

Decision on governance arrangements

Unofficial consolidated version

**(Official Gazette 96/2018, 67/2019, 145/2020, 145/2021, 51/2023, 28/2024 and
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Zagreb, March 2025

Decision on governance arrangements

I GENERAL PROVISIONS

Subject matter

Article 1

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

- 1) organisational structure;
- 2) the tasks and method of organisation and operation of supervisory board committees;
- 3) the internal controls system and control functions;
- 4) general risk management rules;
- 5) credit risk management rules;
- 6) market risks management rules;
- 7) operational risk management rules;
- 8) liquidity risk management rules;
- 9) rules on managing risks arising from exposures to shadow banking entities; and
- 10) rules on the management of interest rate risk arising from non-trading book activities.

Item (10) has been added in paragraph (1) pursuant to the provision of Article 1 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 67/2019, which entered into force on 20 July 2019.

Paragraph (2) has been deleted pursuant to the provision of Article 1 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Compliance with the legal acts of the European Union

Article 1a

This Decision transposes into the legal system of the Republic of Croatia Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (Text with EEA relevance) (OJ L 176, 27.6.2013), as last amended by Directive (EU) 2022/2556 of the European Parliament and of the Council of 14 December 2022 as regards digital operational resilience for the financial sector (OJ L 333, 27.12.2022), hereinafter referred to as 'Directive 2013/36/EU'.

Article 1a has been added pursuant to the provision of Article 1 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Article 1a has been amended pursuant to the provision of Article 1 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 150/2024, which entered into force on 1 January 2025.

Article 1b

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

- 1) Guidelines on internal governance (EBA/GL/2021/05);
- 2) Guidelines issued on the basis of Article 84(6) of Directive 2013/36/EU specifying criteria for the identification, evaluation, management and mitigation of the risks arising from potential changes in interest rates and of the assessment and monitoring of credit spread risk, of institutions' non-trading book activities (EBA/GL/2022/14);
- 3) Guidelines on limits to exposures to shadow banking entities which carry out banking activities outside a regulated framework under Article 395, (2) of Regulation (EU) No 575/2013 (EBA/GL/2015/20).

Article 1b has been added pursuant to the provision of Article 1 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 20 May 2023.

Legal persons subject to the Decision

Article 2

(1) The provisions of this Decision shall apply to credit institutions with head offices in the Republic of Croatia that have been authorised in accordance with the Credit Institutions Act.

(2) The provisions of this Decision shall apply *mutatis mutandis* to branches of third-country credit institutions that have been authorised by the Croatian National Bank to provide services.

(3) A credit institution shall apply the provisions of this Decision on an individual basis and on a consolidated basis in accordance with Articles 97 and 277 of the Credit Institutions Act.

Paragraph (3) has been amended pursuant to the provision of Article 2 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Paragraph (1) has been amended pursuant to the provision of Article 2 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 20 May 2023.

Definitions

Article 3

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

1. 'operation support function' means the activities of a credit institution performed by the persons authorised to keep bookkeeping records and carry out other back office tasks;
2. 'treasury back office function' means the credit institution's activities performed by the persons authorised to conduct treasury back office operations and keep bookkeeping records of contractual transactions;
3. 'front office function' means the credit institution's activities performed by the persons authorised to contract risk-bearing transactions;
4. 'the non-trading book' comprises all on-balance sheet and off-balance sheet items of a credit institution other than those considered to be trading book positions within the meaning of Article 4, paragraph (1), item (86) of Regulation (EU) No 575/2013 of the European Parliament

and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013), as last amended by Regulation (EU) 2022/2036 of the European Parliament and of the Council of 19 October 2022 amending Regulation (EU) No 575/2013 and Directive 2014/59/EU as regards the prudential treatment of global systemically important institutions with a multiple-point-of-entry resolution strategy and methods for the indirect subscription of instruments eligible for meeting the minimum requirement for own funds and eligible liabilities (OJ L 275, 25.10.2022); hereinafter referred to as 'Regulation (EU) No 575/2013');

5. 'trading book' shall have the meaning as defined in Article 4, paragraph (1), item (86) of Regulation (EU) No 575/2013;

