liquidity risk are regularly examined within regular inspections by the BOS in accordance with the RAS/POT Methodology – Internal Part, chapter B.4</p>
EC3	The supervisor determines that a bank's senior management has defined (or established) appropriate policies and processes to monitor, control and limit liquidity risk; implements effectively such policies and processes; and understands the nature and level of liquidity risk being taken by the bank.
Description and findings re EC3	Article 13 of the regulation on risk management and ICAAP sets the responsibilities of the bank's senior management in the area of risk management (including liquidity risk management). It shall include creation and implementation of strategies and policies for taking-up and managing risk, notification of the bank's management and supervisory boards of significant risks which the bank takes-up in the scope of its operations, establishment and maintenance of a management system, establishment of procedures and creation of instructions and guidelines for carrying out the bank's business activities and establishment and control of limits for limiting exposure to risks.
EC4	The supervisor requires banks to establish policies and processes for the ongoing measurement and monitoring of net funding requirements. The policies and processes include considering how other risks (e.g. credit, market and operational risk) may impact the bank's overall liquidity strategy, and require an analysis of funding requirements under alternative scenarios, diversification of funding sources, a review of concentration limits, stress testing, and a frequent review of underlying assumptions to determine that they continue to be valid.
Description and findings re EC4	Paragraph 3 of Article 1 (Annex V) prescribes that the bank must adapt strategies, policies, procedures and systems for liquidity risk management to the business lines and transaction currencies it uses, and to the personnel in the group. These strategies, policies, procedures and systems must take into account the normal

	<p>business flow and emergency liquidity situations or liquidity crises.</p> <p>Paragraph 1 of Article 2.3. (Annex V) prescribes that the methodologies for identifying, measuring, controlling and monitoring shall enable the bank to reconcile current and projected sources of liquidity with the current and projected consumption of liquidity funds in the same period. For this purpose, these methodologies must take into account current and projected material cash flows that arise from assets, liabilities, off-balance sheet items, including contingent liabilities and the possible impact of other risks (reputational).</p> <p>Paragraph 2 of Article 2.1 (Annex V) prescribes that the bank must ensure the adequacy of the methodologies defined in the preceding paragraph on the basis of expert assessments and regular verification of their assumptions. The findings of these reviews must be documented and the senior management of the bank must be notified of the findings.</p> <p>Article 3.1. (Annex V) prescribes that the bank must define different methods of liquidity risk mitigation, which include a system of limits to restrict exposure to liquidity risk, liquidity buffers to overcome emergency liquidity situations, and an adequately diversified liquidity fund structure and definition of access to such funds. The bank must regularly review the adequacy and appropriateness of liquidity risk mitigation methods.</p> <p>Article 3.3. (Annex V) prescribes that the bank must establish procedures to provide adequate diversification of liquidity funds by monitoring liquidity sources and identifying any liquidity source concentrations.</p> <p>Paragraph 1 of Article 4.2. (Annex V) prescribes that the bank must regularly test a range of liquidity management scenarios, including the use of liquidity risk mitigation methods, and their basis must verify the assumptions on which the bank bases its decisions relating to providing liquidity. Based on these scenarios, the bank must define the method of providing appropriate liquidity while taking into account the normal business flow (basic scenario) and emergency liquidity situations (stress scenario). These scenarios must also address the impact of off-balance sheet items and other contingent liabilities, including liabilities arising from relations with special purpose entities, in relation to which the bank acts as sponsor or provides material liquidity support.</p>
EC5	<p>The supervisor obtains sufficient information to identify those institutions carrying out significant foreign currency liquidity transformation. Where a bank or banking group's foreign currency business, either directly, or indirectly through lending in foreign exchange to domestic borrowers, is significant, or where a particular currency in which the bank has material exposure is experiencing problems, the supervisor requires the bank to undertake separate analysis of its strategy for each currency individually and, where appropriate, set and regularly review limits on the size of its cash flow mismatches for foreign currencies in aggregate and for each significant individual currency.</p>
Description and findings re EC5	<p>The standardized liquidity report (quantitative requirements under EC1) is with regard to currencies divided into two parts, Euro currency positions on the one side and all other currencies (aggregate) positions on the other side. The majority of foreign currency maturity mismatch Slovenian banks have is relates to positions in CHF as they have granted some loans (including loans to households to finance properties) in</p>

	<p>CHF. However there is no specific ratio to comply with as regard to foreign currency liquidity exposure.</p> <p>According to Annex V (see above EC4) the banks must adapt strategies, policies, procedures and systems for liquidity risk management to the business lines and transaction currencies it uses, and to the personnel in the group. They also must establish procedures to provide adequate diversification of liquidity funds by monitoring liquidity sources and identifying any liquidity source concentrations relating to currencies.</p> <p>There are no specific requirements in terms of analyzing the liquidity strategy for each individual currency. However it must be mentioned that Slovenian banks so far have been carrying out limited foreign currency transformation, the only material exposures are in CHF and have remained subdued.</p>
EC6	The supervisor determines that banks have contingency plans in place for handling liquidity problems, including informing the supervisor.
Description and findings re EC6	<p>Article 4.3. (Annex V) requires from banks to have contingency plans that define effective strategies to prevent and control liquidity crisis positions, including adequate measures to overcome and limit the consequences of liquidity crises and to re-establish the bank's normal liquidity position. The same article prescribe minimum content of bank's contingency plans, one of the main points is that contingency plan must include method of notifying the BOS of the causes of threats to liquidity and planned action for their elimination. The existence and contain of detailed liquidity plan is checked by BOS when performing on-site examinations.</p> <p>Paragraph 3 of point 3.2 of Annex V of Regulation on risk management and ICAAP states that banks " must maintain an adequate level of liquidity buffers in the form of cash and other highly liquid unencumbered funds that are available to the bank at all times ". However BOS's regulation neither requires a specific level or composition of the liquidity buffers (in practice they largely consist in Slovenian Government Bonds whose rating has been deteriorating and the liquidity has been decreasing somehow) nor the carrying out of real/live liquidity stress-tests (for instance to measurement of the bank's ability to raise overnight financing in the interbank market).</p> <p>As mentioned before, the Supervisor receives daily report on banks' liquidity positions and then is in a position to monitor them closely. A daily internal meeting takes place in the BOS on liquidity issues in which the Banking Supervision Department, the Banking Operations Department and the Financial Stability Department are represented.</p>
Additional criteria	
AC1	The supervisor determines that, where a bank conducts its business in multiple currencies, foreign currency liquidity strategy is separately stress-tested, and the results of such tests are a factor in determining the appropriateness of mismatches.
Description and findings re AC1	There is no explicit requirement for banks to conduct separate foreign currency stress tests. However paragraph 3, Article 1 (Annex V) prescribe that the bank must adapt strategies, policies, procedures and systems for liquidity risk management to the business lines and transaction currencies it uses. Paragraph 3, Article 4.2 (Annex V) prescribe that bank must adjust its liquidity risk strategies, internal policies and limits on the basis of the results of the liquidity management scenario testing (stress tests)

	<p>and produce effective contingency plans. This means that the banks has to stress test a foreign currency liquidity strategy if this is a material issue.</p> <p>Paragraph 4, Article 3.2 prescribes that the bank must provide adequately diversified liquidity buffer structure. This also means that the banks must conduct stress test in a foreign currency (if materially exposed) in order to calculate appropriate level of liquidity buffer in separate foreign currency in which is materially exposed.</p> <p>As already mentioned above (see EC5) so far foreign currency positions have remained of limited size in the Slovenian banking system then the need for stress testing these positions is arguable.</p>
AC2	The supervisor confirms that banks periodically review their efforts to establish and maintain relationships with liability holders, maintain the diversification of liabilities, and aim to ensure their capacity to sell assets.
Description and findings re AC2	<p>Article 3.3 (Annex V) prescribes that the bank must establish procedures to provide adequate diversification of liquidity funds by monitoring liquidity sources and identifying any liquidity source concentrations. The bank must take into account concentrations relating to: the entities issuing liquidity sources, the method of acquiring liquidity (secured/unsecured), the markets and products that are the source of liquidity and geographic location, currency and maturity.</p> <p>Paragraph 2, Article 2.3. (Annex V) prescribes that the bank must monitor asset eligibility and the possibility of their timely availability. In doing so it must distinguish between pledged assets and unencumbered assets that are available at all times – also in emergency liquidity situations. The bank must also monitor the possibility of mobilizing assets in a timely manner in relation to the entities where the assets reside, countries where the assets are registered – in official records or in a bank account and existing legal and other legal, regulatory, operational and other limitations in relation to providing liquidity and transfers of unencumbered assets between entities in the banking group, regardless of whether they are located within or outside the European Economic Area. In assessing asset liquidity, the bank must take into account its capacity to provide liquidity on the basis of these assets within a short time.</p> <p>Moreover the BOS's RAS/POT methodology (public part) provides the banks with some guidance on the Supervisor's expectations regarding access to the liabilities (e.g. reliability, stability and diversification of the financing sources) and the liquidity of assets. The internal part of the RAS/POT methodology enters further into the detail of what should be reviewed and assessed by BOS's examiners/analysts.</p>
Assessment of Principle 14	Largely Compliant
Comments	<p>BOS has set a comprehensive and pertinent liquidity risk supervision framework, both qualitative and quantitative. It encompasses daily banks reporting on liquidity ratio and the compliance with a liquidity ratio. As liquidity strains in European markets were continuing BOS opportunely encouraged banks to deleverage, to sell assets when possible and to make a large use of ECB facilities, including 3 years LTRO. As domestic Slovenian banks have large and relatively stable amount of customer deposits on the liabilities and are deleveraging compliance with the BCBS/EU regulation (LCR) should not be a major challenge. Nevertheless some Slovenian banks have entered in a fierce competition for attracting new deposits and were offering higher rate (up to 5 percent for 1 year) in order to replace to some extent the wholesale market resources they have lost. BOS is timely intervene to refrain the banks to being too much aggressive by requiring additional capital for those offering too high interest rate on deposits, since then upwards pressure on rate has significantly quiet down.</p>

	<p>However, like in many other countries, funding issues were not given timely and sufficient attention by banks and by the Supervisor in advance of the crisis. Thus Slovenian banks (whose loan to deposit ratio was high, above 130 percent) were relying too much on external borrowings and wholesale market and were very exposed to a deterioration of their perceived solvency and liquidity or to the level of cash richness of their external lenders. In this juncture, the recent downgrading of the Slovenian Government debt as well as the downgrading of some Slovenian banks has had a major impact to the banks' access to the wholesale market and on funding costs (when some market access remains open). Thanks to the new ECB LTRO, medium term facilities refinancing of Slovenian banks is now ensured. Nevertheless more structural adjustments by banks will be needed from banks to become less structurally dependent of the Euro system's financing.</p>
Principle 15	<p>Operational risk. Supervisors must be satisfied that banks have in place risk management policies and processes to identify, assess, monitor and control/mitigate operational risk. These policies and processes should be commensurate with the size and complexity of the bank.</p>
Essential criteria	
EC1	<p>The supervisor requires individual banks to have in place risk management policies and processes to identify, assess, monitor and mitigate operational risk. These policies and processes are adequate for the size and complexity of the bank's operations, and the supervisor confirms that they are periodically adjusted in the light of the bank's changing risk profile and external market developments.</p>
Description and findings re EC1	<p>Law, regulations and guidelines dealing with operational risk are :</p> <ul style="list-style-type: none"> -ZBan-1/Banking Act, Articles 186 , 124, 173 and 174, -Regulation on the calculation of capital requirements for operational risk for banks and savings banks (which transposes and enforces the related EU Directive), -Regulation on risk management and ICAAP, in different article and specifically in Annex IV ("general operational risk management standards"), -Guidelines for operational risk management (Bank Association of Slovenia/ BOS, 2007), -RAS/POT methodology (public part), Chapter B-5 ("Operational risk"). <p>According to Article 186 of ZBan-1 (Banking Act), banks need to implement appropriate policies and procedures for operational risk assessment and management, which also include a specification of approaches to treat rare but very serious events representing a major operational risk.</p> <p>Article 124 of ZBan-1 requires bank's management system must include effective procedures of identifying, assessing, measuring or evaluating, mitigating and monitoring and be proportionate to the characteristics, volume and complexity of transactions performed by the banks. For Article 173, see below EC2. For Article 174, see below EC3.</p> <p>Annex IV of the Regulation on risk management and ICAAP sets general standards for managing OR and for establishing business continuity and contingency plans. As regard OR it states that :</p> <ol style="list-style-type: none"> (1) A bank shall provide for the identification and assessment of significant operational risks at least annually. (2) A bank shall provide for the prompt analysis of the causes of significant realized losses from operational risk. A significant loss from operational risk shall be defined in the policies of taking-up and managing risks. (3) A bank shall ensure that it's supervisory and management board and senior

	<p>management are informed about significant losses and exposures from operational risk. This report shall include at least a description of the type of loss from operational risk, the most significant causes of the loss event(s), the extent of the loss and a list of implemented measures. If necessary, a bank's management board shall decide whether additional measures should be adopted for management of operational risk. The management board shall also define the additional measures. A bank shall ensure monitoring of the realization of measures adopted for managing operational risk.</p> <p>Only 2 banks (foreign owned) use the Advance Measurement Approach. 4 banks (among the country's largest ones) use the Standardized approach (on a solo basis only, BIA at the group level) and all the other use the Basic Indicator Approach. It seems quite consistent with the size and complexity of the bank's operation. The fact that AMA is used only by few subsidiaries of foreign bank is fully understandable as they are the only firms that can rely on the infrastructure and know-how of a very large group.</p> <p>It's worth mentioning that one Slovenian bank proposed to reverse from the Standardized approach to BIA but BOS has duly opposed such a move, because lowering the operational risk standards is not desirable.</p>
EC2	<p>The supervisor requires that banks' strategies, policies and processes for the management of operational risk have been approved and are periodically reviewed by the Board. The supervisor also requires that the Board oversees management in ensuring that these policies and processes are implemented effectively.</p>
Description and findings re EC2	<p>According to ZBan-1/Banking Law, Article 173 banks' Management board is responsible to ensure that the bank operates in accordance with the risk management rules therefore must approve and periodically review the bank's strategies and policies for identifying, measuring or assessing, managing and monitoring and adjusted depending on changing bank risk profile To this end, the banks Boards can appoint appropriate decision making bodies.</p> <p>In practice the largest banks have set up operational risk committees which meet quarterly and that are generally chaired by a member of the management board or the CEO him/herself.</p>
EC3	<p>The supervisor is satisfied that the approved strategy and significant policies and processes for operational risk are implemented effectively by management.</p>
Description and findings re EC3	<p>In accordance with Article 174 of ZBan-1 banks must prepare a plan and implementation of risk management measures. Effective implementation measures include:</p> <ul style="list-style-type: none"> • internal risk management procedures, • measures for managing risks and internal procedures for executing such measures, • internal procedures for monitoring the implementation of risk management measures. <p>Moreover, in 2007, Bank Association of Slovenia in cooperation with BS, issued Guidelines for Operational Risk Management to explained more specifically how to implement operational risk management process; guidelines include descriptions of process and procedures that each bank needs to have in place.</p> <p>When performing on-site inspections, BOS's examiners make sure that the strategy, policies and processes approved by the Board are effectively implement. In this respect the internal RAS/POT methodology provides them with some operational guidance in the form of a detailed and comprehensive check-list.</p> <p>However the number of BOS's on-site experts for OR has been very limited for the past 2 years as there are currently only 2 experts where most certainly 4 or 5 would be</p>

	necessary. In such circumstances there has been a limited number of on-site OR examinations (4) in the past 2 years. Nevertheless one of them was one the country largest bank.
EC4	The supervisor reviews the quality and comprehensiveness of the bank's business resumption and contingency plans to satisfy itself that the bank is able to operate as a going concern and minimize losses, including those that may arise from disturbances to payment and settlement systems, in the event of severe business disruption.
Description and findings re EC4	<p>Bank must prepare a contingency and business continuity plans in order to ensure the bank's ability to operate on an ongoing basis and limit losses in the event of severe business disruption (Article 187 of ZBan-1).</p> <p>Regulation on risk management and ICAAP sets out a general operational risk management standards (Annex IV, Chapter 2). Standards provides business continuity and contingency plans preparation for operations in severely disrupted business conditions and must ensured that ancillary capacities for the continuation of business activities.</p> <p>In accordance with Article 29 of the ZPlaSS/Payment Services and Systems Act payment service providers must ensure measures for continuity and reliability of the provision of payment services.</p> <p>From June 2012 BOS plans to implement target supervision on effectiveness of business continuity planning in Slovenian banks. It will be the first time that such specifically targeted examinations will be carried out. However less in-depth assessment were made on a regular basis through on-site examinations in accordance with the RAS/POT methodology.</p>
EC5	The supervisor determines that banks have established appropriate information technology policies and processes that address areas such as information security and system development, and have made investments in information technology commensurate with the size and complexity of operations.
Description and findings re EC5	<p>In accordance with Article 26 ("Information systems") of the Regulation on risk management and ICAAP banks must establish an information systems development strategy and information systems security policy. Same Article defines minimum content of information systems security policy and internal control activities with regard to information systems (such us: development strategy, information systems security: logical and physical controls for accessing information systems; etc.).</p> <p>Banks must provide a documentation for ensuring the fulfillment of other conditions for the granting of authorization to provide banking services ; documentation must also include a strategy for the development of information systems and information systems security policy that takes into account the recommendations of Slovenian Standards (oSIST ISO/IEC 27001:2006, oSIST ISO/IEC 17799:2005 in SIST ISO/IEC 17799:2003) issued by the Slovenian Institute for Standardization or other authorized body, (Article 9 of the Regulation on the Documentation for the Granting of Authorizations to Provide Banking and Financial Services and for Status Transformations).</p> <p>The Supervisor's expectations on IT related issues are described quite extensively in the public part of the RAS/POT methodology. The non public part is even more detailed and provides the BOS's examiners with a useful tool for assessing IS. Unfortunately, at present BOS has very few IT experts available for on-site examinations (see below Principle 20).</p>
EC6	The supervisor requires that appropriate reporting mechanisms are in place to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.