6. 'credit exposure' means exposure subject to credit risk as provided for in the Decision on the classification of exposures into risk categories and the method of determining credit losses (Official Gazette 114/2017, 110/2018 and 139/2022; hereinafter referred to as 'Decision on the classification of exposures into risk categories and the method of determining credit losses');

7. 'risk culture' means ethical norms, attitudes and behaviours related to risk awareness, risk assumption and risk management, and the controls that shape decisions on risk;

8. 'non-performing credit exposures' means exposures meeting the conditions referred to in Article 6 of the Decision on the classification of exposures into risk categories and the method of determining credit losses;

9. 'risk containment' means the overall strategic determinants, methods, criteria and procedures to accept, avoid, mitigate or transfer the identified risk;

10. 'risk profile' means the measurement or assessment of all risks to which a credit institution is or might be exposed in its operation;

11. 'securitisation' and the terms related to 'securitisation' shall have the meaning as defined in Regulation (EU) No 2017/2401 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (OJ L 347, 28.12.2017) and Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (OJ L 347, 28.12.2017), as last amended by Regulation (EU) 2021/557 of the European Parliament and of the Council of 31 March 2021 amending Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation to help the recovery from the COVID-19 crisis (OJ L 116, 6.4.2021);

12. 'risk appetite' means the level and types of risk a credit institution is willing to assume within its defined risk capacity to achieve its strategic objectives;

13. 'risk capacity' means the maximum level of risk a credit institution is able to assume given its capital base, its risk management and control capabilities, and its regulatory constraints;

14. 'entities treated as central governments' include exposures to regional or local self-government units and exposures to public sector entities which are treated as exposures to a central government as provided for in Articles 115 and 116 of Regulation (EU) No 575/2013;

15. 'internal controls system' shall have the meaning as defined in Article 104, paragraph (1) of the Credit Institutions Act;

16. 'risk management system' means the overall organisational structure, rules, processes, procedures, systems and resources to identify, measure or assess, contain, monitor and report on risk exposure and overall risk management, and it implies the establishment of an adequate

corporate governance and risk culture, and the adoption of the strategy, policy and other internal bylaws on risk management;

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

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

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

20. 'significant credit institution' means any credit institution designated as global systemically important institution (G-SII) or other systemically important institution (O-SII) and any credit institution whose four-year average assets reported in audited financial statements as at the last day of the preceding four business years on an individual basis exceed EUR 1 billion;

21. 'group' shall have the meaning as defined in Article 4, paragraph (1), item (138) of Regulation (EU) No 575/2013;

22. 'gender neutral remuneration policy' shall have the meaning as defined in Article 3, paragraph (1), item (62a) of the Credit Institutions Act;

23. 'managerial responsibility' shall have the meaning as defined in Article 1, paragraph (1) of Commission Delegated Regulation (EU) 2021/923 of 25 March 2021 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards setting out the criteria to define managerial responsibility, control functions, material business units and a significant impact on a material business unit's risk profile, and setting out criteria for identifying staff members or categories of staff whose professional activities have an impact on the institution's risk profile that is comparably as material as that of staff members or categories of staff referred to in Article 92(3) of that Directive.

Items (21) and (22) have been added pursuant to the provision of Article 1 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2020, which entered into force on 1 January 2021.

Items (23), (24) and (25) have been added pursuant to the provision of Article 3 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

The words "an amount equivalent to" in the amended item (20) have been deleted pursuant to the provision of Article 19, paragraph (1) of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which enters into force on the date of introduction of the euro as the official currency in the Republic of Croatia.

Items (4), (6) and (11) have been amended, and items (21) and (22) have been deleted pursuant to the provision of Article 3 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 20 May 2023. The former items (23), (24) and (25) became items (21), (22) and (23).

Risk definitions

Article 4

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

1. 'interest rate risk arising from non-trading book activities' ('IRRBB') means the current or prospective risk to both the earnings and the economic value of a credit institution arising from adverse movements in interest rates that affect interest rate sensitive instruments, including gap risk, basis risk and option risk;

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

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

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

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

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

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

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

9. 'business risk' means a negative, unexpected change in business volume and/or profit margins that may lead to significant losses and reduce the market value of a credit institution. In particular, a business risk may arise due to a significant deterioration in the market environment and changes in competition or consumer behaviour;

10. 'legal risk' as defined in Article 4, paragraph (1), item (52a) of Regulation (EU) No 575/2013;

11. 'dilution risk' shall have the meaning as defined in Article 4, paragraph (1), item (53) of Regulation (EU) No 575/2013;

12. 'reputation risk' means the risk of loss of trust in the integrity of a credit institution caused by adverse public opinion on the credit institution's business practices, regardless of whether there are any grounds for such a public opinion or not;

13. 'residual risk' means the risk of loss arising when recognised credit risk mitigation techniques used by a credit institution prove less effective than expected;

14. 'country risk' means:

1) the risk that the central government, the central bank and/or entities treated as central governments will not settle their liabilities to domestic creditors and/or creditors in other countries; and

2) the risk that a counterparty having its head office or domicile outside the Republic of Croatia will not settle its liabilities due to economic and political factors specific for the country in which the counterparty has its head office or domicile;

15. 'outsourcing risks' is a collective name for all the risks associated with outsourcing by a credit institution on a contractual basis to a counterparty (service providers) of the activities that it would otherwise execute itself;

16. 'information system risk' ('ICT risk') as defined in Article 4, paragraph (1), item (52c) of Regulation (EU) No 575/2013;

17. 'funding liquidity risk' means the risk that a credit institution will not be able to meet successfully both expected and unexpected current and future cash flow and collateral needs without affecting its regular daily operations or its financial performance;

18. 'model risk' as defined in Article 4, paragraph (1), item (52b) of Regulation (EU) No 575/2013;

19. 'settlement risk' means the risk of loss of a credit institution due to the difference in the agreed settlement price for a particular debt, equity, foreign currency or commodity instrument and its current market value;

20. 'conduct risk' means the current or prospective risk of losses to a credit institution arising from inappropriate supply of financial services, including cases of wilful or negligent misconduct;

21. 'risk of excessive leverage' shall have the meaning as defined in Article 4, paragraph (1), item (94) of Regulation (EU) No 575/2013;

22. 'credit valuation adjustment risk' or 'CVA risk' shall have the meaning as defined in Article 381 of Regulation (EU) No 575/2013;

23. 'profit (earnings) risk' means the risk which arises due to inadequate composition and distribution of earnings or the inability of a credit institution to ensure an adequate and constant level of profitability;

24. 'free delivery risk' means the risk of loss of a credit institution which arises when securities, foreign currencies or commodities have been paid for before they are received or when the delivery has been made before they have been paid for, i.e. if the payment or delivery does not take place in accordance with the expected time dynamics;

25. 'market liquidity risk' means the risk that a credit institution will not be able to simply offset or eliminate a position at the market price because of market disruption or inadequate market depth;

26. 'property investment risk' means the risk of loss arising from changes in the market value of the property portfolio of a credit institution;

27. 'compliance risk' means the risk of imposition of measures and fines and the risk of substantial financial loss or loss of reputation to be suffered by a credit institution due to failure to comply with regulations, standards, codes and internal bylaws;

28. 'securitisation risk' means the risk arising from the economic transfer of one exposure or a group of exposures, i.e. the transfer of the credit risks of these exposures;

29. 'strategic risk' means the risk of loss caused by adverse business decisions, lack of responsiveness to changes in the economic environment, etc.;

30. 'market risk' shall have the meaning as defined in Article 4, paragraph (1), item (141) of Regulation (EU) No 575/2013;

30.a 'foreign exchange risk' shall have the meaning as defined in Article 4, paragraph (1), item (142) of Regulation (EU) No 575/2013;

30.b 'commodity risk' shall have the meaning as defined in Article 4, paragraph (1), item (143) of Regulation (EU) No 575/2013;

31. 'governance risk' as defined in Article 4, paragraph (1), item (52i) of Regulation (EU) No 575/2013;

32. 'currency-induced credit risk' means the risk of loss to which a credit institution assuming credit risk arising from exposures denominated in or indexed to foreign currency is additionally exposed;