Description and findings re EC6	<p>In the case of “events that may significantly affect the bank's operations in accordance with the risk management rules” banks must prepare reports about individual facts and circumstances (Article 195 of ZBan-1/Banking “Reports on individual facts and circumstances”). Moreover Article 22 of Regulation on risk management and ICAAP states that “In addition to reports on risks, the following [reports] shall be included:</p> <p>(a) information regarding the bank's operations, (b) information regarding the compliance of the bank's operations with valid legislation, standards, codes and internal acts, (c) information regarding the bank's external business environment and external development trends”. However it must be noticed that these regulatory prescriptions leave room for interpretation.</p> <p>In addition, bank should implement a comprehensive internal reporting of loss events and losses for the Management body (in its management and supervisory function) and senior management (paragraph 3, chapter 1 of Annex IV of Decree on Risk Management and ICAAP). These reports must contain all relevant data on operational risk exposures (i.e. a description of the type of loss from operational risk, the most significant causes of the loss event(s), the extent of the loss and a list of implemented measures). These reports are only available to BOS on request (usually for on-site examination and/or other off-site purposes).</p> <p>Last, AMA banks are required to fulfill COREP report on operational risk details (OPR Details), which contain partial and aggregated internal data on the losses due to operational risk that the bank incurred in the previous year (Article 29 of Decree on COREP reporting). The bank reports gross losses by business areas and by different types of loss events. These reports are available to BOS on request (usually at the preparation time for on-site examination or other off-site purposes).</p>
EC7	The supervisor confirms that legal risk is incorporated into the operational risk management processes of the bank.
Description and findings re EC7	<p>Definition of operational risk includes explicitly legal risk, as stated in Article 112 of ZBan-1/Banking Act. The definition of operational risk is directly transposed from CRD Directive as it is obligatory for all EU members.</p> <p>BOS's on-site examiners shall check that banks' internal operational risk database includes data collection of losses from the legal risk area.</p>
EC8	<p>The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing risk management program should cover:</p> <ul style="list-style-type: none"> • conducting appropriate due diligence for selecting potential service providers; • structuring the outsourcing arrangement; • managing and monitoring the risks associated with the outsourcing arrangement; • ensuring an effective control environment and • establishing viable contingency planning. <p>Outsourcing policies and processes should require the institution to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.</p>
Description and findings re EC8	<p>Article 18 of the Regulation on risk management and ICAAP (“Rules for the use of outsourcing”) requires that banks shall prepare internal policies for managing risks which include a policy for the use of outsourcing. Policy must contain approach to the use of outsourcing, guidelines with regard to risk management concerning the use of outsourcing, approach to ensuring business continuity regarding the activities transferred to outsourcers, measures in the case of expected or unexpected termination of the contractual relationship with an outsourcer.</p> <p>Banks must ensure that use of external parties does not impair the execution of its business activities, risk management process or internal control system. Banks must</p>

	<p>have a documented plan for the use of external parties (including a method of management of risks, assurance of effective reporting of risks resulting from the use of outsourcing, monitoring of compliance of an external party's operations with valid legislation, inclusion of the internal audit in the review of the appropriateness of use and operations of outsourcers). The contractual rights and obligations between bank and an outsourcer must be precisely defined and understandable. Outsourcer must provide a level of quality of services as agreed (Service Level Agreement -SLA) with the bank. The Service Level Agreement shall include quantitative and/or qualitative criteria, based on which the outsourcer and bank can assess the adequacy of the quality of respective services. If the level of quality of services is not in accordance with the contract, the bank shall immediately take the appropriate corrective measures.</p> <p>It is expected by the Supervisor and shall be checked by on-site examiners that in establishing outsourcing risk program banks use guidelines on outsourcing of credit institution (issued by the CEBS in 2006) and have signed relevant contracts and SLAs with major suppliers.</p>
Additional criteria	
AC1	<p>The supervisor determines that the risk management policies and processes address the major aspects of operational risk, including an appropriate operational risk framework that is applied on a group-wide basis. The policies and processes should include additional risks prevalent in certain operationally intensive businesses, such as custody and correspondent banking, and should cover periods when operational risk could increase.</p>
Description and findings re AC1	<p>Banks are required to implement risk management strategies and policies, which include operational risk (Article 3 of Decree on Risk Management and ICAAP). The requirements on the content of these strategies and policies cover all major aspect or risk management issues. In addition Decree on Risk management and ICAAP puts special emphasis on operational risk management issues as banks are obliged to comply with general op risk management standards (Article 5). As the general rule, the bank shall ensure that it is, at all times, capable to manage every material risk to which is exposed in the scope of its operations (including operational risk). Operational risk management standards are elaborated in the Annex IV of the same decree. These requirements provide clear regulatory basis for setting and implementing the operational risk management framework.</p> <p>Performance of obligations on a consolidated basis is defined by Article 131 of ZBan-1/Banking Act. Pursuant to the paragraph 7 banks shall ensure that organizational structure, processes and systems within a banking group are consistent and well integrated, the parent bank in the banking group must meet the obligations from Article 124 of ZBan-1 (“banks must set up and implement a sound and reliable management system which include effective procedures of identifying, assessing, measuring or evaluating, mitigating and monitoring of risks to which the banks are or might be exposed during their operation”) on a consolidated basis at a group or subgroup level.</p> <p>However BOS does not required detailed reporting on OR losses on a regular basis. Detailed reporting on OR losses as well as OR Committee minutes are nevertheless provided by banks on request when BOS is performing on-site examination. Thus BOS is hardly in a position to assess if a bank appropriately addresses the major aspects of operational risk including OR prevalent in its activities and businesses.</p> <p>Moreover BOS has not put a lot of emphasis on prevention and supervision of OR in relation with market activities which has been yet for the past 15 years a major source</p>

	<p>of losses not only in some large CIB (Société Générale, UBS....) but also in smaller banks with limited market activities (Barings, Allfirst). Moreover internal fraud related to market activities is not an issue confined to the trading book (which is not a big issue in most of Slovenian banks) as Treasury and ALM functions are also exposed to it as Slovene banks of course do have Treasurers and Asset and Liability managers.</p> <p>The BOS indeed made some communication efforts to publicize the EBA/CEBS guideline on this topic (a letter was sent to Slovenian banks, some internal training took place in BOS) but did not go beyond these actions to heighten awareness of market participants as well as supervisors. It is a fact that the Annex II of Regulation on risk management and ICAAP –a two page document dealing in rather general terms of market risk management standards- is very vague compared to the EBA/CEBS 16 page guideline. The same kind of remark also goes for the RAS/POT methodology.</p> <p>Another potential operational risk on which several banks and the Supervisor have possibly underestimated and/or not addressed timely derives from CHF denominated loans. A number of banks, especially foreign owned banks, have granted a significant amount of loans denominated in CHF (total amount was around 3,5 percent of total assets at the end of 2011 but it was much more –up to 16 percent- for some individual banks). This is a potential source of credit risk (the ability and willingness of the borrowers having taken such a FX exposure to repay these loans is sometimes questionable) and also an operational risk (possible customers' complaints, disputes) and a reputational risk.</p>
Assessment of Principle 15	Largely Compliant
Comments	<p>There is no evidence that OR is not adequately covered by capital and BOS might be right overall in making the basic assumption that OR are limited in the Slovenian banking industry.</p> <p>Although BOS' OR reporting requirements are in line with COREP reporting requirements on loss events, they are insufficient. Collecting of loss event data on aggregate basis (OPR Loss COREP template) is required on quarterly basis. Collecting of loss events details is on request only. Moreover on- site investigations have been limited in number and depth so far due to the lack of skilled human resource then it is not sure that the Supervisor has put enough emphasis on this category of risk. Then BOS may have not paid adequate attention to some specific OR the Slovenian banking industry is exposed to. Thus it seems that OR linked to marked activities (namely "rogue trading") have been somewhat neglected and that suitability has possibly been inappropriately taken into account in lending activities (CHF denominated loans).</p>
Principle 16	Interest rate risk in the banking book. Supervisors must be satisfied that banks have effective systems in place to identify, measure, monitor and control interest rate risk in the banking book, including a well defined strategy that has been approved by the Board and implemented by senior management; these should be appropriate to the size and complexity of such risk.
Essential criteria	
EC1	The supervisor determines that a bank's Board approves, and periodically reviews, the interest rate risk strategy and policies and processes for the identification, measuring, monitoring and control of interest rate risk. The supervisor also determines that management ensures that the interest rate risk strategy, policies and processes are developed and implemented.
Description and findings re EC1	Law and regulations dealing with interest rate risk are ZBan-1/Banking Act's articles 173, 181 and 182, Regulation on risk management and ICAAP article 3 and annex III.

	<p>Article 173 of ZBan-1 requires that management board must determine clear, transparent and consistent internal relationship which provides clear segregation of duties and prevents conflicts of interest. Management board must assure regular verification of strategies and policies for risk measuring, for all risks that the bank is currently exposed to or can be exposed to. Management board is responsible, that bank operates according to the principles of proper risk management.</p> <p>Article 181 of ZBan-1 requires that the bank must establish appropriate systems for assessing and managing risks arising from potential changes in interest rates, which affect its operations, except those in trading book.</p> <p>Article 182 of ZBan-1 requires that the bank must properly coordinate its investments which exposes bank to the potential losses due to the changes in interest rates, foreign currency, exchange rates, changes in price or other market risks with the bank's liabilities, which are also dependent of the same market factors. Uncoordinated items must be properly managed.</p> <p>Article 3 of the Regulation on risk management and ICAAP requires that banks establish and implement an appropriate, effective and comprehensive strategies and policies for risks taking and managing. According to Article 2 (e) this encompasses "interest rate risk" defined as the risk of losses arising due to unfavorable interest rate changes in the banking book. Strategies for risks taking and managing must be documented and must include at least :</p> <ul style="list-style-type: none"> (a) the objectives and general principles or guidelines for risk taking and managing; (b) approaches for managing individual risks, (c) approaches for implementing the process of assessing internal capital adequacy, (d) an outline of plans for significant business activities and a description of any planned changes in the bank's business strategy. <p>The strategies should reflect the relationship of banks to the risks they assume in their business, in order to avoid any inconsistencies, ambiguities and imbalances in their governance.</p> <p>Policies for risks taking and managing must be documented and must include at least:</p> <ul style="list-style-type: none"> (a) the methodology for assessing the risk bearing capacity, (b) the organizational rules for implementing the risk management process, including the description, (c) rules for assessing the bank's risk profile, including methodologies for evaluating and measuring and assessing the risks, (d) the rules of the internal control system, (e) the rules of the process of assessing internal capital adequacy. <p>The policies must ensure the implementation of strategies for taking and managing risks.</p> <p>Annex III of the Regulation on risk management and ICAAP sets some general interest rate risk management standards.</p> <p>Moreover the BOS's RAS/POT methodology (public part) provides banks with some guidance on what are the Supervisor's expectations with regard to the management of the interest rate risk on the banking book. The internal part of the methodology provides the BOS's on-site examiners and off-site analysts with further guidance in the form of a detailed check list.</p>
EC2	The supervisor determines that banks have in place comprehensive and appropriate interest rate risk measurement systems and that any models and assumptions are

	<p>validated on a regular basis. It confirms that banks' limits reflect the risk strategy of the institution and are understood by and regularly communicated to relevant staff. The supervisor also confirms that exceptions to established policies, processes and limits should receive the prompt attention of senior management, and the Board where necessary.</p>
<p>Description and findings re EC2</p>	<p>According to the Annex III of Regulation on risk management :</p> <p>(1) the procedure for assessing interest rate risk shall take into account the significant characteristics of interest rate risk. The assumptions used by the bank for assessing interest rate risk must be documented".</p> <p>(2) the bank's assessment of interest rate risk must take into account all non-trading interest rate sensitive items and assess:</p> <ul style="list-style-type: none"> (a) risks arising from maturity mismatch of active and passive interest-sensitive items, (b) the risk of yield curve movement, (c) basis risk, (d) risks arising from options integrated into interest-sensitive items. <p>(3) the bank shall also determine the amount of interest rate risk based on the effects of changes in interest rates:</p> <ul style="list-style-type: none"> (a) on an income statement; (b) on the present value of interest-sensitive items (economic value of equity). <p>(4) the assessment of interest rate risk includes the assessment of losses under normal market circumstances and losses under extraordinary circumstances.</p> <p>(5) the bank shall define limits for restricting losses with regard to the level of its capital and its revenues while taking into account the results of testing of extraordinary but plausible situations.</p> <p>(6) the bank shall define the interest sensitivity of items without maturity, based on appropriate analysis.</p> <p>(7) the bank which faces significant interest rate risk in various currencies shall assess such risk for every currency separately.</p> <p>(8) the frequency of interest rate risk monitoring shall be adjusted to the bank's exposure to such risk, the size of the bank and the activities which changes the bank's exposure to interest rate risk.</p> <p>Whereas it is not explicit in the regulation, the BOS expects the banks calculated the loss from a parallel shift of the yield curve by 200 basis points separately by currency. The entire sum of losses is an internal assessment of capital requirements for interest rate risk in banking book and is taken into account to evaluate the bank's capital needs (ICAAP/SREP methodology).</p> <p>The public part of the RAS/POT methodology opportunely draws the attention on two critical issues sometimes neglected by the banks, namely the basis risk and the embedded options. It also stresses that if the only regulatory stress testing requirement is about a parallel shift of 200 bps, it is expected from banks that they have tested some more scenario of changing shape of the yield curve.</p> <p>The internal part of the RAS/POT methodology provides the BOS's examiners with some more specific guidance on model validation process, assessment of assumptions of assets and liabilities items deprived of a fixed maturity (e.g. sight deposits), limits assessment, and governance/internal reporting standards.</p> <p>It seems therefore that BOS pays an appropriate attention to the supervision of banks interest rate risk. Anyway interest rate risk on the banking books are generally moderate in Slovenian banks as most of them have a very classical balance sheet</p>

	structure and as the vast majority of loans are indexed on EURIBOR. If some banks have some significant fixed rate bond inventories they are usually swapped into variable rates.
EC3	The supervisor requires that banks periodically perform appropriate stress tests to measure their vulnerability to loss under adverse interest rate movements.
Description and findings re EC3	Annex III of the Regulation on risk management and ICAAP requires that “the assessment of interest rate risk includes the assessment of losses under normal market circumstances and losses under extraordinary market circumstances”. It is implicit that banks shall at least calculate the loss from the parallel shift of the yield curve by 200 basis points separately by currency, in accordance with the BCBS recommendations. Last, the RAS/POT methodology suggests (but not formally requires) that banks have some measurement of the impact of a non parallel shift of the yield curve and of the basis/spreads between different variable rate indices. When performing on-site supervision BOS’s examiners assess the appropriateness of the stress scenarios.
Additional criteria	
AC1	The supervisor has the power to obtain from banks the results of their internal interest rate risk measurement systems, expressed in terms of the threat to economic value, including using a standardized interest rate shock on the banking book.
Description and findings re AC1	According to Annex III of Regulation on risk management and ICAAP, the interest rate risk assessment should include assessment of losses in the event of extraordinary market circumstances. It is expected by the Supervisor that banks measure the impact of a parallel shift of the yield curve by 200 basis points when performing ICAAP. If the bank finds out that the estimated loss is more than 20 percent of the regulatory capital, it must immediately inform the BOS. When giving notice to the BOS, the bank must provides to the BOS also a list of actions to be carried out within a reasonable time in order to reduce its exposure to interest rate risk.
AC2	The supervisor assesses whether the internal capital measurement systems of banks adequately capture the interest rate risk in the banking book.
Description and findings re AC2	Article 126 of ZBan-1/Banking Act requires that the bank must establish and implement appropriate, effective and integrated strategies and processes for continuous evaluation and provide the amounts, types and distribution of internal capital, which it considered necessary to cover all the risk, which the bank is exposed to or may be exposed to during its operations. This strategies and processes must be subject to periodic internal reviews to ensure that they remain clearly and comprehensively defined and proportional to the characteristics, extent and complexity of transactions performed by the bank. According to the 30. Article of the Regulation on risk management and ICAAP banks shall determine and categorize the significant risks, based on the risk profile, to be taken into account in the process of assessing internal capital adequacy. According to the 35. Article of the Regulation on risk management and ICAAP the bank shall ensure that the estimated internal capital is consistent with its ability to take risks. The bank shall assess the adequacy of internal capital and its allocation at least annually and whenever any significant change in risk exposure. According to Annex 3 of the Guidelines on the process of internal capital adequacy, the bank calculated the loss under extraordinary market circumstances. This must be understood as a sudden parallel shift of the yield curve by 200 basis points separately

	by currency. The entire sum of losses is an internal assessment of capital requirements for interest rate risk in banking book.
AC3	The supervisor requires stress tests to be based on reasonable worst case scenarios and to capture all material sources of risk, including a breakdown of critical assumptions. Senior management is required to consider these results when establishing and reviewing a bank's policies, processes and limits for interest rate risk.
Description and findings re AC3	<p>According to the 4 Paragraph of 1 Point of Annex III of Decree on risk management, assessment of interest rate risk covers the evaluation of losses under normal market conditions, and loss in circumstances of a stress in the market.</p> <p>According to the Guidelines on the process of internal capital adequacy, bank's stress tests should be carried out from the changes in market conditions for the purpose of the internal assessment of capital needs at least once a year. To determine changes in market conditions that may adversely affect its future capital adequacy, stress tests should also take into account the general state of the business cycle (procyclicality) relating to the general deterioration of economic conditions due to the decrease of economic activity (recession) or deterioration of the situation in specific economic sectors, which are financial supported by the bank.</p>
AC4	The supervisor requires banks to assign responsibility for interest rate risk management to individuals independent of and with reporting lines separate from those responsible for trading and/or other risk-taking activities. In the absence of an independent risk management function that covers interest rate risk, the supervisor requires the bank to ensure that there is a mechanism in place to mitigate a possible conflict of interest for managers with both risk management and risk-taking responsibilities.
Description and findings re AC4	<p>Article 173 of ZBan-1/Banking Act requires that management board must determine clear, transparent and consistent internal relationship which provides clear segregation of duties and prevents conflicts of interest. Management board must assure and regular verification of strategies and policies for risk measuring, for all risk that the bank is currently exposed or can be exposed, including risks from macroeconomic environment. Management board is responsible, that bank operates according to the principles of proper risk management.</p> <p>Article 9 of the Regulation on risks management and ICAAP requires that the organizational structure in banks must be based on appropriate segregation of duties between all employees, including management. Segregation of duties is appropriate if prevents conflict of interest and provides transparent and documented process of decision taking.</p>
Assessment of Principle 16	Compliant.
Comments	<p>BOS's regulatory requirements are not very specific on different aspects of the interest rate risk management, including assumptions and stress-tests. BOS's approach to this regard is more a principle based one than prescriptive one. In such an environment it does not seem that Slovenian banks have implemented sophisticated methodologies and a large variety of scenarios for measuring impact of interest rate, basis and spreads changes on their banking book.</p> <p>However the need for comprehensive and sophisticated methodologies is limited as the balance sheet structure of Slovenian banks does not induced very significant interest rate exposure. Indeed a large portion of loans to corporate or households including mortgages are granted with variable rates while most liabilities are also indexed on BOR indices. Then interest rest mismatches are subdued, and the part</p>