33. 'gap risk' means the risk resulting from the term structure of interest rate sensitive instruments that arises from differences in the timing of their rate changes, covering changes to the term structure of interest rates occurring consistently across the yield curve (parallel risk) or differentially by period (non-parallel risk);

34. 'basis risk' means the risk arising from the impact of relative changes in interest rates on interest rate sensitive instruments that have similar tenors but are priced using different interest rate indices. Basis risk arises from the imperfect correlation in the adjustment of the rates earned and paid on different interest rate sensitive instruments with otherwise similar rate change characteristics;

35. 'option risk' means the risk arising from options (embedded and explicit), where the credit institution or its customer can alter the level and timing of their cash flows, namely the risk arising from interest rate sensitive instruments where the holder will almost certainly exercise the option if it is in their financial interest to do so and the risk arising from flexibility embedded implicitly or within the terms of interest rate sensitive instruments, such that changes in interest rates may affect a change in the behaviour of the client;

36. 'credit spread risk from non-trading book activities' ('CSRBB') means the risk driven by changes in the market perception about the price of credit risk, liquidity premium and potentially other components of credit-risky instruments inducing fluctuations in the price of credit risk, liquidity premium and other potential components, which is not explained by IRRBB or by expected credit/(jump-to-)default risk;

37. 'restitution risk' means the risk of restitution of assets or their value to those who have been unlawfully deprived of it (e.g. by theft, violence, illegitimate decisions) or the payment of compensation for personal harm and damage to the assets. The basic liability of the parties in the case of nullity shall be restitution (lat. *restitutio in integrum*), in such a manner that either party shall be liable to return to the other party all that the party has received on the basis of such a contract;

38. 'step-in risk' means the risk that a credit institution decides to provide financial support to an unconsolidated entity, that is not a fully or proportionately consolidated entity, that is facing stress, in the absence of, or in excess of, any contractual obligations to provide such support.

39. 'environmental, social and governance risk' ('ESG risk') as defined in Article 4, paragraph (1), item (52d) of Regulation (EU) No 575/2013;

40. 'environmental risk' as defined in Article 4, paragraph (1), item (52e) of Regulation (EU) No 575/2013;

41. 'physical risk' as defined in Article 4, paragraph (1), item (52f) of Regulation (EU) No 575/2013;

42. 'transition risk' as defined in Article 4, paragraph (1), item (52g) of Regulation (EU) No 575/2013;

43. 'social risk' as defined in Article 4, paragraph (1), item (52h) of Regulation (EU) No 575/2013.

Item (1) has been amended and items (33) to (36) have been added pursuant to the provision of Article 2 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 67/2019, which entered into force on 20 July 2019.

Items (16) and (30) have been amended pursuant to the provision of Article 4 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Item (30) has been amended and items (30.a) and (30.b) have been added pursuant to the provision of Article 4 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

The Croatian words translated as "gap risk" have been replaced by other Croatian words, with no relevance to the English translation, in items (1) and (33), and items (37) and (38) have been added pursuant to the provision of Article 4 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 20 May 2023.

Items (10), (16), (18) and (31) have been amended and items (39) to (43) have been added pursuant to the provision of Article 2 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 150/2024, which entered into force on 1 January 2025.

II ORGANISATIONAL STRUCTURE

Duties and responsibilities of supervisory and management boards

Structure and organisation

Article 5

(1) A credit institution shall insure that its management and supervisory boards, in line with their competences, have ultimate and overall responsibility for the establishment, implementation and oversight of governance arrangements.

(2) Management and supervisory boards shall, in line with their competences:

1) ensure and document a suitable and transparent organisational and operational structure for the credit institution and they shall ensure that it is in line with the approved business strategy, the risk management strategy and the risk appetite; and

2) ensure compliance with applicable regulatory requirements on the prevention of money laundering and terrorist financing.

(3) A credit institution shall ensure that the reporting lines and the allocation of competences and responsibilities, in particular among key function holders, are clear, well-defined, coherent, enforceable, and adequately and timely documented.