	<p>which is not naturally hedged is usually hedged with the recourse to plain vanilla IRS. An evidence of the limited IR exposure of the Slovenian banks is provided by the fact that it accounts for only 5 percent of their overall capital needs as measures by banks' ICAAP as well as by BOS's SREP.</p> <p>Further disclosure by banks on ALM issues would be notwithstanding desirable. Nevertheless one cannot neglect some banks exposure to credit spread as they hold significant amounts of Slovenian Government Bond as a source of income and a liquidity buffer.</p>
Principle 17	<p>Internal control and audit. Supervisors must be satisfied that banks have in place internal controls that are adequate for the size and complexity of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.</p>
Essential criteria	
EC1	<p>Laws, regulations or the supervisor establish the responsibilities of the Board and senior management with respect to corporate governance to ensure that there is effective control over a bank's entire business.</p>
Description and findings re EC1	<p>Slovenian Companies Act, Banking Act and BOS regulations (Regulation on risk management and ICAAP and Regulation on diligence of members of the management and supervisory boards of banks) determine the responsibilities of the management board.</p> <p>According Companies Act and Banking Act the management of the bank shall ensure that the bank's operations are consistent with The Banking Act and regulations issued on its basis, with other acts governing the performance of financial services provided by banks, with other regulations issued on their basis thereof, with other corporate finance and banking rules and with the highest ethical standard.</p> <p>Regulation on Risk Management provides fundamental requirements in respect to responsibilities of the Board and senior management to all levels of risk management system (i.e. risk strategies and policies, internal governance issues, roles and responsibilities) (Articles 12 and 13 of Regulation on Risk Management and ICAAP). Furthermore, the organizational structure of the bank should be clear in terms of well-defined, transparent and consistent lines of responsibility (Article 8 of Regulation on Risk Management and ICAAP) while competencies and duties amongst employees should be segregated to limit/prevent conflicts of interests and provide a transparent process of management decision making.</p> <p>BOS's Regulation on the diligence of members of the management and supervisory boards of banks and savings banks determine the responsibilities of members of the management and supervisory boards.</p> <p>The responsibilities shall be clearly defined and documented. The documentation shall include:</p> <ul style="list-style-type: none"> • a definition of the most important duties of management and supervisory board members in connection with the performance of their function, including relevant work procedures, • minutes of management and supervisory board meetings, and

	<ul style="list-style-type: none"> • other important documentation based on which the BOS is able to assess the activities of the bank's management and supervisory board members. <p>In particular, the responsibilities of members of the management and supervisory boards shall include the formulation and supervision of the following:</p> <ul style="list-style-type: none"> • the bank's basic business objectives, taking foremost into account the long-term interests of the bank, in accordance with valid regulations and requirements and recommendation of the BOS and other competent supervisory bodies, • objectives concerning the risk profile, and strategies for risk-taking and risk management, • a stable and transparent organizational structure, and a policy for appointing and replacing persons in key positions at the bank, • effective internal reporting systems with regard to the situation in the bank's organizational structure and relations with competent bodies, • basic principles of management at the bank, including a code of conduct and other comparable principles, and • an appropriate and effective internal control system. <p>Moreover the public part of the BOS's RAS/POT methodology sets standards with respect to corporate governance and internal control in chapters C.10 (Internal controls) and C.12 (Management). The internal part of the RAS/POT methodology enters more into the details and then provide the on-site examiners and off-site analyst with a comprehensive check-list.</p>
<p>EC2</p>	<p>The supervisor determines that banks have in place internal controls that are adequate for the nature and scale of their business. These controls are the responsibility of the Board and/or senior management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments. More specifically, these controls address:</p> <ul style="list-style-type: none"> • Organizational structure: definitions of duties and responsibilities, including clear delegation of authority (for example, clear loan approval limits), decision-making policies and processes, separation of critical functions (for example, business origination, payments, reconciliation, risk management, accounting, audit and compliance). • Accounting policies and processes: reconciliation of accounts, control lists, information for management. • Checks and balances (or "four eyes principle"): segregation of duties, cross-checking, dual control of assets, double signatures. • Safeguarding assets and investments: including physical control.
<p>Description and findings re EC2</p>	<p>According the Regulation on Risk Management and ICAAP banks shall establish and realize a sound and reliable internal governance framework encompassing the following well interconnected elements:</p> <ol style="list-style-type: none"> (a) a clear organizational structure, (b) an effective risk management process, (c) an adequate internal control systems, (d) an adequate remuneration system for employees. <p>The management system referred to in previous paragraph shall be comprehensive and proportionate to the characteristics, extent and the complexities of the bank's operations. A management system is comprehensive if it is established for all significant activities and organizational units of the bank.</p>

	<p>A bank shall ensure regular review and development of its own management system.</p> <p>The bank must ensure adequate segregation of duties for all bank's processes in order to avoid possible conflicts of interest. The bank must ensure that through a precise description of duties the functions of identification, measuring and monitoring risk are separated from those parts of the bank that deal with controlling risk in terms of reducing or avoiding it. Reporting that derives from processes of risk management must be aimed directly at the management board and/or another managerial level at the bank.</p> <p>The public part of the RAS/POT methodology sets much more detailed standards to be met by banks. The non public part of the RAS/POT methodology give further guidance to BOS's on-site examiners and off-site analysts for assessing the quality and exhaustiveness of banks' internal controls set-ups.</p>
EC3	<p>Laws, regulations or the supervisor place the responsibility for the control environment on the Board and senior management of the bank. The supervisor requires that the Board and senior management understand the underlying risks in their business and are committed to a strong control environment.</p>
Description and findings re EC3	<p>According to the ZBan-1/Banking Act (article 124) Banks shall set up and implement a sound and reliable management system, which shall include the following: clear organizational structure with precisely defined, transparent and consistent internal relations regarding responsibilities, effective procedures of identifying, assessing, measuring or evaluating, mitigating and monitoring of risks to which the banks are or might be exposed during their operations, appropriate internal control system which includes appropriate administrative and accounting procedures.</p> <p>Organizational structure, procedures and systems shall be defined in a clear and understandable manner and shall be proportionate to the characteristics, volume and complexity of transactions performed by the banks. For each type of risk the bank must have in place an effective and adequate system of management. It is important that the management board and senior executives maintain a good overview of the entire framework of risk management. Individuals, too, must be aware of their duties and responsibilities in managing risk and of the importance of fulfilling their role in management adequately and appropriately.</p> <p>In practice however the way some banks, among the bigger in the country, have been managing their credit risk, sectoral concentration risk and liquidity risk cast some doubt about the Board and senior management understanding of the underlying risks and their commitment to a strong internal control.</p>
EC4	<p>The supervisor has the power to require changes in the composition of the Board and senior management to address any prudential concerns related to the satisfaction of these criteria.</p>
Description and findings re EC4	<p>BOS is empowered to withdraw the authorization to perform the function of a member of the bank's management board in specific cases: when the authorization was obtained by stating false information, when the management board of which the person is a member violates its obligations from Article 173 (obligations related to risk management) of the Banking Act, when a management board member violates other duties pertaining to his office, as laid down by regulations or rules from Article 66 (Members of the bank's management board shall ensure that the bank's operations are consistent with the Banking Act and regulations issued on its basis , other acts governing the performance of financial services provided by banks, and other regulations issued on their basis, other corporate finance and banking rules.), when a management board member is convicted by a final judgment of a criminal offence.</p>

	<p>BOS may decide not to withdraw the authorization if the management board member does not commit another violation on the grounds of which it might be possible to withdraw the authorization or issue a letter of admonishment within a trial period to be determined by the BOS and lasting not less than six months and not more than two years from the decision date.</p> <p>BOS shall repeal the conditional withdrawal of authorization and withdraw the authorization if the management board member commits a new violation during the trial period which might be a reason for withdrawal of authorization or issue of a letter of admonishment.</p> <p>BOS issues recommendations, admonishment or decrees, send to the Board and senior management. At the present time, there are a significant number of open actions, which shows that the BOS is quite active in asking remediation measures but that also suggest that banks internal control practices are far from perfect which is confirmed by a high level of impairment and a high cost of risk.</p>
EC5	The supervisor determines that there is an appropriate balance in the skills and resources of the back office and control functions relative to the front office/business origination.
Description and findings re EC5	The appropriate balance in the skills and resources of both mentioned parts of a bank is explicitly in the scope of the on-site examinations. It is in fact one of the crucial points on the examiners' checklist (internal RAS/POT methodology). If and when the BOS's examiners detect some unbalancing of skills and resources in the back office function and/or the risk control function the BOS can and do impose measures for eliminating such kind of weakness of a bank.
EC6	According to Article 20 (3) of Regulation on risk management and ICAAP: "When appropriate, the internal control system also includes the Compliance function and the Security information function. The compliance function shall identify and assess the compliance risk to which the bank is or could be exposed. The compliance risk is a risk of loss arising from regulatory sanctions and measures of supervisory boards which a bank may incur from intentional or unintentional non-compliance with valid legislation, standards and codes and internal acts". BOS's expectation is a bank establishes Compliance function on the basis of proportionality principle, it means that complex banks could decide to establish compliance function as independent department or as a part of Legal department (good practice). In any case as a part of the "internal control system" the compliance function must be independent of the business activities of the bank. However it is a fact that Slovenian regulatory requirements on compliance function are very general in terms and give to banks a lot leeway to arrange their own setup. The RAS/POT methodology (public part) is not more specific on compliance as it is dealing with the issue only through two short paragraphs.
Description and findings re EC6	The bank has to organize the compliance function for prevention of money laundering and terrorist financing. In the other areas of banking activities the compliance function is incorporated in the function itself which can possibly hampered its independence.
EC7	The supervisor determines that banks have an independent, permanent and effective internal audit function charged with (i) ensuring that policies and processes are complied with and (ii) reviewing whether the existing policies, processes and controls remain sufficient and appropriate for the bank's business.
Description and findings re EC7	The Article 198 of the Banking act prescribes that the Internal Audit Department exercises, among others, the following functions: verification of completeness, reliability and timeliness of reporting in compliance with regulations and verification of compliance of the bank's operations with regulations, internal rules and measures adopted on this basis.

	<p>On regulation level the internal audit function is part of internal control system of the bank. Its primary function is to provide an independent, periodic and comprehensive review and assessment of the adequacy of the management system, quality of internal controls and ICAAP (Article 28 of Regulation on Risk Management).</p> <p>Public part of the RAS/POT methodology states that “Independent internal audit is an essential element of monitoring and assessing the comprehensiveness of internal controls and the system of internal supervision” and gives to banks some guidance about the conditions to be met to have an effective internal audit function.</p> <p>As usual the un-public part of the RAS/POT methodology establishes more precise standards that are include in the examiner’s check-list (e.g. a benchmark ratio of 1 percent between the audit staff and the total staff).</p>
EC8	<p>The supervisor determines that the internal audit function:</p> <ul style="list-style-type: none"> • has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing; • has appropriate independence, including reporting lines to the Board and status within the bank to ensure that senior management reacts to and acts upon its recommendations; • has full access to and communication with any member of staff as well as full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties; • employs a methodology that identifies the material risks run by the bank; • prepares an audit plan based on its own risk assessment and allocates its resources accordingly; and • has the authority to assess any outsourced functions.
Description and findings re EC8	<p>The obligation of establishing Internal Audit Department is written in the ZBan-1/Banking Act where the main tasks of this department are stated:</p> <ul style="list-style-type: none"> • -Monitoring and evaluating the efficiency of risk management systems and providing • -assistance in risk management; • -Review, assessment and testing of efficiency of internal control systems; • -Evaluation of the process of assessing the necessary internal capital of the bank in terms of its risk evaluation, • Assessment of reliability of the information system, including the electronic information system and electronic banking services, • -Assessment of accuracy and reliability of accounting records and financial reports, • -Verification of completeness, reliability and timeliness of reporting in compliance with regulations, • Verification of compliance of the bank's operations with regulations, internal rules and measures adopted on their basis, • Conduct of special investigations. <p>The internal audit department shall follow the Standards of professional conduct for internal auditing, Code of principles of internal auditing and Code of ethics of internal auditors.</p> <p>Internal Audit Department reports to the management board and supervisory board. Independent internal audit is an essential element of monitoring and assessing the comprehensiveness of internal controls and the system of internal supervision. Each</p>

	<p>bank must have an established independent internal audit system that enhances the adequacy and effectiveness of carrying out organizational and procedural controls. The bank's management board must ensure the independence of regular auditing reviews and assessments.</p> <p>The bank shall employ at least one person having acquired the title of auditor or certified internal auditor. Persons who carry out the tasks of internal auditing may not carry out any other tasks in the bank. Tasks of the internal audit department may not be carried out by members of the bank's management board. The annual plan of activities of the internal audit department shall be based on the assessment of risks made at least once a year and shall be adopted by the bank's management board in agreement with the supervisory board.</p>
Additional criteria	
AC1	In those countries with a unicameral Board structure (as opposed to a bicameral structure with a Supervisory Board and a Management Board), the supervisor requires the Board to include a number of experienced non-executive directors.
Description and findings re AC1	<p>According to the Companies Act a bank (as a stock company) can have the management board and supervisory board. The other solution is a unicameral Board structure which is also possible according to the Companies Act. In unicameral Board structure the members are executive and non-executive directors. The B o S licences the executive directors of a bank.</p> <p>In practice only one foreign owned bank has not a bicameral structure. Even in this case, the "four-eye principle" is met as the bank has two licensed top managers who can be held responsible for every aspect of the bank's management and functioning.</p>
AC2	The supervisor requires the internal audit function to report to an audit committee, or an equivalent structure.
Description and findings re AC2	<p>The Banking Act determines that the internal audit department shall draw up half yearly internal audit reports comprising the following elements:</p> <ul style="list-style-type: none"> -Description of operational audits carried out, -General assessment of risk management adequacy and efficiency, -Appropriateness and effectiveness of internal control systems operation, -Violations and irregularities identified by the internal audit department during individual operational audits and proposed measures for eliminating such violations and irregularities. The internal audit department shall prepare an internal audit annual report comprising the following: -Report on the implementation of the annual program of activities, -Summary of major findings during operational audits. <p>The internal audit department shall submit its semi-annual and annual reports to the bank's management and supervisory boards.</p> <p>The management board shall submit the internal audit annual report and the supervisory board's opinion to the bank's general meeting simultaneously with the bank's annual report and the supervisory board's report.</p> <p>The existence of an audit committee is compulsory only for larger banks. Then the audit committee shall have at least one independent/non executive member. However the non executive members don't need to get licensed by the BOS. A bill has been prepared by the BOS to expand the licensing powers of the Supervisor bus has not been voted by the Parliament yet.</p>
AC3	In those countries with a unicameral Board structure, the supervisor requires the audit committee to include experienced non-executive directors.

Description and findings re AC3	The bank with a unicameral Board structure shall establish the audit committee in cases when the bank owns one or more dependent companies (leasing, factoring, real estate etc.). This is imposed by the Companies Act. If the Board of directors (executive board) appoints an audit committee, at least one member must be appointed from among the independent experts in the field of accounting or finance. Besides them, only the members of the Board of directors can be appointed members of the audit committee.
AC4	Laws or regulations provide, or the supervisor ensures, that banks must notify the supervisor as soon as they become aware of any material information which may negatively affect the fitness and propriety of a Board member or a member of the senior management.
Description and findings re AC4	Article 195 of the Banking Act (“Reports on individual facts and circumstances”) states that the bank shall report to the BOS on the all important facts and circumstances that can be important, including the information related to the changes in management and supervisory board.
Assessment of Principle 17	Largely Compliant.
Comments	<p>The Banking Law and BOS regulations (Regulation on risk management and ICAAP and Regulation on diligence of members of the management and supervisory board of banks) set general principles as regards the banks internal control framework. Going further the RAS/POT methodology (public part) provides the bank with some more guidance on the Supervision’s expectations. The un-public part of the RAS/POT methodology offers to BOS examiners a more comprehensive toolkit for assessing banks’ internal controls and the internal audit function. However, the supervisors face impediments in removing members of the supervisory board in the event they inattentive or do not fulfill their responsibilities in other ways relative to a bank’s corporate governance and internal controls environment.</p> <p>The credit risk problems and the liquidity strains that the Slovenian banking system is now facing cast some doubt on the adequacy of banks’ internal controls and on the skills and/or independence of the control functions including the internal audit (as regards risk management function see Principle 7). It also tends to demonstrate that even if the Supervisor is now very active in prescribing remedial, correcting measures it may have not been in the recent past proactive enough to this regard and/or unable to enforce in a timely manner the prescribed improvements in banks internal controls.</p>
Principle 18	Abuse of financial services. Supervisors must be satisfied that banks have adequate policies and processes in place, including strict “know-your-customer” rules, that promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.
Essential criteria	
EC1	Laws or regulations clarify the duties, responsibilities and powers of the banking supervisor and other competent authorities, if any, related to the supervision of banks’ internal controls and enforcement of the relevant laws and regulations regarding criminal activities.
Description and findings re EC1	<p>As regards the supervision of AML/CFT the Central Bank’s duties and responsibilities are determined in the Banking Act and in the AML/CFT Act. Pursuant to Banking Act the BOSI has power to issue to following measures in the case of violation of legal requirements:</p> <ul style="list-style-type: none"> • recommendation and warning, • order to eliminate a violation; • order with additional measures for implementing risk management rules;

	<ul style="list-style-type: none"> • withdrawal of license; • appointment of special administration; • decision on ground of bankruptcy. <p>In general all these measure are used for the purpose of prudential supervision but the same provisions are also used for the purpose of AML/CFT supervision. As regards the AML/CFT the supervisory power and competence are additionally determined in AML/CFT Act.</p> <p>Pursuant to AML/CFT Act the Central Bank is one of supervisory authorities which are responsible for AML/CFT compliance. Beside the Central Bank there are Securities Market Agency, Insurance Supervision Agency and the Market Inspectorate which are also competent for AML/CFT supervision of the financial sector.</p> <p>As regards the AML/CFT supervision the BOS is responsible for the following institutions:</p> <ul style="list-style-type: none"> • banks and savings houses, • payment institutions, • issuer of e-money, • exchange offices. <p>Apart from competence to issue adequate supervisory measures BOSI has also duty and responsibility to impose administrative sanctions.</p>
EC2	<p>The supervisor must be satisfied that banks have in place adequate policies and processes that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, for criminal activities. This includes the prevention and detection of criminal activity, and reporting of such suspected activities to the appropriate authorities.</p>
Description and findings re EC2	<p>Pursuant to Banking Act the members of Board and Supervisory board are obliged to respect high ethical and professional standards, apart from this legal requirement banks have internally adopted Code of Conduct which obliged all employee to respect high ethical and professional standards.</p> <p>As regards the AML/CFT banks are obliged to have adequate policies and procedures referring CDD and On-going monitoring. Banks are also obliged to report suspicious activities to the competent authority (FIU) irrespective of the amount.</p>
EC3	<p>In addition to reporting to the financial intelligence unit or other designated authorities, banks report to the banking supervisor suspicious activities and incidents of fraud when they are material to the safety, soundness or reputation of the bank.</p>
Description and findings re EC3	<p>As regards the AML/CFT there is legal requirement to report the FIU the following transactions:</p> <ul style="list-style-type: none"> • cash transactions exceeded 30.000 EUR; • suspicious transactions (including intended transactions) irrespective of the amount; • transactions (out-flows) exceeded 30.0000 EUR which are designated to receivers in high risk countries* <p>BOS does not receive any reports about the transaction above. Statistical data about STRs and CTRs are always available from the FIU upon the request. However during on-site visits BOS has access to those data.</p>

	<p>As regards other suspicious activities not connected with AML/CFT (like incidents, frauds) such activities are treated and reported as loss events within Operational Risk Management. Apart from internal reporting banks are required to report to the competent supervisor (BOS) all facts and circumstance which have significant impact on bank's risk exposure.</p> <p>* The list of those countries is published on the FIU's web site.</p>
EC4	<p>The supervisor is satisfied that banks establish "know-your-customer" (KYC) policies and processes which are well documented and communicated to all relevant staff. Such policies and processes must also be integrated into the bank's overall risk management. The KYC management program, on a group-wide basis, has as its essential elements:</p> <ul style="list-style-type: none"> • a customer acceptance policy that identifies business relationships that the bank will not accept; • a customer identification, verification and due diligence program; this encompasses verification of beneficial ownership and includes risk-based reviews to ensure that records are updated and relevant; • policies and processes to monitor and recognize unusual or potentially suspicious transactions, particularly of high-risk accounts; • escalation to the senior management level of decisions on entering into business relationships with high-risk accounts, such as those for politically exposed persons, or maintaining such relationships when an existing relationship becomes high-risk; and • clear rules on what records must be kept on consumer identification and individual transactions and their retention period. Such records should have at least a five year retention period.
Description and findings re EC4	<p>Chapter 2.1 of AML/CFT Act defines the bank's obligation as regards AML/CFT (appointment of AML compliance officer, training, reporting to FIU...) while the chapter 2.2 of AML/CFT Act includes detailed provisions referring CDD and On-going monitoring.</p> <p>Beside that it should be pointed out that AML/CFT Act imposes to supervisors an obligation to issue guidelines in order to ensure uniform implementation of the AML/CFT provisions. In accordance with this provision BOS has issued "<i>Guidelines for implementation of measures regarding AML/CFT for the banking sector</i>" which were adopted by the Governing Board of the BOS.</p> <p>The first Chapter of Guidelines mentioned above imposes to banks an obligation to ensure effective system for AML/CFT management. Such system has to include the following elements:</p> <ul style="list-style-type: none"> • AML compliance officer and his adequate position in the organizational structure; • System of internal controls; • Education and training of staff; • Independent internal audit. <p>As regards the system of internal controls bank needs to define internal rules and procedures at least for the following activities:</p>

	<ul style="list-style-type: none"> • the possibility to refuse to start a business relationship or to terminate the existing one; • to determine AML/CFT customer's risk profile; • to conduct appropriate Customer Due Diligence (normal, enhance, simplified) before the beginning of business relationship or before the executing a transaction; • to ensure adequate on-going monitoring process in order to identify unusual and suspicious activities. <p>AML/CFT Act includes the legal provisions referring the high risk customers. According the AML/CFT high risk customers are: politically exposed persons (PEP's), non-face-to face business and correspondent relationships with banks from third countries. Apart from that banks are free to define other types of high risk customers according to their internal methodology for risk assessment. One of required additional measures referring high risk customers is of course senior management approval.</p> <p>As regards the keeping of records AML/CFT Act requires that all customer's data and files have to be saved 10 years after the termination of the business relationship or after the transaction is executed.</p>
EC5	<p>The supervisor is satisfied that banks have enhanced due diligence policies and processes regarding correspondent banking. Such policies and processes encompass:</p> <ul style="list-style-type: none"> • gathering sufficient information about their respondent banks to understand fully the nature of their business and customer base, and how they are supervised; and • not establishing or continuing correspondent relationships with foreign banks that do not have adequate controls against criminal activities or that are not effectively supervised by the relevant authorities, or with those banks that are considered to be shell banks.
Description and findings re EC5	<p>AML/CFT Act includes special provision on enhanced CDD regarding correspondent relationship with banks in third countries. The following data are required as additional measures:</p> <ul style="list-style-type: none"> • obtaining the data about banking licence; • obtaining the data about the bank's system of internal controls referring AML/CFT; • obtaining the data about the legal AML/CFT framework in respective third country; • obtaining written declaration, that a bank does not operate as shell bank; • obtaining written declaration that a bank is supervised by the competent supervisory authority including AML/CFT supervision. <p>In all those cases it is also required to obtain senior management approval to start such relationship.</p> <p>Pursuant to AML/CFT it is prohibited to start a new or to continue existing correspondent relationship with the bank from the third country in the following cases:</p> <ul style="list-style-type: none"> • required data as stated above were not obtained; • senior management approval was not obtained; • if the respective bank operates in third country where there is no legal AML/CFT framework or the bank is not legally required to respect AML/CFT rules;

	<ul style="list-style-type: none"> if the respective bank in third country operates as shell bank. 																
EC6	The supervisor periodically confirms that banks have sufficient controls and systems in place for preventing, identifying and reporting potential abuses of financial services, including money laundering.																
Description and findings re EC6	<p>The BOS undertakes two kinds of on-site examination in order to find out whether banks have in place adequate systems, controls to effective manage AML/CFT risk:</p> <ul style="list-style-type: none"> Regular on-site examination according to annual plan; Extraordinary examination based on gathered information from different sources. <p>As regards the type of on-site examination it can be:</p> <ul style="list-style-type: none"> Full scope: in one institution the whole area of AML/CFT is examined; Targeted examination: in one institution specific AML/CFT issue is examined; Thematic examination: the same AML/CFT issue is examined in several banks. <p>The process of on-site examination normally includes:</p> <ul style="list-style-type: none"> reviewing the AML/CFT system (position of AML compliance officer, education and training of staff, internal policies and procedures, independent internal audit) examining the sample of customers files (in order to check the implementation of CDD and On-going monitoring). <p>The risk of potential abuse of financial services (other than AML/CFT) is normally not examined separately but it is regularly examined within Credit Risk, Market Risk.</p> <p>However, at present, BOS has very human resources to carry-out on-side examination as it has on 2 examiners having an expertise in AML field. Thus, the number of on-site examinations is low and since the beginning on AML/CFT on-site examination in 2008 only 50 percent of the banks have been inspected (see below EC7).</p>																
EC7	The supervisor has adequate enforcement powers (regulatory and/or criminal prosecution) to take action against a bank that does not comply with its obligations related to criminal activities.																
Description and findings re EC7	<p>As already stated in EC 1, BOS has power to take action against the bank that does not comply with the legal requirements. As regards the AML/CFT issue from the statistics below it is evident that BOS has already used this power.</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th></th> <th style="text-align: center;">AML/CFT on-site visits</th> <th style="text-align: center;">Cases of violation</th> <th style="text-align: center;">Types of measures</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">2009</td> <td style="text-align: center;">3</td> <td style="text-align: center;">2</td> <td style="text-align: center;">Letter to the Mgmt with several warnings (2)</td> </tr> <tr> <td style="text-align: center;">2010</td> <td style="text-align: center;">7 + 1 Follow-up</td> <td style="text-align: center;">5</td> <td style="text-align: center;">Letter to the Mgmt with several warnings (4) Order with measures (1)</td> </tr> <tr> <td style="text-align: center;">2011</td> <td style="text-align: center;">3 + 7 Follow-up</td> <td style="text-align: center;">6</td> <td style="text-align: center;">Order with measures (4) Order with additional measures (2)</td> </tr> </tbody> </table>		AML/CFT on-site visits	Cases of violation	Types of measures	2009	3	2	Letter to the Mgmt with several warnings (2)	2010	7 + 1 Follow-up	5	Letter to the Mgmt with several warnings (4) Order with measures (1)	2011	3 + 7 Follow-up	6	Order with measures (4) Order with additional measures (2)
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	<p>However it is also quite clear that in the first years of on-site examinations BOS has restrained from taking stringent measures against non compliant banks. It also worth to mention that no fines have been issued and that these actions taken by BOS were not made public. Consequently it is doubtful that the BOS so far have been exemplary enough and are acting as a deterrent.</p>
EC8	<p>The supervisor must be satisfied that banks have:</p> <ul style="list-style-type: none"> • requirements for internal audit and/or external experts to independently evaluate the relevant risk management policies, processes and controls. The supervisor must have access to their reports; • established policies and processes to designate compliance officers at the management level, and appointed a relevant dedicated officer to whom potential abuses of the bank's financial services (including suspicious transactions) shall be reported; • adequate screening policies and processes to ensure high ethical and professional standards when hiring staff; and • ongoing training programs for their staff on KYC and methods to detect criminal and suspicious activities.
Description and findings re EC8	<p>As regards the role of internal and external audit it should be pointed out that according the AML/CFT guidelines issued by the BOS internal audit is obliged to conduct independent evaluation of the appropriateness of bank's AML/CFT risk management. As regards the external audits they usually do not assess the AML/CFT risk management as this is not a legal requirement. BOS as a supervisor has access to all internal audit report (whether during on-site or off-site examination).</p> <p>Pursuant to AML/CFT Act bank is obliged to appoint on AML compliance officer and his deputy. Full time responsibility for AML/CFT tasks depends on the size of the bank, number of employees and volume of business activities. AML compliance officer might be responsible for other tasks if it does not have impacts on effective AML/CFT risk management.</p> <p>In general AML compliance officer is responsible for bank's compliance with AML/CFT rules and performing of sanctioning measures. In the terms of AML compliance officer's position AML/CFT Act requires that he performs his task as independent organizational unit, which is directly responsible to the Board or other administrative body and is functionally and organizationally separated from other units. In practice there are cases where AML compliance officer is positioned directly under the Board and in some cases bank placed him in compliance or compliance and legal department. As regards the reporting requirement the AML compliance officer collect STRs within the bank and he is responsible to send them to FIU. As regards the reporting of other potential abuse of financial system such cases are normally internally reported to Operational Risk Manager and not to AML compliance officer.</p> <p>One of the legal requirements for nomination of AML compliance officer is the evidence that he/she has not been convicted by a final judgment. In the terms of high moral and ethical standard he is required to respect the internal Code of Conduct.</p> <p>As regards the AML/CFT there are legal provisions and AML/CFT guidelines (2008) which impose to banks on obligation for on-going education and training of employees.</p>

EC9	The supervisor determines that banks have clear policies and processes for staff to report any problems related to the abuse of the banks' financial services to either local management or the relevant dedicated officer or to both. The supervisor also confirms that banks have adequate management information systems to provide managers and the dedicated officers with timely information on such activities.
Description and findings re EC9	<p>All potential abuse of financial services should be treated and reported as loss events within Operational Risk Management. Banks have defined the process of regularly reporting about loss events to Operational Risk Manager who on timely basis reports to the Board.</p> <p>In the case of loss event which has a significant impact to banks risk exposure the banks have defined the policy to immediately report to the Board and the competent supervisor.</p> <p>Regulation on risk management and ICAAP Chapter 1 (Treatment of operational risk) of Annex IV (General operational risk management standards) defines the required data set that should be a part of reporting process mentioned above. An instance of such report should include at least a description of the type of loss from operational risk, the most significant causes of the loss event(s), the extent of the loss and a list of implemented measures. In relation to the last the regulation also requires a bank's management board to decide whether additional measures should be adopted for management of operational risk. In accordance with Article 124 of ZBan-1 and proportionately to the characteristics, volume and complexity of transactions performed banks have developed systems that cover data collection, analysis and reporting of various complexity. Adequacy of this systems is subject to on-site examinations, within which data quality and results of analysis are examined in addition to timelines and/of the measures taken.</p> <p>In practice deriving from the fact that BOS does not have an adequate number of experts both in IT/IS and AML/CFT (see above Principle 15 and EC6) the desirable checking and assessments are not always performed.</p>
EC10	Laws and regulations ensure that a member of a bank's staff who reports suspicious activity in good faith either internally or directly to the relevant authority cannot be held liable.
Description and findings re EC10	Pursuant to AML/CFT Act the Bank and its staff are not liable for damage caused to customers or to third persons in the cases when they obtain, process, and submit customer's data to the FIU or perform other activities in order to fulfill AML/CFT requirements.
EC11	The supervisor is able to inform the financial intelligence unit and, if applicable, other designated authority of any suspicious transactions. In addition, it is able, directly or indirectly, to share with relevant judicial authorities information related to suspected or actual criminal activities.
Description and findings re EC11	<p>Obligation to report criminal offences liable to public prosecution</p> <p>Pursuant to Articles 145 and 147 of the Criminal Procedure Act currently in place in Slovenia, the BOS is bound to report criminal offences liable to public prosecution of which it has been informed or which were brought to its notice in some other way. Crime reports shall be submitted to the competent public prosecutor in writing or orally. Crime reports submitted to the court, the police or unauthorized public prosecutor shall be accepted and forwarded forthwith to the competent public prosecutor.</p>

Obligation to Safeguard Confidential Information

The BOS has the authority and responsibility to collect and process the information about facts and circumstances which are important to the performance of its tasks and responsibilities laid down by the Banking Act currently in place in Slovenia. Pursuant to Article 228 of this Act, the BOS's employees, auditors and other professionals who have acted under the authority of the BOS shall safeguard all information obtained during the performance of supervision and other transactions for the BOS as confidential (hereinafter referred to as "confidential information"). Confidential information may not be disclosed to any other person or state authority except in the form of an extract from which one cannot identify individual banks to which such confidential information relates. This prohibition does not however apply in cases of confidential information required for carrying out criminal proceedings.

Persons Allowed to be Disclosed Confidential Information

Pursuant to article 231 of the aforementioned Banking Act, the BOS may disclose confidential information to the following persons in the Republic of Slovenia and other Member States:

1. Competent authorities responsible for the supervision of supervised financial undertakings;
2. Judicial and other authorities performing actions in the process of compulsory liquidation or bankruptcy of the bank or in other similar proceedings;
3. Auditors in charge of auditing financial statements of supervised financial undertakings;
4. Persons or authorities managing deposit guarantee schemes;
5. Authorities responsible for supervising authorities that perform activities in the process of compulsory liquidation or bankruptcy of the bank or in another similar proceedings;
6. Authorities responsible for supervising auditors that perform the tasks of auditing financial statements of supervised financial undertakings;
7. Judicial authority, state prosecutor's office or the police if such information is required for the proceedings conducted within their competencies;
8. The central bank of the European System of Central Banks or another body with similar tasks and responsibilities as the central monetary authorities when these pieces of information are significant for the performance of their statutory prescribed duties including the management of monetary policies and related provision of liquidity, overseeing payments systems, clearing systems and settlement systems and protection of financial system stability or another body responsible for payment systems supervision;
9. Ministry responsible for finance or state authority of another Member State responsible for the implementation of the laws governing supervision of credit institutions, financial institutions, investment firms or insurance undertakings; however only to the extent necessary for the implementation of their tasks and responsibilities;
10. Central securities clearing corporation or other clearing corporation or settlement system pursuant to the act governing financial instruments market in connection with the performance of clearing and settlement transactions concluded on one of the markets in the Republic of Slovenia if the BOS deems that his information is necessary in order to provide for appropriate action to be taken by such corporation regarding non-compliance or eventual non-compliance by participants in these markets;

	<p>11. Members of a College referred to in Articles 278a. and 294.a of this Act and members of the College, in which the competent authority of another Member State is responsible as a consolidated competent authority, within the framework of carrying out duties of the College and</p> <p>12. European Banking Authority within the scope necessary for carrying out its responsibilities and duties according to Regulation (EU) No 1093/2010 and</p> <p>13. European Systemic Risk Board within the scope necessary for carrying out its responsibilities and duties according to Regulation (EU) No 1092/2010.</p> <p>Pursuant to AML/CFT Act supervisory authorities are obliged to notify the FIU immediately if they establish or discover facts during supervision that indicate or may indicate money laundering or terrorist financing.</p>
EC12	The supervisor is able, directly or indirectly, to cooperate with the relevant domestic and foreign financial sector supervisory authorities or share with them information related to suspected or actual criminal activities where this information is for supervisory purposes.
Description and findings re EC12	<p>Cooperation among Competent Authorities of the Republic of Slovenia, Member State Competent Authorities and the European Banking Authority</p> <p>Pursuant to Article 230 of the Banking Act currently in place in Slovenia, the BOS and competent authorities of the Republic of Slovenia which are responsible for the supervision of other supervised financial undertakings shall, upon request by individual competent authorities, provide these authorities with all the information concerning the bank or other supervised financial undertaking required in the process of supervising this undertaking, in the process of issuing authorizations and permissions or in deciding on other individual matters. Competent authorities are obliged on their initiative to notify each other of any irregularities or other circumstances identified during the supervision or other duties and responsibilities when such regularities are also relevant to the work of other competent authorities. Pursuant to article 230.a of the aforementioned Act, the BOS also cooperates with competent authorities of other Member States, particularly by forwarding information of key importance or significant for the performance of their supervisory tasks. For the attainment of this purpose, the BOS forwards to another competent authority on their request or on its own initiative all information of key importance or significant for the performance of that competent authority's supervisory tasks.</p>
Additional criteria	
AC1	If not done by another authority, the supervisor has in-house resources with specialist expertise for addressing criminal activities.
Description and findings re AC1	<p>The BOS (as all state agencies and organizations having public authority) is bound by the Criminal Procedure Act (Article 145) to report criminal offences liable to public prosecution of which they have been informed or which were brought to their notice in some other way. Within the BS such reports are usually done by legal counsels with cooperation of banking inspectors, when necessary. All senior legal counsels at the BS are required to have passed a state examination, which includes training in the area of criminal law.</p> <p>Furthermore, the BOS is a minor offence authority (e.g. Article 402 of ZBan-1, Article 232 of ZPlaSS, Article 33 of ZPotK, Article 85 of ZPPDFT, Article 11 and 13 of ZDevP) and is therefore entitled to impose administrative sanctions to offenders in case of violations. All employees of the BOS, who have been informed of any behavior which might be qualified as a minor offence, are required to report to the Minor Offence</p>

	<p>Commission (consisting of qualified legal counsels from the BS). The Commission, after reviewing the facts of the case, acts within its powers.</p> <p>However, only a few inspectors (2 at present) within the Banking Supervision Department are designated to deal only with AML/CFT.</p>
Assessment of Principle 18	Largely Compliant.
Comments	<p>Slovenian law and regulations as well as the BOS's "Guidances for the implementation of measures regarding the prevention of money laundering and terrorist financing for the banking sector" (a 59 pages document approved in May 2008) have set the legal framework for promoting high ethical standards and preventing the banks for being used for criminal activities.</p> <p>However, as already noticed in the March 2012 MONEYVAL follow-up report, the efficiency of this framework is in practice hampered by two major shortcomings :</p> <ul style="list-style-type: none"> -the relatively low number and severity of administrative sanctions imposed by BOS for AML/CFT non compliance. The fact that so far measures taken were often warnings rather than more stringent actions, the fact that no fine has ever been issued and the fact that measures taken by BOS are not made public drive to the conclusion the sanctioning regime can hardly be regarded as effective and dissuasive. It must be said however that the BOS has taken recently a somewhat tougher stance, -the still inadequate on-site examination resources devoted to AML/CFT and consequently the only partial coverage of the scope by BOS examiners. <p>Such shortcomings could be acceptable if the ML/FT risk was low. However, whereas there is not any National Rating Assessment so far (the first one is planned in 2013) BOS assessment for ML risk is "medium" because of Slovenia geographical position (entry point from Balkan and East European countries to EU) and a high risk in non-resident clients especially, but not only, Italians.</p>
Principle 19	Supervisory approach. An effective banking supervisory system requires that supervisors develop and maintain a thorough understanding of the operations of individual banks and banking groups, and also of the banking system as a whole, focusing on safety and soundness, and the stability of the banking system.
Essential criteria	
EC1	The supervisor has policies and processes in place to develop and maintain a thorough understanding of the risk profile of individual banks and banking groups.
Description and findings re EC1	<p>The Supervisory Review Evaluation Process (SREP) designed by the BOS in compliance with the principles of Pillar II (Basel agreement and CRD) is a key element to understanding and monitor banks risk profile. The so-called SREP-ICAAP dialog (see Principle 6) and the ongoing refreshing of the POT risk matrix are then extensively used and powerful tools at the command of the Supervisor.</p> <p>Key element of BOS supervision consists also in the RAS/POT methodology, a very detailed internal manual which on-site examiners use when inspecting banks. This RAS/POT methodology represents a common policy and approach to evaluate risks in individual bank; it also provides the examiners with a very useful check-list.</p> <p>Banks regulatory reporting (namely daily liquidity reporting, monthly financial statements, quarterly consolidated financial statements, quarterly capital reporting, quarterly large exposure reporting, monthly credit portfolio classification or "credit register", yearly loss events OR questionnaire, monthly interest rate risk reporting), along with other information (ad hoc reporting or internal audit reports occasionally requested from banks, banks requests, customers' complaints, public information, external auditor reports ...) are other sources and materials used on a regular basis by BOS's banking supervision department.</p>

EC2	The supervisor monitors and assesses trends, developments and risks for the banking system as a whole. The supervisor also takes into account developments in non-bank financial institutions through frequent contact with their regulators.
Description and findings re EC2	<p>On a yearly basis the Banking supervision department prepares a RAS report for whole banking system (report is discussed on Governing Board meeting), where major trends and development in banking sector are presented.</p> <p>Additionally the BOS's Financial Stability department evaluates the trends and major risks of the banking system in monthly bulletins and in an annual comprehensive document (80 pages) entitled "Stability of the Slovenian Banking System".</p> <p>The developments in non banking sector are discussed on some regular meetings with "Big four" auditing firms as well as the auditing firm association and with cooperation and common examinations with other regulators (Securities Market Agency, Insurance supervision Agency, Institute of macroeconomic analysis and development [an office of MoF]). There is a "coordination" in place at the higher level between the 3 Slovenia supervisory authorities (for Banks, Insurance and Markets) and some contacts at the operational level. Furthermore on a yearly basis BOS and the Market supervisory body set up a plan for common examinations (usually 2 or 3 a year).</p>
EC3	The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, importance and scope of the risks to which individual banks or banking groups are exposed. The methodology should cover, inter alia, the business focus, the risk profile and the internal control environment, and should permit relevant comparisons between banks. Supervisory work is prioritized based on the results of these assessments.
Description and findings re EC3	<p>BOS's RAS/POT internal methodology determines the approach in assessing individual risks when performing on-site examinations. It encompasses a procedure for assessing "inherent risk" and for assessing "internal control environment" for individual risks. Putting together inherent risk and mitigating elements deriving from internal controls results in a score ranging from 1 (the best) to 4 (the worse). The resulting risk matrix is refreshed on an ongoing basis every times significant information is made available (e.g. BOS's on-site inspection reports).</p> <p>RAS/POT methodology covers management, strategy, profitability, risk profile, internal control and every different risk (credit, liquidity, market, operational, interest rate risk on the banking book, reputation, and solvency). As on-site and off-site examiners use extensively this common methodology it permits relevant comparisons between banks.</p> <p>The final result and risk profile of individual bank is also the basis for planning examination in future and distribution of human resources in banking supervision department. Banks having weaker control environment and being less risk averse are subject to more frequent examination with greater emphasis on problematic areas. The RAS is therefore the Supervisor's main tool for organizing (i.e. planning, prioritizing and allocating) the use of supervisory resources, and performing and managing the supervisory risk assessment.</p> <p>Additionally, BOS has written some specific methodologies for dealing with specific issue, namely public guidelines for AML (2008) and an internal examiner guide/reminder for IRB.</p>
EC4	The supervisor confirms banks' and banking groups' compliance with prudential regulations and other legal requirements.

Description and findings re EC4	<p>Part of BOS's internal RAS methodology deals with the evaluation of compliance with prudential regulations and other legal requirements. Under the heading "Compliance" examiners in charge have to evaluate the compliance of the banks with regard to regulations. Compliance is also assessed as part of internal control environment and should be assessed for all risks that are subject of RAS methodology (see above EC3).</p> <p>See above Principle 18 on abuse of financial services.</p>
EC5	<p>The supervisor requires banks to notify it of any substantive changes in their activities, structure and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements.</p>
Description and findings re EC5	<p>According to the ZBan-1/Banking Law the banks must notify BOS in the following circumstances :</p> <ul style="list-style-type: none"> • in case of changes in their activities, furthermore the bank shall accompany its notification by a business plan (article 89), • in case of breaching the maximum allowable credit exposure to a single person or a group of connected clients or the total of exposures resulting from the merger of two legal persons or due to other reasons beyond its control (article 168), • in case of any development that could have an impact on overall condition or activity of the bank (article 195; see also Principle 6, AC4). <p>Except for exceeding of limits on large exposure, there is no specific, explicit regulatory requirement imposing banks to notify BOS of a breach of legal or prudential requirements. However article 195 stipulates that the bank's management board shall notify the BOS forthwith of the following events : threats to the bank's liquidity or capital adequacy, changes in the bank's financial position so that the bank's capital falls short of the minimum capital requirement, the bank is unable to repay a maturing deposit.</p>
EC6	<p>The supervisor has an adequate information system which facilitates the processing, monitoring and analysis of prudential information. The system aids the identification of areas requiring follow-up action.</p>
Description and findings re EC6	<p>BOS has an ORACLE data warehouse + OBI (Oracle Business Intelligence) a software use for extracting and processing data. Examiners can access BOS database when on-site. OBI tool looks very user friendly and makes easily accessible a lot of information on individual banks on an aggregate basis.</p> <p>Moreover BOS has developed ICAS for assessing PDs (see Principle 9) and a valuation model for assessing the value of non liquid securities or bonds (see Principle 13).</p> <p>Risks identified or irregularities detected through off-site analysis of received information are part of on-site examination planning process.</p>
Additional criteria	
AC1	<p>The supervisor employs a well defined methodology designed to establish a forward-looking view on the risk profile of banks, positioning the supervisor better to address proactively any serious threat to the stability of the banking system from any current or emerging risks.</p>
Description and findings re AC1	<p>According to BOS internal manual for examiners (RAS/POT methodology non public part) examiners shall assess what could be future development in portfolios and how this could impact the bank's profitability, capital adequacy and liquidity. BOS has also</p>

	<p>set a 3 year audit plan adjusted when establishing the yearly audit plan, both of which take into account identified risks and tends to take a prospective view.</p> <p>In practice while more emphasis has recently be put by the Banking supervision department on trend analysis, the on-site reports don't always offer a prospective diagnosis of the banks activity, profitability and risks. They still are more "point in time" rather than "forward looking" even if some improvement to this regard has been taking place Thus BOS has been trying to limiting the rise of loans in the last few years with several actions (additional capital claim for exposures related to financial holdings financing – 150 percent weight), there were also targeted on- site examinations on quality of banks' problematic loans identification and collection process, but the deterioration of financial position of clients especially from constructing and financial holdings sector was extremely fast and severe and these initiatives were too slow in coming and not enough intensive to have a decisive impact. Considering the recent rise of credit risks (high level of NPLs, impairments and provisions) and the serious strain in liquidity it seems quite clear that the Slovenian Supervisor, like many other, has not been enough proactive in the recent past (see Principles 8, 9 and 14).</p>
Assessment of Principle 19	Largely Compliant.
Comments	<p>Through SREP-ICAAP dialog, RAS/POT methodology and some other tools (e.g. ICAS) BOS has implemented a robust and well designed supervisory approach. BOS can also rely on the high quality of its supervisory staff for understanding the operations and for assessing the individual banks' risk.</p> <p>Nevertheless the crisis revealed some serious weaknesses in the past supervisory approach of the BOS. It appears quite obvious that the Supervisor has been overconfident in the banks' ability to master and command their risks and has failed to identify and failed to address in a timely manner the development of a credit bubble, of sectoral concentration risks and the dependence of Slovenian banks to foreign wholesale funding. Then there is a strong need for more in-depth reviews and ongoing monitoring by the off-site supervision (which will require additional staff) and overall for a more forward looking, a more proactive rather than reactive approach and a somewhat more intrusive implementation of banking supervision.</p>
Principle 20	Supervisory techniques. An effective banking supervisory system should consist of on-site and off-site supervision and regular contacts with bank management.
Essential criteria	
EC1	The supervisor employs an appropriate mix of on-site and off-site supervision to evaluate the condition of banks, their inherent risks, and the corrective measures necessary to address supervisory concerns. The specific mix may be determined by the particular conditions and circumstances of the country. The supervisor has policies and processes in place to assess the quality, effectiveness and integration of on-site and off-site functions, and to address any weaknesses that are identified.
Description and findings re EC1	<p>According to article 223-1 ("Method of exercising supervision") of ZBan-1/Banking Act "the BOS shall conduct its supervision of banks by:</p> <ol style="list-style-type: none"> 1. Monitoring, collecting and verifying reports and notifications by banks and other persons which are obliged to report to and notify the BOS of individual facts and circumstances, 2. Auditing the banks' operations and 3. Imposing measures of supervision".

	<p>On-site and off-site supervision is performed by one single division of BOS's Banking supervision department. This division employs 29 FTE (out of 62 FTE for the whole banking supervision department). Other divisions provide legal and methodological support or are in charge of regulation (e.g. EU directive transposition) and licensing. The split of the staff between off-site and on-site is respectively 10 and 19 FTE. The 10 off-site relationship managers and analysts are shared out by 4 units each one in charge of a group of banks. The on-site examiners section is structured in 3 pools of experts: credit risk experts (11), financial risks experts (4) and operational and compliance risk experts (4). Some of these experts have one secondary field of expertise. If the on-site pool looks overall adequately staffed, it lacks of experts in information systems (2 only at the present time where more probably 4 would be needed). Moreover the on-site section, with only 10 officers in charge of 25 banks and saving banks, is hardly in a position to carry-out as many in-depth analyses as it would be desirable and to play a truly pro-active role in supervision. Notwithstanding, on-site examiners also play a role in off-site supervision as they devote roughly 30 percent of their time and workforce to analysis of data and follow-ups of recommended supervisory actions. The somewhat blurred border between on-site and off-site has some pluses as it allows fluid exchange of information and practices within the division but it could also have some shortcomings as it could hampered the independence and objectivity of on-site examiners.</p> <p>In terms of policies, processes and methodology it appears that BOS has developed efficient tools and provides its examiners and analysts with an well designed and robust methodology of which on-site and off-site officers make an extensive use. The 2 main elements of the supervisory process are the SREP-ICAAP dialog (see principle 6) and the internal RAS/POT methodology.</p> <p>BOS's RAS/POT methodology (a 216 pages document) employs a mix of off-site and on-site supervision to evaluate the current position of individual banks that should be summed up in risk profile of the bank.</p> <p>Supervision is also performed through monitoring, collection and checking bank reports and notices, and (while more occasionally) through meeting with banks on specific topics.</p>
EC2	<p>The supervisor has in place a coherent process for planning and executing on-site and off-site activities. There are policies and processes in place to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives and outputs, and that there is effective coordination and information sharing between the on-site and off-site functions.</p>
Description and findings re EC2	<p>The planning process for on-site activities starts in November and is reiterated in June next year. Basis for planning are results of risk analysis (POT risk matrix, risk profile of the bank), financial analysis, macroeconomic influences and other information about individual banks (including regulatory reportings and reports of external auditors). Off-site relationship officers are involved in the planning process as they represent the link between on and off site supervision. Relationship officers give proposals for next year examinations and risk areas.</p> <p>The cooperation between off site and on site supervision is made fluid by the fact the 2 functions are part of the same division and because on-side examiners are involved in some off-site supervision tasks. However, as mentioned before (see EC1) such an organization has also some potential shortcomings.</p>
EC3	<p>On-site work, conducted either by the supervisor's own staff or through the work of external experts, is used as a tool to:</p>

	<ul style="list-style-type: none"> • provide independent verification that adequate corporate governance (including risk management and internal control systems) exists at individual banks; • determine that information provided by banks is reliable; • obtain additional information on the bank and its related companies needed for the assessment of the condition of the bank, the evaluation of material risks, and the identification of necessary remedial actions and supervisory actions, including enhanced off-site monitoring; and • monitor the bank's follow-up on supervisory concerns.
Description and findings re EC3	<p>On site supervision is performed by the on-site examiners workforce of the BOS. To staff this function the BOS's Banking supervision department recruits 3 to 5 years experienced officers with a University degree in Economics/Finance/Accounting and/or Mathematic/Statistics, coming from banks or auditing firms. It appears that BOS is able to hire high quality people with appropriate profile. The salary issue has been less an issue since the beginning of the crisis. In this juncture turnover seems to be moderate.</p> <p>When performing on-site examination, BOS's examiners assess inherent risks and control environment of individual bank. They make an extensive use of the guidance given by the internal RAS/POT methodology especially of its chapters dealing with Management, Internal Controls and Internal audit.</p> <p>When performing on-site examination, BOS's examiners also review the reliability and correctness of bank's external reports and in case of deficiencies measures (orders, admonishments or recommendations) are taken against the bank. The figures in the reports send by the bank are compared with original documentation and contracts.</p> <p>When performing on site examination, on-site examiners are entitled to ask for additional information and documentation from the bank including some which are not part of reporting requirements. Then the conclusions made by off-site supervision are tested when performing on site review (POT matrix is then revised accordingly).</p> <p>After finalized examination measures (orders, admonishments or recommendations) against the bank can be decided. In this event the bank is given a deadline to implement the required corrective or remedial actions. After due date follow up procedures are taking place when on-site supervisors test if bank has duly corrected the identified deficiencies or weaknesses.</p> <p>Evaluated through a sample of on-site reports made available in English by the BOS for the purpose of the FSAP mission, it appears that on-site reports are high quality reports in which examiners have not only performed formal compliance checks but also provide off-site with an assessment of the quality of the management, the risk culture, the strategy and other qualitative aspects of the bank's management and risks. Furthermore an appropriate emphasis is given to the trend (improvement or deterioration).</p>
EC4	<p>Off-site work is used as a tool to:</p> <ul style="list-style-type: none"> • regularly review and analyze the financial condition of individual banks using prudential reports, statistical returns and other appropriate information, including publicly available information; • follow up on matters requiring further attention, evaluate developing risks and help identify the priorities and scope of further work; and • help determine the priorities and scope of on-site work.

Description and findings re EC4	<p>Off site supervision is performed by ongoing monitoring and systematic examination of regulatory reports send by individual banks. These tasks are performed mainly by the off-site analysts but also by the Systemic analysis department (which performs macro analysis for whole banking sector).</p> <p>Analysts also keeps report of regular correspondence with the bank, collects annual reports, participates on annual meetings with bank management and occasional topical meeting during year, manages open requests to the bank and open measures (informs responsible examiner and collects bank report on open measures), collecting the report from other examiners and institutions. The findings of off-site supervision are used when planning on site examinations in future.</p> <p>Nevertheless the effectiveness of off-site supervision is somewhat hampered by two weaknesses.</p> <p>The first one lies in the shortage of resources that prevents off-site to perform as much in-depth analysis, portfolios reviews and meetings with banks senior managers that it would be desirable.</p> <p>The second lies in the limitations of the credit risk reporting itself (RAZ-1/credit register) which limited granularity and disputable classification criteria does not provides the analysts with an efficient tool for challenging banks' credit assessment and impairment/provision rates (see Principles 7 and 8). However the quality of credit risk reporting is checked at every on site examination and additional effort are put in to increase the quality of reporting by offsite analytics.</p> <p>Moreover it seems that off-site supervision could use more systematically, extensively and then capitalize on internal audit reports and other internal reportings realized by banks' independent function. It could then be for the Supervisor a way to promote enhanced internal reporting and auditing when needed. Last it would be a mean to leverage its limited resources.</p>
EC5	<p>Based on the risk profile of individual banks, the supervisor maintains sufficiently frequent contacts as appropriate with the bank's Board, non-executive directors, Audit Committee and senior and middle management (including heads of individual business units and control functions) to develop an understanding of and assess such matters as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality and risk management systems.</p>
Description and findings re EC5	<p>In addition to on and off-site supervision the relationship officers and analysts have exchanges on a regular basis with banks through meetings and other inquires.</p> <p>The analyst who is in charge for individual bank has regular communication with various bank representatives when inquiring on answers based on off-site supervision. The frequency of conversation is based on the risk profile of individual bank. The contacts with bank management and supervisory board are also maintained by head of supervision department, members of Governing board and Governor.</p> <p>It seems however that the further development of meetings and discussions on ad hoc reportings at the higher management level but also at more operational levels could improve the overall quality and effectiveness of supervision as there is a general need for it to be both more proactive and more intrusive especially in the present crisis juncture.</p>
EC6	<p>On an ongoing basis during on-site and off-site supervisory activities, the supervisor considers the quality of the Board and management.</p>
Description and findings re EC6	<p>The quality of management and supervisory board is evaluated in on-site examination as examiners have to evaluate the involvement of management and supervisory board</p>

	<p>in daily business and risk management process, in accordance with the RAS/POT methodology. During off site supervision the quality of management and supervisory board is assessed through annual and occasional meetings and response to open measures.</p> <p>However as suggested before there it seems that there is some room for developing off-site ongoing evaluation of the quality of the management/risk management through more regular meetings, ad hoc reportings and other exchanges of information.</p>
EC7	<p>The supervisor evaluates the work of the bank's internal audit function, and determines whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk.</p> <p>However BOS does not systematically ask for presentation of banks audit plans neither for the communication of internal audit reports nor for the internal follow-up of audit recommendation while this could be a way of identifying issues and risks precociously. Nevertheless the audit function is reviewed in on-site examinations inside the regular three years cycle.</p>
Description and findings re EC7	<p>According to the internal part of RAS/POT methodology BOS's on-site examiners have to review and evaluate the work done by the bank's internal audit function. In fact they have to deliver an expert opinion on the overall functioning and production of the internal audit function when examining internal controls AND they also have to systematically evaluate the materiality and quality of the bank internal audit's contribution when assessing in individual risk (credit risk, market risk, liquidity risk....).</p> <p>More specifically, supervisors have to evaluate the frequency and scope of internal audits on individual risk, the quality of reports and findings, and the response of other sectors in bank to internal audit findings. Internal audit reports are also included in documentation request prior to on site examination.</p> <p>However BOS does not systematically ask for presentation of banks audit plans neither for the communication of internal audit reports nor for the internal follow-up of audit recommendation while this could be a way of identifying issues and risks precociously.</p>
EC8	<p>The supervisor communicates to the bank the findings of its on- and off-site supervisory analyses by means of written reports or through discussions or meetings with management.</p>
Description and findings re EC8	<p>The findings of on-site examinations are communicated to the bank through the letter to the management and supervisory board when the evaluation of inherent risk and control environment based on RAS methodology are presented. The letter to the management and supervisory board usually contains requests (in the form of orders, admonishments or recommendations, depending on seriousness of examiners' findings) for corrective and remedial actions accompanied by deadlines. The report itself remains an internal document and it is not shared with the audited bank.</p> <p>Evaluation of the bank done by the off-site supervision with some input of the on-site examiners is communicated to the management through SREP/ICAAP process on a yearly basis.</p>
Additional criteria	
AC1	<p>The supervisor meets periodically with senior management and the Board to discuss the results of supervisory examinations and the external audit. The supervisor should also meet separately with the independent Board members, as necessary.</p>

Description and findings re AC1	Meetings with senior management and supervisory board are held at least once a year (in case no on site examination is planned for that year). Regular meetings with management are also held at the beginning of examination and at the closing of examination. In case of extraordinary events or increased risk further meetings with bank management may be arranged. The proportionality is also taken into account and meetings with management of systematically important banks are held on a more regular (in principle quarterly) basis. In special cases or when important deficiencies are discovered the members of supervisory board are invited to meetings with members of Governing board or Governor of BOS.
Assessment of Principle 20	Largely Compliant.
Comments	Supervisory resources have been expanded by 25 percent globally since the last FSAP (2003). Nevertheless the off-site supervision section is still understaffed and despite the quality of its relationship managers and analysts and in spite of the existence of appropriate methodology (RAS/POT methodology and risk matrix) and tools (e.g. SREP-ICAAP analysis) it is not in a position to conduct as many in-depth analyses and monitoring that it would be desirable in a juncture of financial instability. A significant increase in resources would allow the off-site section to developed meetings with the banks both at the higher level and at more operational level. It would also permits to better capitalize on banks' internal audit function production whose reports are not yet systematically used and evaluated. Significant increase of off-site staff, some targeted hiring of on-site resource (which presently is short of IT and OR experts), and better leveraging of internal controls and audits would result in a more proactive, more intrusive, more forward looking and hopefully more efficient banking supervision.
Principle 21	Supervisory reporting. Supervisors must have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on both a solo and a consolidated basis, and a means of independent verification of these reports, through either on-site examinations or use of external experts.
Essential criteria	
EC1	The supervisor has the power to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, at regular intervals. These reports provide information on such matters as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, asset concentrations (including by economic sector, geography and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk and market risk.
Description and findings re EC1	<p>Article 223, 234 and 129 of the Banking Act provide BOS with the authority to require banks to furnish on a regular basis information and documentation related to the financial condition of the bank. These articles empower BOS to monitor, collect and verify reports submitted to the supervisors for supervisory purposes in sufficient detail and in accordance with the frequency and method of reporting prescribed by BOS.</p> <p>Most information is furnished on both a solo and consolidated basis, but certain information is furnished only on a solo basis. For example, financial statements, information relative to capital and capital requirements, data on large exposures and data on a bank's investments in qualifying holdings in the non-financial sector is filed both on a solo basis and in aggregate, but liquidity data and credit quality information</p>

	<p>are filed only on a solo basis. Subsidiaries of banks, such as non-bank financial subsidiaries do not file such information on a stand-alone basis.</p> <p>Banks file a set of eight regulatory reports with BOS. The reports provide data on the balance sheet and operating performance, liquidity, credit exposure and credit quality, and capital adequacy. However, data is not collected formally through the regulatory reporting process on related party interests, or interest and market risk. While there is no report that directly collects data on asset concentrations, the data submitted can be manipulated through the automation process to collect that information. There is some data collected on the large exposure report relative to related party interests, but it is incomplete, as it does not collect information on business interests of the related parties. Data is collected on interest rate risk in the banking from returns filed with the Financial Statistics Department. This data can be manipulated for supervisory purposes.</p> <p>All banks file the same set of reports. Depending upon the report, submission requirements are either daily, monthly quarterly or annually.</p>
EC2	The supervisor provides report instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally.
Description and findings re EC2	<p>The Regulation on the Books of Account and Annual Reports of Banks and Savings Banks provides detailed mapping instructions relative to the completion of the regulatory reports, especially the balance sheet and income statement. Separate regulations provide instructions for credit quality, liquidity and capital adequacy filings. Banks are required to have the same chart of accounts internally in accordance with these regulations, which facilitates mapping of accounts to line items on the returns.</p> <p>The accounting standards employed by banks in the filing of regulatory reports, annual reports to shareholders and for internal accounting purposes is IFRS, a standard that was adopted by banks in Slovenia in 2006. Both the Companies Act (Chapter 8) and the Banking Act (Article 203) require banks to file reports and maintain their books and records in accordance with IFRS.</p>
EC3	The supervisor requires banks to utilize valuation rules that are consistent, realistic and prudent, taking account of current values where relevant.
Description and findings re EC3	Banks are required to account for assets employing fair value accounting and other valuation rules when IFRS requires it. In accordance with the Banking Act (Article 204), in addition to a sound internal control environment, skilled management and adequate policies and procedures, a bank must be able to account for such assets or other instruments on a fair value basis or other valuation methodologies as required by IFRS.
EC4	The supervisor collects and analyses information from banks at a frequency (e.g., monthly, quarterly and annually) commensurate with the nature of the information requested, and the size, activities and risk profile of the individual bank.
Description and findings re EC4	BOS is empowered to collect supervisory information from banks in accordance with Articles 223 and 129 of the Banking Act. More granularly, the Banking Act requires banks to file data on specific risks, such as liquidity, capital adequacy and large exposures and interest rate risk. Specific regulations complementing the provisions of the Banking Act stipulate the frequency and manner of reporting.

	On an <i>ad hoc</i> basis, and separately from the regulatory returns structure, and in connection with BOS's supervisory strategy, a bank may be required to file periodic reports relative to supervisory issues until such time that the supervisor is satisfied that the issue is resolved. The explicit authority to require such information is granted in Article 234 of the Banking Act.
EC5	In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).
Description and findings re EC5	All banks must file the same set of regulatory reports both on a solo and consolidated basis. The information submitted is manipulated for statistical purposes on an automated platform to facilitate analysis of the data for individual banks or holistically. The data is used, <i>inter alia</i> , in trend analysis, peer group analysis, special studies and in BOS's stress testing program. The stress testing program is conducted annually on both a micro- and macro-level. The supervisors conduct the stress tests on individual banks, and the Financial Stability Department conducts an industry-wide test.
EC6	The supervisor has the power to request and receive any relevant information from banks, as well as any of their related companies, irrespective of their activities, where the supervisor believes that it is material to the financial situation of the bank or banking group, or to the assessment of the risks of the bank or banking group. This includes internal management information.
Description and findings re EC6	Article 217 of the Banking Act empowers BOS to collect data from or examine companies that have an equity interest in the bank, is closely linked or affiliated, or performs services for the bank in an outsourcing capacity. In practice such activities rarely occur, and no data is collected from these entities routinely.
EC7	The supervisor has the power of full access to all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank's Board, management and staff, when required.
Description and findings re EC7	The supervisor is granted access to all banking data and documents at both the bank and in subsidiaries, affiliates, qualifying holders and vendors who are engaged in outsourcing arrangements for a bank. Members of the management board and all employees are subject to "full disclosure" in this regard as well. As a result, virtually any type of bank information is covered, including minutes of board meetings and committees thereof and customer accounts. Automated data, the books of account and administrative and business documentation all are covered in the law. The governing statute is Article 237 of the Banking Act.
EC8	The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines that the appropriate level of senior management is responsible for the accuracy of supervisory returns, can impose penalties for misreporting and persistent errors, and can require that inaccurate information be amended.
Description and findings re EC8	Sanctions or penalties against a bank failing to file regulatory returns accurately and in a timely manner typically occur in several stages. Failing to do so is considered a violation of the law and a bank typically would be issued an enforcement action that would require management to resolve the problem in a manner satisfactory to BOS.

	<p>In the event the issue is not resolved, the supervisory strategy escalates, first with more stringent enforcement actions and ultimately the levying of a fine or other monetary penalty as described in Chapter 14 of the Banking Act. In extreme cases, if the bank consistently misreports and does not improve its internal systems, it may be considered grounds for withdrawing the bank's license to offer banking services.</p> <p>There have been many penalties against banks in the last year for incomplete reporting or reporting of poor quality, especially on credit exposure and classification of clients and on data regarding collateral. Banks were provided corrective measures to improve the quality of reporting this data.</p>
EC9	The supervisor utilizes policies and processes to confirm the validity and integrity of supervisory information. This includes a program for the periodic verification of supervisory returns by means either of the supervisor's own staff or of external experts.
Description and findings re EC9	The filing of all returns is automated, and the automated platform possesses a series of logical and other checking mechanisms to verify the accuracy of the data, both prior to and after the data is manipulated for supervisory purposes. In the event a bank changes its own automated system, the bank must submit the documentation to BOS showing the complete specification for operations of the accounting system. On that basis, supervisors can determine whether the specifications would ensure that data is filed in accordance with regulatory instructions and would follow the mapping system to ensure that all line items are mapped accurately to the appropriate account. The regulatory return process, including the computer solutions and controls, may be reviewed during on-site examinations.
EC10	The supervisor clearly defines and documents the roles and responsibilities of external experts, including the scope of the work, when they are appointed to conduct supervisory tasks and monitors the quality of the work. External experts may be utilized for routine validation or to examine specific aspects of banks' operations.
Description and findings re EC10	BOS may retain the services of external experts, usually certified auditors, to conduct forensic reviews, conduct special audits or for similar purposes. These services are authorized under Article 235 of the Banking Act. The most frequent occurrence would be in connection with the results of an on-site examination, and would complement the findings of the examination. External auditors are authorized to have free access to bank information in the event of such reviews or analyses, and since they are sanctioned by BOS, the remuneration for the auditors would be paid by the supervisors. The use of external experts is rare.
EC11	The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.
Description and findings re EC11	Whether it is in connection with an outsourced event or routine audit work, an auditing firm is required to inform BOS of the results of such undertakings, irrespective of whether there are material shortcomings. In particular, however, auditors are required to inform the supervisors of breaches in internal controls or risk management processes, violations of the law, adverse financial events, or circumstances that would result in a qualified auditor's opinion.
Assessment of Principle 21	Largely Compliant

Comments	BOS receives an abundance of information from banks that the supervisors utilize in ongoing supervision, including in the risk assessment process, off-site evaluations, planning of on-site examinations, and for the stress testing program. However, the level of information collected should be expanded. More complete data on related party transactions should be required. In particular, information on exposure to the business interests of related parties is warranted. To improve the level of consolidated supervision, data on non-bank financial companies should be collected from banks on a solo basis and consideration should be given to receiving information on affiliated companies.
Principle 22	Accounting and disclosure. Supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with accounting policies and practices that are widely accepted internationally, and publishes, on a regular basis, information that fairly reflects its financial condition and profitability.
Essential criteria	
EC1	The supervisor has the power to hold bank management and the bank's Board responsible for ensuring that financial record-keeping systems and the data they produce are reliable.
Description and findings re EC1	<p>BOS is responsible for establishing rules that require banks to maintain financial record-keeping systems and reliable data. The rules required by banks in this regard are contained in Chapter 5 of the Banking Act, and address the chart of accounts, the contents of accounting and management reports, the accuracy and timeliness of monthly regulatory reports on financial information and disclosure of additional information that enables the public to determine the risk profile of the bank (Pillar III disclosure). They also address the quality of data relative to specific risk areas such as credit, market, operations and interest rate risk and of risk management more broadly. The requirements stipulated in the Banking Act are complemented by a series of implementing regulations.</p> <p>The Banking Act also clearly establishes the responsibility of the management board and the supervisory board to provide qualitative and quantitative information that fairly reflects the bank's financial condition, and that controls and systems have been established to ensure the reliability and completeness of information. A cross-section of Articles in the Banking Act governs this requirement. Most prominently, Articles 66 and 74 explain the responsibilities of these executive bodies in a broad sense, tying together responsibilities in this regard contained in other provisions of the Banking Act. They also stipulate the requirement that the bank's annual reports and other financial reports must be verified in connection with their presentation to shareholders, and that an assessment of the bank's internal audit work and management performance relative to financial reports also must be presented to the shareholders.</p> <p>As corporate bodies, banks are required by the Companies Act to maintain records in accordance with appropriate accounting standards – IFRS in Slovenia – and that consolidated annual reports must provide a true and honest presentation of the financial position of the companies included in the consolidated statements. The statements must be audited in accordance with the Auditing Act.</p>
EC2	The supervisor has the power to hold bank management and the bank's Board responsible for ensuring that the financial statements issued annually to the public receive proper external verification and bear an external auditor's opinion.

Description and findings re EC2	By law banks are required to have their financial statements audited by an external auditing firm. As a corporation, in accordance with the Companies Act. The external auditor is expected to render an opinion on the bank's financial statements subsequent to the audit. The audit must be conducted in accordance with standards defined by the International Standards on Auditing. Auditors are expected to prepare an analysis of the bank's internal control environment and risk management processes for BOS at completion of the audit.
	The supervisor requires banks to utilize valuation rules that are consistent, realistic and prudent, taking account of current values where relevant, and to show profits net of appropriate provisions.
Description and findings re EC3	Banks are required to prepare all relevant supervisory reports and financial statements disclosed to the public in accordance with IFRS and have been provided guidance through the issuance of the Regulation on the Books of Account and Annual Reports of Banks and Savings Banks and the Regulation on the Assessment of Credit Risk Losses of Banks and Savings Banks. Provisions and other valuation rules related to fair value accounting must be made in accordance with IFRS.
EC4	Laws or regulations set, or the supervisor has the power, in appropriate circumstances, to establish, the scope of external audits of individual banks and the standards to be followed in performing such audits.
Description and findings re EC4	BOS has the option to determine the scope of an audit or to request auditors to investigate aspects of a bank's operations as deemed necessary in accordance with Article 204 of the Banking Act. On an ad hoc basis, BOS may require the auditing firm to perform a review of a specific issue or include an activity or area of risk in the audit scope. Such a requirement is rare. More broadly, Article 211 requires the auditing firm that performed the audit to submit an evaluation of a bank's internal control environment and risk management practices as a complement to the audited report. The report is filed with BOS and serves as a basis for on-site work or elements of a supervisory strategy by the supervisors, and for follow-up work in subsequent audits by the external auditors.
EC5	Supervisory guidelines or local auditing standards determine that audits cover such areas as the loan portfolio, loan loss reserves, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, and the adequacy of internal controls over financial reporting.
Description and findings re EC5	A combination of auditing standards and the legal framework ensure that there is adequate audit coverage relative to the risks in an institution. The Banking Act is explicit about certain types of activities and risks that are covered in this connection, including risk management rules and activities relative to major banking risks, such as credit risk and liquidity risk, together with trading book positions and securitized transactions. In practice, auditors devote a significant amount of time on audits to the assessment of credit risk and credit risk management.
EC6	The supervisor has the power to reject and rescind the appointment of an external auditor that is deemed to have inadequate expertise or independence, or not to be subject to or not to follow established professional standards.
Description and findings re EC6	BOS does not have the authority by law to reject the appointment of a bank's external auditor. However, it does require that a bank be audited by a certified auditor. The professional standard for a certified auditor is high and is established in the Auditing Act. The Act sets standards of independence, educational qualifications, expertise and

	<p>professionalism in the auditing profession in accordance with international best practice.</p> <p>The Agency for Public Oversight of Audit is the regulatory body, by virtue of the Auditing Act, that sets local accounting standards and rules, and defines the professional standards for a certified auditor prepared by the Slovenian Institute of Auditors. The Agency also investigates complaints. The Slovenian Institute of Auditors licenses certified auditors and conducts examinations to ensure they maintain the desired level of expertise and professionalism. It is responsible for training and continuing education.</p> <p>The influence of BOS in the appointment of external auditors is otherwise indirect and occurs through the supervisory process. In the event the supervisors are dissatisfied with the quality of the audit report or the audit work, it may require the bank to retain another auditing firm to repeat the audit at the bank's expense; or it may have the firm revise the audit report based on an adjusted audit program or audit procedures. Article 211 of the Banking Act is the authorizing legislation.</p>
EC7	The supervisor requires banks to produce annual audited financial statements based on accounting principles and rules that are widely accepted internationally and have been audited in accordance with internationally accepted auditing practices and standards.
Description and findings re EC7	The audited financial statements that are produced annually by banks are subject to the Companies Act and the Auditing Act, which require that such reports be published on a solo and consolidated basis in accordance with IFRS by certified auditors. Auditors in Slovenia are certified in accordance with international best practice standards. Moreover, the financial statements are reported in accordance with the system of reporting established by FINREP as required by the CEBS/EBA.
EC8	Laws, regulations or the supervisor require periodic public disclosures of information by banks that adequately reflect the bank's true financial condition. The requirements imposed should promote the comparability, relevance, reliability and timeliness of the information disclosed.
Description and findings re EC8	<p>BOS requires detailed disclosures to the public by listed banks in annual and quarterly financial statements, and in the management review (business report), the supervisory board's report, and statements or opinions from the directors, management or the external auditor. The governing legislation is Articles 204 and 213 of the Banking Act, the Regulation on the Books of Account and Annual Reports of Banks and Savings Banks, and the Regulation on Disclosures by Banks and Savings Banks. This legislation includes all compulsory disclosures required under relevant accounting standards and disclosure of other material detail. Guidance and instructions are modeled after disclosure requirements in IFRS and in Pillar 3 of Basel II, and are contained in the regulation.</p> <p>The annual report, together with the audited financial statements, has to be posted to each bank's website and submitted to the Agency of the Republic of Slovenia for Public Legal Records and Related Services for its publication. Banks have some discretion relative to the information posted relative to the Pillar 3 disclosures.</p>
EC9	The required disclosures include both qualitative and quantitative information on a bank's financial performance, financial position, risk management strategies and practices, risk exposures, transactions with related parties, accounting policies, and

	basic business, management and governance. The scope and content of information provided and the level of disaggregation and detail should be commensurate with the size and complexity of a bank's operations.
Description and findings re EC9	There is an extensive array of information that must be disclosed in accordance with the requirements of the legal framework. For example, banks are required to disclose significant accounting policies and their affect on the financial statements, and other relevant information required by the Companies Act, the Banking Act, the Regulation on the Books of Account and Annual Reports of Banks and Savings Banks, the Regulation on Disclosure by Banks and Savings Banks and IFRS disclosure requirements. Quantitative and qualitative requirements include financial performance and position, risk management strategies and practices, credit risk exposures, transactions with related parties, and a description of the bank's business, organizational and management structure, and senior management and board of directors.
EC10	Laws, regulations or the supervisor provide effective review and enforcement mechanisms designed to confirm compliance with disclosure standards.
Description and findings re EC10	<p>As a matter of policy, BOS reviews each bank's annual reports and their disclosures under Pillar 3 for compliance with disclosure requirements stipulated in the law. Of particular interest is general information relating to the policy and objectives of the risk management framework and the entities included in the disclosures; the amount of detail provided regarding exposures to specific risks, and the bank's approach to calculating capital requirements for credit market and operations risk.</p> <p>Article 392 of the Banking Act authorizes BOS to impose penalties for violations of the disclosure rules. Inadequate disclosure of audited financial statements and annual reports as covered by the Companies Act and the disclosures covered under the Pillar 3 disclosures are explicitly listed as examples where fines would be applied.</p> <p>A bank's management and supervisory board also are held responsible for compliance with the rules on disclosure. Their liability extends to possible dismissal, or actual damages for inappropriate due diligence.</p>
EC11	The supervisor or other relevant bodies publish aggregate information on the banking system to facilitate public understanding of the banking system and the exercise of market discipline. Such information includes aggregate data on balance sheet indicators and statistical parameters that reflect the principal aspects of banks' operations (balance sheet structure, capital ratios, income earning capacity, and risk profiles).
Description and findings re EC11	BOS publishes a range of monetary and financial statistics and aggregated data regarding the banking system. These are published regularly in the <i>Monthly Bulletin</i> , the <i>Financial Stability Review</i> and the <i>Banking Stability Review</i> . Risks facing the banking sector, commentary on the financial condition of the industry and the challenges facing the industry are frequent areas of discussion or analysis. The goal of these disclosures is to facilitate public understanding of the banking system and for market discipline.
Additional criteria	
AC1	The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.

Description and findings re AC1	Banking supervisors and the audit industry maintain a dialogue, but most of the contacts are with the auditing firms that are responsible for auditing the banks in Slovenia. Contact with these auditing firms on a formal basis typically occurs annually when the supervisors and auditors exchange information on broad areas of interest, including trends in the banking industry and new banking legislation, requirements that would affect the manner in which audits are conducted or significant changes in accounting treatment of a class of assets. Contact with individual auditing firms typically is in connection with their audit work at the banks, but meetings at the conclusion of audits are not routinely held because BOS receives both the audit report and the accompanying management letter, and a separate analysis of the bank's internal control environment and risk management practices (i.e., the additional auditor's report on compliance with the bank's risk management rules) in accordance with regulations.
AC2	External auditors, whether or not utilized by the supervisor for supervisory purposes, have the duty to report to the supervisor matters of material significance, for example failure to comply with the licensing criteria or breaches of banking or other laws, or other matters which they believe are likely to be of material significance to the functions of the supervisor. Laws or regulations ensure that auditors who make any such reports in good faith cannot be held liable for breach of a duty of confidentiality.
Description and findings re AC2	Auditors are required by regulation to contact the supervisor in connection with a material issue identified during the audit that would adversely affect the financial condition of the bank or represent a serious breach of the legal framework or the licensing criteria. The Auditing Act preserves the capacity for the auditors to divulge such information without liability.
AC3	Laws, regulations or the supervisor require banks to rotate their external auditors (either the firm or individuals within the firm) from time to time.
Description and findings re AC3	The Auditing Act stipulates that the engagement partner who is in charge of an audit must be rotated after seven year, but may rotate back to his/her previous position two years later. There is no requirement to rotate audit firms.
AC4	The supervisor requires banks to have a formal disclosure policy.
Description and findings re AC4	Article 207 of the Banking Act requires banks to develop a clear policy for meeting disclosure requirements. These policies must be assessed for the appropriateness of their contents and the frequency of the disclosure on a periodic basis. The supervisors review the policy statements governing disclosure by the banks.
AC5	The supervisor has the power to access external auditors' working papers where necessary.
Description and findings re AC5	Under Article 212 of the Banking Act, auditors must provide to BOS at its request information required to facilitate the supervision of a bank. There is no limitation on the type of information. Working papers are included.
Assessment of Principle 22	Compliant
Comments	Notwithstanding the high standards of professionalism and expertise established by the Slovenian Institute of Auditors, it is recommended that BOS obtain the power to reject the appointment of an auditor by a bank. With this power, the supervisor can ensure that all banks select auditors of the highest quality that have been licensed by the Agency, would not be compromised by conflicts of interest, or would be objectionable for other reasons.

	<p>The authorities should consider requiring banks to rotate external auditing firms periodically. Practically speaking, the rotation of external auditors may result in an expansion of acceptable auditing firms, thus creating some added competition.</p> <p>On a routine basis, the supervisors should consider conducting a meeting with the external auditor subsequent to the conclusion of an audit. Such a meeting would be a good opportunity to discuss more granularly the external auditor's assessment of the risk management system of the bank.</p>
Principle 23	Corrective and remedial powers of supervisors. Supervisors must have at their disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability, where appropriate, to revoke the banking license or to recommend its revocation.
Essential criteria	
EC1	The supervisor raises supervisory concerns with management or, where appropriate, the Board, at an early stage, and requires that these concerns are addressed in a timely manner. Where the supervisor requires the bank to take significant remedial actions, these are addressed in a written document to the Board. The supervisor requires the bank to submit regular written progress reports and checks that remedial actions are completed satisfactorily.
Description and findings re EC1	<p>Under normal supervisory practice, supervisors have frequent contact with a bank and take the opportunity to inform management of identified weaknesses or criticisms and expect them to respond indicating the manner in which corrective measures have been taken. The on-site examination process is one such level of contact, but not the only one. The results of examinations are presented to a bank's supervisory and management boards, and a formal response is required describing the actions instituted by the bank to resolve the supervisory issues. Depending on the level, nature and volume of issues, the bank is required to submit progress reports until such time as the supervisor is satisfied that appropriate action has been taken and the issues are resolved. Frequently, such supervisory actions will take the form of an enforcement action, such as a Recommendation or Admonishment, or more stringent actions carrying the force of law for more severe problems or those that have not been resolved satisfactorily.</p> <p>Through the off-site evaluation process, a similar strategy is pursued. Meetings are held with appropriate levels of senior management, and if warranted, an enforcement action is developed prescribing the areas that need to be addressed by the bank, and progress reports are filed so that the supervisors can monitor the bank's progress.</p> <p>Under the SREP/ICAAP process, the supervisor has an opportunity to analyze and gauge the quality of risk management programs, management processes, corporate governance and capital adequacy of a bank. The results of these evaluations are reported to the institution and form the basis for an ongoing dialogue about these issues. A formal meeting is held annually with the management and supervisory boards to discuss the results of these evaluations, and identified weaknesses are expected to be resolved, with the supervisors employing their normal supervisory practices. Remedial powers may be employed under this program as well.</p>

	<p>Remedial actions are prescribed commensurate with the severity of deficiencies. Under certain circumstances, the supervisor may require the bank's internal auditor to monitor progress as well. In practice, the supervisors typically pursue informal supervisory actions, which have been effective in resolving safety and soundness issues; these supervisory actions are grounded in the least formal of the enforcement tools available to the supervisors. These practices take the form of meetings with management, monitoring programs that include progress reports and other strategies of this nature. A Recommendation frequently is used for such supervisory strategies.</p> <p>Articles 242 – 244 of the Banking Act enable BOS to take prescriptive actions against banks with safety and soundness concerns. Other provisions of the law describe the various types of enforcement tools available to the supervisors. There are in aggregate four such tools that can be applied if the supervisor elects to pursue formal supervisor actions. Their use depends upon the severity of the supervisory issues, and they range from the Recommendation to the Order with Additional Measures.</p>
EC2	The supervisor participates in deciding when and how to affect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).
Description and findings re EC2	<p>A bank exhibiting weak risk management practices that have not been resolved through one of the enforcement tools, and whose financial condition is deteriorating may be placed under Special Administration by BOS. Among other factors that would be considered in determining the bank's overall financial condition, BOS would determine that the bank is undercapitalized and that its shareholders may not contribute additional capital.</p> <p>Chapter 7.7 empowers BOS to appoint a Special Administrator. The Administrator is required to manage the bank in accordance with directions received from BOS, and his status is that of an executive officer of the bank. In consultation with BOS, his principal responsibility is to manage the bank's routine operations while identifying prospective purchasers of the institution. The purchasers may be members of the existing shareholder body, in the event they decide to contribute the required capital, or third party purchasers. The structure of such a purchase, such as a purchase and assumption transaction, establishment of a bridge bank or other resolution programs is not identified in the law and these programs would have to be enacted prior to their use.</p> <p>Special Administration status may last one year. In the event a buyer is not identified, the bank may be liquidated or declared bankrupt. Chapter 7.8 empowers BOS to appoint a liquidator. Chapter 9 defines the process under which bankruptcy may proceed. BOS may appoint a liquidator in the event the Special Administrator has been unsuccessful in selling the bank or otherwise restoring its capital to a satisfactory level. Under certain circumstances, the bank may still have capital although it may be undercapitalized, and may even be operating profitably. At least in theory, BOS has the power to liquidate a going concern. Bankruptcy may be declared by BOS when the bank actually is operating without capital, at which time the bank's depositors would be paid off under the deposit guarantee scheme.</p>
EC3	The supervisor has available an appropriate range of supervisory tools for use when, in the supervisor's judgment, a bank is not complying with laws, regulations or supervisory decisions, or is engaged in unsafe or unsound practices, or when the

	interests of depositors are otherwise threatened. These tools include the ability to require a bank to take prompt remedial action and to impose penalties. In practice, the range of tools is applied in accordance with the gravity of a situation.
Description and findings re EC3	BOS employs a range of tools in its supervisory strategy relative to the supervisory issues identified in a bank. These range from informal actions to those with the force of law for more severe problems or recalcitrant institutions. There are four such enforcement tools in Slovenian banking law. The lowest form of action typically is employed for more routine problems, many of which may be detected during an examination. The two more severe enforcement tools have the force of law and address recurring issues, deteriorating capital adequacy, poor risk management practices or other problems of a serious nature.
EC4	The supervisor has available a broad range of possible measures to address such scenarios as described in EC 3 above and provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from banking, replacing or restricting the powers of managers, Board directors or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, and revoking or recommending the revocation of the banking license.
Description and findings re EC4	Particularly in cases when enforcement tools carrying the force of law are applied, the supervisor may restrict the activities of a bank or employ a wide range of other options. These include a requirement to discontinue certain banking services such as the granting of new loans, or concluding transactions with shareholders or members of the management and supervisory board; transactions with affiliates or other "closely linked" entities also may be prohibited or restricted such that the bank effectively can be ring-fenced. Such transactions as the payment of dividends thus can be terminated. The provisions of the law also enable BOS to remove members of the management board.
EC5	The supervisor has the power to take measures should a bank fall below the minimum capital ratio, and seeks to intervene at an early stage to prevent capital from falling below the minimum. The supervisor has a range of options to address such scenarios.
Description and findings re EC5	Article 136 of the Banking Act establishes the minimum amount of capital required by a bank. In accordance with Article 248 of the Act, BOS may require a bank to have capital above the required minimum in the event the supervisors deem the bank's risk management systems and internal capital assessment to be less than satisfactory. From a more forward-looking perspective, the supervisors may require a bank to raise additional capital as a result of its ongoing assessment. In the event the supervisors deem risk management practices or the internal capital assessment inadequate, BOS may require the bank to raise additional capital even if its capital ratios are above the minimum prescribed by law or regulation. In practice, the supervisors have been content to monitor improvements in risk management practices that would alleviate the pressure on the capital base.
EC6	The supervisor applies penalties and sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.
Description and findings re EC6	BOS can impose penalties directly on a bank and to members of the supervisory and management boards. Such penalties are described in Article 392 of the Banking Act. The duties and responsibilities of the members of the supervisory board and management board are described in Articles 74 and 66 of the Banking Act. Breaches

	<p>of their duties and responsibilities can result in the fines described in the Act. Other provisions of the law provide sanctions that can be imposed against management for inadequate risk management practices, inadequate capital and other supervisory issues. Ultimately, the license for a member of the management board can be revoked if performance is deemed unsatisfactory by BOS or for other reasons.</p> <p>No such sanctions appear in the law relative to the performance of a member of the supervisory board although administrative fines may be applied. That is because BOS does not have the power to license a member of the supervisory board.</p>
Additional criteria	
AC1	Laws or regulations guard against the supervisor unduly delaying appropriate corrective actions.
Description and findings re AC1	<p>There are no specific laws or internal processes that provide time lines under which a prospective corrective action must be approved by BOS authorities and imposed on the bank. As a practical matter, the authorities strive to have the process completed in one month subsequent to the conclusion of an on-site examination, provided the action stems from examination results.</p> <p>A bank must be officially informed by BOS when the actions taken to resolve issues contained in an enforcement action have been completed in a satisfactory manner. The bank must be informed within two months after the supervisors have deemed the issues to have been resolved.</p>
AC2	The supervisor has the power to take remedial actions, including ring-fencing of the bank from the actions of parent companies, subsidiaries, parallel-owned banking structures and other related companies in matters that could impair the safety and soundness of the bank.
Description and findings re AC2	A provision under Article 248 of the Banking Act prohibits a bank from engaging in transactions with shareholders, members of the management or supervisory boards, or closely linked entities as part of an enforcement action. Closely linked has been defined in the law as affiliated companies or other related parties. This provision of the law can be used to develop a ring-fencing mechanism to protect a bank from abuse from affiliates or other closely related parties.
AC3	When taking formal remedial action in relation to a bank, the supervisor ensures that the regulators of non-bank related financial entities are aware of its actions and, where appropriate, coordinates its actions with them.
Description and findings re AC3	The supervisors of the insurance industry and the securities market are informed of remedial actions imposed on a bank and where coordination of such efforts is necessary. These relationships are governed by the cooperative agreements to which each of these parties are signatories.
Assessment of Principle 23	Largely compliant
Comments	BOS's capacity to employ appropriate corrective or remedial actions is strong, but with respect to capital adequacy issues, the supervisors do not act aggressively to move to require banks to increase capital. This may partly due to current economic conditions, but also is reflective of the supervisors determination to improve risk management practices

	<p>With the exception of fines prescribed in the law for breach of duty, there is no power in the legal framework to remove a supervisory board member easily for incompetence or lack of good faith. The board member cannot have his license revoked because BOS does not have the authority to license him in the first place. Consideration should be given to amending the Banking Act to enable BOS to have greater powers relative to this issue. At a minimum, the supervisor should have the authority to remove a supervisory board member for the same or similar reasons upon which a management board member can be removed. To do so, the Bank should be authorized to license members of the supervisory board.</p> <p>The existing resolution framework for a bank in a deteriorating financial condition should be revised. BOS needs an effective set of bank resolution tools.</p>
Principle 24	Consolidated supervision. An essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential norms to all aspects of the business conducted by the group worldwide.
Essential criteria	
EC1	The supervisor is familiar with the overall structure of banking groups and has an understanding of the activities of all material parts of these groups, domestic and cross-border.
Description and findings re EC1	<p>Slovenia's banking system is dominated by the two large Government controlled banking institutions, and they are conglomerates in the sense that they consist of a combination of one or more banking institutions combined with an array of non-bank financial institutions, some of which are located in Slovenia, and some of which are located in foreign jurisdictions, principally in the Balkans. The majority of the Slovenian system activity in these foreign jurisdictions is operated through subsidiary banks. To gain an understanding of the organizational and ownership structure, and the nature and types of activities in which the components of these banking institutions engage, BOS is authorized by regulation to collect information on the structure and nature of their activities on a semi-annual basis. The information is used to determine which entities in the group should be subject to consolidated supervision. The data collected requires the bank to report on the manner in which the ownership interest in a subsidiary is structured as well, so that the supervisor can determine whether a particular entity is owned directly or indirectly.</p> <p>All banking groups located in Slovenia are required to file the structure report, and the report must be filed <i>ad hoc</i> in the event of a material change in the structure of the organization, such as an acquisition.</p> <p>The report also requires banking groups to provide other types of information. For example, the banking groups must provide the list of the members of the management and supervisory boards of each subsidiary, information on the supervisor of the institution if located in another country, and the nature and volume of intercompany transactions with other entities in the group. The Regulation on the Supervision of Banks and Savings Banks on a Consolidated Basis provides BOS with the authority to collect this information.</p>

EC2	The supervisor has the power to review the overall activities of a banking group, both domestic and cross-border. The supervisor has the power to supervise the foreign activities of banks incorporated within its jurisdiction.
Description and findings re EC2	<p>Chapter 7.9.3 of the Banking Act requires BOS to supervise financial institutions under its supervisory jurisdiction whenever the institution serves either as a parent bank or is a subsidiary of banking group or financial holding company in Slovenia or the EU. There are certain other situations in which an institution may be subject to consolidated supervision, such as in the event BOS assumes the role of consolidated supervisor upon agreement with the EU. However, at present all institutions supervised on a consolidated basis are either parent organizations or subsidiary banks as defined in the Banking Act. This Chapter of the Banking Act also stipulates certain responsibilities the BOS has in connection with its supervision of an organization on a consolidated basis. For example, BOS's role as a coordinator of a supervisory college is outlined in the law.</p> <p>BOS also is empowered to supervise the activities of foreign banks operating in Slovenia. For banks whose home country supervisor is located in a third country, their prospective activities must be licensed prior to establishing operations. Banks located in EU-Member States must notify BOS prior to opening a branch or other operating entity.</p> <p>Various provisions of the Banking Act grant BOS the power to examine the Slovenian operations of foreign banks on-site, and they are required to file regulatory returns in a manner similar to Slovenian banks. They are subject to corrective or remedial actions as well.</p>
EC3	The supervisor has a supervisory framework that evaluates the risks that non-banking activities conducted by a bank or banking group may pose to the bank or banking group.
Description and findings re EC3	<p>BOS possesses the supervisory framework to evaluate the risks posed by non-banking subsidiaries, but it is not fully utilized because most of these activities are perceived to be immaterial and have an insignificant impact on the banking group.</p> <p>BOS collects information that enables it to determine the nature of the activities and banking products offered by the non-bank financial subsidiaries, and they are subject to on-site examinations. However, they are not required to file regulatory returns on a solo basis, nor are they subject to an evaluation of their risk management practices or adequacy of their capital on a solo basis through the ICAAP/SREP process. Information on the nature and volume of intercompany transactions is not normally reviewed. As a result, the supervisor is unable to determine whether the banking group has allocated sufficient capital at the subsidiary level relative to the risks that it has undertaken, nor is the supervisor aware on an ongoing basis of the level of risk in these subsidiaries.</p>
EC4	The supervisor has the power to impose prudential standards on a consolidated basis for the banking group. The supervisor uses its power to establish prudential standards on a consolidated basis to cover such areas as capital adequacy, large exposures, exposures to related parties and lending limits. The supervisor collects consolidated financial information for each banking group.

Description and findings re EC4	<p>Several Articles in the Banking Act empower BOS to impose prudential standards on a consolidated basis. Articles 129, 226, 131 and 289 require the establishment of prudential rules on the preparation of consolidated financial statements, a capital adequacy regime, intercompany transactions, large exposures and corporate governance.</p> <p>Chapter 4.2 of the Banking Act establishes requirements for risk management, including appropriate internal controls systems, and the effective identification, measuring and monitoring of various banking risks. These laws are complemented by a set of regulations that expand on the requirements for certain risks, including liquidity, credit and market risk.</p> <p>Of particular importance is the Regulation on Risk Management and Implementation of the Internal Capital Adequacy Assessment Process. In the appendix to the regulation, there is a compendium of risk management standards and practices relative to credit, market, operations, liquidity and interest rate (in the banking book) risk. Banks are required to adapt these standards in accordance with the size and complexity of their operations. While exposures to related parties are not addressed in this regulation, such guidance is contained in a separate regulation.</p> <p>This regulation also contains a set of principles related to the development of remuneration policies for banks so that they are consistent with and promote sound and effective risk management. Toward that end, policy and practice is expected to discourage excess risk taking by employees in an effort to increase their remuneration package.</p>
EC5	The supervisor has arrangements with other relevant supervisors, domestic and cross-border, to receive information on the financial condition and adequacy of risk management and controls of the different entities of the banking group.
Description and findings re EC5	<p>The medium through which BOS obtains information from other financial system supervisors is a series of cooperative arrangements with both foreign and domestic supervisors that govern the exchange of supervisory information. BOS has entered into such agreements with ten European countries. BOS also participates in supervisory colleges with eight European banking supervisors with responsibility for banking conglomerates operating in Slovenia. These are coordinated by the banking supervisors in France, Italy and Austria and are governed by multilateral agreements for each banking group.</p> <p>The overseas operations of Slovenian banks are concentrated principally in the Balkan states, and are operated by the country's two largest banks. BOS has established a supervisory college to supervise each of these institutions, and serves as the coordinator. Through the college, information is exchanged on the financial condition and risk assessment of the bank on a consolidated basis, and for the banking subsidiaries. This undertaking occurs annually at the college meeting and semiannually through a series of reports that the host supervisory authorities submit to BOS describing the results of their own risk assessments. It is supplemented by the results of on-site examinations and intermittent visits to the home country supervisor.</p> <p>In Slovenia, the exchange of supervisory information with other domestic financial supervisory authorities is governed by a series of bilateral agreements similar to the agreements with foreign bank supervisors. As a result of these agreements, the</p>

	<p>supervisors exchange information on examinations and coordinate examination schedules. In addition to BOS, the supervisor of the insurance industry, securities markets and the securities clearing corporation are signatories to these agreements. The level of information exchanged relative to risk management practices is not as robust under these arrangements as it is between foreign bank supervisors.</p>
EC6	<p>The supervisor has the power to limit the range of activities the consolidated group may conduct and the locations in which activities can be conducted; the supervisor uses this power to determine that the activities are properly supervised and that the safety and soundness of the bank are not compromised.</p>
Description and findings re EC6	<p>To operate in a third party country, a Slovenian bank must seek the authorization of BOS. The supervisors may limit the locations in which its banks may operate by applying the "impediment" test, under which BOS determines whether the host country supervisor's supervisory and legal framework is sufficiently transparent so as not to impede the supervision of the entity. No such restrictions exist in EU-Member States and Slovenian banks must only provide BOS with a notification that they intend to establish operations in the EU.</p>
EC7	<p>The supervisor determines that management is maintaining proper oversight of the bank's foreign operations, including branches, joint ventures and subsidiaries. The supervisor also determines that banks' policies and processes ensure that the local management of any cross-border operations has the necessary expertise to manage those operations in a safe and sound manner and in compliance with supervisory and regulatory requirements.</p>
Description and findings re EC7	<p>A principal focus of the review of corporate governance practices, desk surveys of foreign operations and on-site examinations of foreign operations is to evaluate senior management's oversight of its foreign operations. Toward that end, the supervisors gauge the manner in which the bank ensures adherence to established policies and practices, the quality and frequency of information filed at the home office, the frequency and quality of internal audits conducted in these locations, the application of risk management practices and internal control systems relative to banking risks assumed by the entity, visits to the entities by senior management to evaluate performance and discuss strategic issues, and the suitability of management in the foreign entity.</p> <p>To further monitor such foreign operations, banks typically place a member of management on the supervisory board of the banking subsidiary, or in the case of a non-bank financial subsidiary place a home office member of management in the position of Chief Executive Officer. When the incumbent has been a member of the management board of a bank, these officers have been granted a license by BOS, and their suitability has been evaluated.</p> <p>The supervisors also will evaluate the corporate governance issues such as the organizational structure relative to its transparency and clear delegation of responsibility, the budgeting process relative to the overseas operations and business and strategic planning.</p>
EC8	<p>The supervisor determines that oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) includes: (i) information reporting on its foreign operations that is adequate</p>

	<p>in scope and frequency to manage their overall risk profile and is periodically verified; (ii) assessing in an appropriate manner compliance with internal controls; and (iii) ensuring effective local oversight of foreign operations.</p> <p>For the purposes of consolidated risk management and supervision, there should be no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. Transmission of such information is on the understanding that the parent bank itself undertakes to maintain the confidentiality of the data submitted and to make them available only to the parent supervisory authority.</p>
Description and findings re EC8	<p>As a matter of supervisory policy, BOS requires banks with operations in foreign countries to establish sound corporate governance, risk management and internal control systems. To obtain a license in third countries, all of these elements of satisfactory oversight of foreign operations must be met. In reviewing the quality and frequency of information filed with the home office, for example, the supervisors will ascertain the types of information provided. These would include with respect to credit risk, an evaluation of asset quality information, concentrations of credit, collateral positions on the portfolio, the application of loan loss reserves relative to portfolio quality, and performance indicators to evaluate the profitability of lending activities. Depending upon the complexity of the lending portfolio, the information would be subdivided or bifurcated into specialized lending activities to gauge performance of the portfolios.</p> <p>For Slovenian banks operating overseas, the preponderance of risk exposure is retail in nature, so the data is divided by type of consumer loans and other data characteristic of such portfolios in addition to the aggregated data.</p> <p>To evaluate internal control systems, the supervisor relies principally on the results of internal and external audits and on-site examinations performed by the home country supervisor to evaluate the quality of control systems. Stress tests on operating systems are conducted on a consolidated basis, and at the banking subsidiary level, and not at all in the non-bank financial subsidiaries. These banks are not permitted at present to model their operations risk for capital adequacy purposes.</p> <p>Through the supervisory colleges, BOS is able to determine the level of supervision provided by the home country supervisor. BOS receives the results of on-site examinations and the analysis of risk management practices and internal control systems performed by the home country supervisor through the supervisory colleges it administers.</p>
EC9	<p>The home supervisor has the power to require the closing of foreign offices, or to impose limitations on their activities, if:</p> <ul style="list-style-type: none"> • it determines that oversight by the bank and/or supervision by the host supervisor is not adequate relative to the risks the office presents; and/or • it cannot gain access to the information required for the exercise of supervision on a consolidated basis.
Description and findings re EC9	<p>BOS has the authority to close the operations of a foreign office based on powers granted in Article 250 of the Banking Act. However, the closing powers are granted in connection with specific acts of omission or commission and may not fit the situation under which the foreign office is operating. The supervisors may turn to Article 248 of</p>

	<p>the Banking Act as an alternative, which enables BOS to virtually shut down the operations of the entity by revoking its capacity to conduct a banking business.</p> <p>In either case, BOS would affect the winding down of the entity in cooperation with the host country supervisor, under whose jurisdiction and legal framework these operations would close and would be governed by the cooperation agreement. BOS would require the home country to monitor the winding down of the entity to ensure that it is being conducted in a safe and sound manner. Reports would be required that would reflect the progress made in closing the office.</p>
EC10	The supervisor confirms that oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is particularly close when the foreign activities have a higher risk profile or when the operations are conducted in jurisdictions or under supervisory regimes differing fundamentally from those of the bank's home country.
Description and findings re EC10	<p>Based on the evaluation of the banking group through the supervisory college, in the event certain foreign bank operations were considered to have a higher risk profile, BOS would coordinate the supervisory strategy with the home country supervisor to ensure that the degree of monitoring was elevated. The supervisory strategy could include targeted on-site examinations and a requirement to file progress reports with the home country supervisor; with copies to the coordinator until such time as it is determined that the problems have been resolved.</p> <p>At present, there is one such foreign entity that is subject to such a supervisory strategy.</p>
Additional criteria	
AC1	<p>For those countries that allow corporate ownership of banking companies:</p> <ul style="list-style-type: none"> • the supervisor has the power to review the activities of parent companies and of companies affiliated with the parent companies, and uses the power in practice to determine the safety and soundness of the bank; and • the supervisor has the power to establish and enforce fit and proper standards for owners and senior management of parent companies.
Description and findings re AC1	<p>BOS is empowered to review the activities of "mixed-activity" companies in accordance with Article 300 of the Banking Act. In particular the supervisors are authorized to evaluate interparty transactions, risk manage practices, internal control systems and large exposures. BOS can impose remedial action against the company or an affiliate in the event abusive practices are identified, or an entity is engaging in activities that jeopardize the financial condition of the bank. Supervisors are permitted to evaluate the suitability of senior management of affiliated companies in accordance with the Financial Conglomerates Act.</p> <p>In practice, the supervisory activities devoted to affiliated institutions in a mixed activity company are not vigorous. Most supervisory resources are devoted to the supervision of the bank, and banking subsidiaries located in foreign countries; to a lesser degree there are resources devoted to non-bank financial subsidiaries whether located in Slovenia or abroad. To the degree such activities are monitored at all, it is in connection with evaluating the nature and volume of transactions with affiliates or other intercompany transactions.</p>

AC2	The home supervisor assesses the quality of supervision conducted in the countries in which its banks have material operations.
Description and findings re AC2	BOS does not have a formal program under which it assesses the quality of supervision by host country supervisors. It evaluates the quality of their supervision based on their performance and contributions as participants in the supervisory colleges in which it serves as a coordinator.
AC3	The supervisor arranges to visit the foreign locations periodically, the frequency being determined by the size and risk profile of the foreign operation. The supervisor meets the host supervisors during these visits. The supervisor has a policy for assessing whether it needs to conduct on-site examinations of a bank's foreign operations, or require additional reporting, and has the power and resources to take those steps as and when appropriate.
Description and findings re AC3	Such visits by BOS are typically for the purpose of participating in an on-site examination, or as a separate visit to discuss supervisory issues with the host country supervisor. The supervisors normally visit the foreign operations of Slovenian banks during these visits as well. The visits are irregular and occur in connection with BOS's goal to develop a risk profile for the local institution that would be included in the overall risk assessment of the banking group, attend closing meetings subsequent to the conclusion of an examination, or to develop a supervisory strategy for the foreign office.
Assessment of Principle 24	Largely compliant
Comments	<p>While BOS has developed an overall satisfactory program of consolidated supervision, there are aspects of the program that need to be enhanced. In particular the approach to the supervision of non-bank financial companies should be upgraded. Despite their comparatively small size, they represent real risk – particular credit risk -- to the banks that operate them. For example, these entities should be required to file regulatory reports on a solo basis and should be formally incorporated into the SREP process on a consolidated basis such that its assets and risk management practices are evaluated directly. However, because of their size, the authorities could consider a target capital level for each subsidiary rather than a fully vetted ICAAP.</p> <p>The amount of information collected on related parties should be improved, as this information is not collected presently on a consolidated basis. The non-bank financial companies should be included in the collection of data in this regard. The data collected needs to be more extended such that business interests as well as family interests should be collected.</p> <p>Greater attention to relationships in mixed activity companies, particularly with respect to the nature and volume of transactions with affiliates should be considered.</p> <p>The authorities have considered conducting on-site examinations of specific areas or activities across a banking group. The supervisors are commended for undertaking such an activity. It is recommended that such an examination be field-tested and the results discussed with other participants in the supervisory college. These examinations are valuable for a number of reasons, not the least of which is testing consistency of the application of risk management practices with an organization.</p>

Principle 25	Home-host relationships. Cross-border consolidated supervision requires cooperation and information exchange between home supervisors and the various other supervisors involved, primarily host banking supervisors. Banking supervisors must require the local operations of foreign banks to be conducted to the same standards as those required of domestic institutions.
Essential criteria	
EC1	Information to be exchanged by home and host supervisors should be adequate for their respective roles and responsibilities.
Description and findings re EC1	BOS has established arrangements to exchange information with a number of banking supervisory agencies in Europe. The information exchanged relates principally to the on-site and off-site supervisory function. The supervisory agencies inform each other about the results of examinations, the need for supervisory action when considered necessary, the risk profile and risk exposures in the institution, and on other risk management issues. Under these agreements, BOS, as a home country supervisor, provides information on capital evaluation exercises for the Slovenian operations of large institutions in which it participates in supervisory colleges, and on risk management issues on a consolidated basis. The agreements also provide for joint examinations when deemed appropriate. All agreements and information exchanges are in accordance with EBA guidelines.
EC2	For material cross-border operations of its banks, the supervisor identifies all other relevant supervisors and establishes informal or formal arrangements (such as memoranda of understanding) for appropriate information sharing, on a confidential basis, on the financial condition and performance of such operations in the home or host country. Where formal cooperation arrangements are agreed, their existence should be communicated to the banks and banking groups affected.
Description and findings re EC2	<p>Two Slovenian banks have a small network of operations located in foreign countries, principally in the Balkans, necessitating the establishment of home-host relationships. These relationships are governed by formal arrangements, principally in the form of Memoranda of Understanding, which facilitate contact between the regulators as frequently as needed. At present many of these relationships are governed by bilateral arrangements. However, since 2008, BOS is in the process of establishing supervisory colleges and has begun the process of converting the bilateral arrangements to multilateral cooperation and coordination agreements in connection with its role as the coordinator. Both are nearing finalization.</p> <p>There are a number of foreign banks that have established operations in Slovenia. Bilateral arrangements have been established with their home country supervisors as well. BOS also participates in two supervisory colleges for eight large European banking conglomerates operating in Slovenia. These are coordinated by the banking supervisory agencies in Austria, France, and Italy, and are governed by multilateral cooperation and coordination agreements.</p> <p>The banking groups that are the subject of these arrangements for supervisory purposes are aware of their existence, and that they serve to facilitate the exchange of information effectively and confidentially.</p>
EC3	The home supervisor provides information to host supervisors, on a timely basis, concerning:

	<ul style="list-style-type: none"> • the overall framework of supervision in which the banking group operates; • the bank or banking group, to allow a proper perspective of the activities conducted within the host country's borders; • the specific operations in the host country; and • where possible and appropriate, significant problems arising in the head office or other parts of the banking group if these are likely to have a material effect on the safety and soundness of subsidiaries or branches in host countries. <p>A minimum level of information on the bank or banking group will be needed in most circumstances, but the overall frequency and scope of this information will vary depending on the materiality of a bank's or banking group's activities to the financial sector of the host country. In this context, the host supervisor will inform the home supervisor when a local operation is material to the financial sector of the host country.</p>
Description and findings re EC3	<p>In its role as a home country supervisor for two banks, BOS established supervisory colleges to facilitate cross-border supervision. Through the supervisory colleges and through the bilateral agreements still in place when necessary, BOS has communicated critical information to host country supervisors relative to the risk profile of the banks, and other information concerning supervisory structure.</p> <p>Information provided by BOS relates to the overall risk profile of the institution, but tailored to the principal risks undertaken by the entity supervised by the host country supervisor. In this regard, the supervisors devote the preponderance of their efforts on credit liquidity and operations risk issues and practices. BOS has provided an organizational structure of the banks to the host country supervisors as well.</p>
EC4	<p>The host supervisor provides information to home supervisors, on a timely basis, concerning:</p> <ul style="list-style-type: none"> • material or persistent non-compliance with relevant supervisory requirements, such as capital ratios or operational limits, specifically applied to a bank's operations in the host country; • adverse or potentially adverse developments in the local operations of a bank or banking group regulated by the home supervisor; • adverse assessments of such qualitative aspects of a bank's operations as risk management and controls at the offices in the host country; and • any material remedial action it takes regarding the operations of a bank regulated by the home supervisor. <p>A minimum level of information on the bank or banking group, including the overall supervisory framework in which they operate, will be needed in most circumstances, but the overall frequency and scope of this information will vary depending on the materiality of the cross-border operations to the bank or banking group and financial sector of the home country. In this context, the home supervisor will inform the host supervisor when the cross-border operation is material to the bank or banking group and financial sector of the home country.</p>
Description and findings re EC4	<p>The role of the host country supervisors is to provide BOS with the analysis of the risk profile, assessment of each risk, results of on-site examinations, information on material events that would affect the financial condition of the operations in the host country, changes in senior management or other events of importance. Host country supervisors also provide details of enforcement actions and progress made on resolving supervisory issues.</p>

EC5	A host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.
Description and findings re EC5	In accordance with the Banking Act, the operations of foreign banks located in Slovenia are subject to the same level and intensity of supervision as are domestic banks. They are subject to the same level and frequency of examination and are required to file regulatory returns. If they are foreign bank subsidiaries they are subject to the ICAAP/SREP process.
EC6	Before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For purposes of the licensing process, as well as ongoing supervision of cross-border banking operations in its country, the host supervisor assesses whether the home supervisor practices global consolidated supervision.
Description and findings re EC6	<p>A no objection letter is required from the home country supervisor of any banking institution desiring to establish operations in Slovenia. In cases where a license is required, by law BOS must determine that the regulatory and supervisory framework would not impede effective supervision.</p> <p>Through its participation in supervisory colleges, the supervisors assess the level of consolidated supervision practiced by other supervisors with whom it cooperates.</p>
EC7	Home country supervisors are given on-site access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group's safety and soundness and compliance with KYC requirements. Home supervisors should inform host supervisors of intended visits to local offices and subsidiaries of banking groups.
Description and findings re EC7	<p>In countries in which Slovenian banks operate, the supervisors are permitted to conduct on-site examinations in accordance with the bilateral agreements governing the exchange of information. The host country supervisor usually participates on these examinations. In most cases, BOS relies on the examinations conducted by the host country supervisor. When BOS conducts the examination, the focus of the examination is the management of the entity by the home office of the institution. As a result, adherence to policy and procedure, validation of information routinely filed with headquarters, the frequency and nature of contact with headquarters, and the scope and frequency of audits all are reviewed.</p> <p>There are several home country supervisors in EU-Member States with banking groups operating in Slovenia. Broadly speaking, the larger the institution, the less likely they will conduct an on-site examination; they rely on BOS examiners. To the degree such on-site examinations are contemplated, BOS grants them the same access in accordance with EU directives as reflected in the multiple cooperation or bilateral agreements. There have been few such examinations.</p>
EC8	The host supervisor supervises shell banks, where they still exist, and booking offices in a manner consistent with internationally agreed standards.
Description and findings re EC8	There are no such institutions of a financial nature subject to supervision by BOS either in its capacity as a home or host country supervisor, nor does BOS license such entities.
EC9	A supervisor that takes consequential action on the basis of information received from

	another supervisor consults with that supervisor, to the extent possible, before taking such action.
Description and findings re EC9	When supervisory colleges exist, such actions are handled bilaterally with the coordinating supervisor, and other supervisors are made aware of the issue as appropriate, depending upon the affect on their local operations. For supervisory actions that are necessary based on bilateral situations, the degree of communication is dictated by the materiality of the supervisory issue. Information is received by BOS or submitted to host country supervisors benchmarked to certain standards. For example, issues that would be considered by a supervisor to jeopardize the stability of a bank must be communicated, as does penalties or enforcement actions imposed on the bank. There are communication standards governing licensing activities, on-site examinations and ongoing supervision as well. They all are in accordance with EU standards.
Additional criteria	
AC1	Where necessary, the home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy should reflect the size and complexity of the cross-border operations of the bank or banking group.
Description and findings re AC1	To enhance the communication strategy with foreign countries in which Slovenian banks operate, BOSn has developed a supervisory college framework that will facilitate joint meetings of the host country supervisors and other such improvements. Toward this end, multilateral cooperation and coordination agreements have been developed and are nearly finalized.
Assessment of Principle 25	Compliant
Comments	The existing arrangements with foreign bank supervisors have proven to be satisfactory, but the supervisors should continue to seek ways to strengthen the communications links with participants in the supervisory colleges as a means to further improve its supervision of banking groups on a consolidated basis.