(4) A credit institution shall ensure that its organisational structure does not impede the ability of the supervisory board to oversee the risks to which the credit institution is or might be exposed in its operation or the management board to manage effectively the risks, or the Croatian National Bank to effectively supervise the credit institution.

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

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

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

(8) When setting, approving and overseeing the implementation of the governance arrangements referred to in paragraph (1) of this Article, a credit institution shall, in accordance with the nature, scale and complexity of its activities and the risks inherent in its business model, ensure that governance arrangements, including a risk management system, take into account all risks to which a credit institution is or might be exposed to in its operation, as well as all relevant risk factors, including environmental, social and governance risk factors.

Paragraph (2) has been amended and paragraph (8) has been added pursuant to the provision of Article 5 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Complex structures and non-standard or non-transparent activities

Article 6

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

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

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

1) the extent to which the jurisdiction in which the structure will be set up complies effectively with the European Union and international standards on tax transparency, anti-money laundering and countering the financing of terrorism;

2) the extent to which the structure serves an obvious economic and lawful purpose;

3) the extent to which the structure could be used to hide the identity of the ultimate beneficial owner;

4) the extent to which the client's request that leads to the possible setting up of a structure gives rise to concern;

5) whether the structure might impede appropriate oversight by the credit institution's supervisory board or its management board's ability to manage the related risk; and

6) whether the structure poses obstacles to effective supervision by the Croatian National Bank.

Duties and responsibilities of supervisory board members

Article 7

In the course of performance of their duties referred to in Article 49, paragraph (1), item (5)

of the Credit Institutions Act, supervisory board members shall oversee:

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

Notification to the supervisory board

Article 8

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

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

Duties and responsibilities of management board members

Article 9

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

1) establish clearly defined and consistent lines of responsibility, including the separation of authorities and responsibilities for the assumption and management of risks among the supervisory board, the management board, appointed boards and senior management;

2) ensure that adequate resources are allocated to the management of all material risks, including an adequate number of employees possessing the necessary knowledge and experience to be involved in risk management, and for the valuation of assets, the use of external credit ratings and internal models related to those risks;

3) establish and implement the risk culture;

4) adopt and implement a code of conduct and appropriate policies;

5) adopt and implement a policy to identify, assess, manage, mitigate or prevent actual and potential conflicts of interest.

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

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

1) the work methodology of a control function;

2) realisation of the work plan of a control function;

3) the number of employees included in the operation of a control function;

4) the structure and content of reports of a control function;

5) findings of a control function during the period covered by the assessment of the adequacy of procedures and efficiency of a control function;

6) credit institution's risk profile;

7) business and risk management strategy; and

8) other criteria and documentation which are deemed to have effect on the adequacy of procedures and efficiency of a control function.

Supervisory board committees
Establishment of supervisory board committees

Article 10

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

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

(3) By way of derogation from paragraph (1) of this Article, the provisions of this Decision shall not apply to the audit committee whose functioning and composition are defined by the Audit Act (Official Gazette 127/2017, 27/2024 and 85/2024).

Paragraph (1) has been deleted, the former paragraph (2) has become paragraph (1) and has been amended, and the former paragraph (3) has become paragraph (2) pursuant to the provision of Article 6 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Paragraph (3) has been added pursuant to the provision of Article 5 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 20 May 2023.

Paragraph (3) has been amended pursuant to the provision of Article 3 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 150/2024, which entered into force on 1 January 2025.

Composition of supervisory board committees

Article 11

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

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

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

Processes of supervisory board committees

Article 12

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

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

(3) Supervisory board committees shall mutually cooperate.

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

1) have adequate access to all information and data necessary to perform their tasks, including information and data from relevant corporate functions (e.g. legal, finance, human resources, ICT, etc.) and control functions, as well as information on AML/CTF compliance and aggregated information on suspicious transaction reports, and money laundering and terrorist financing risk factors;

2) receive regular reports, *ad hoc* information, communications and opinions from the

persons responsible for control functions concerning the current risk profile of the credit institution, its risk culture and its risk exposure limits, as well as on any material breaches of internal rules and other regulations that may have occurred, with detailed information on and recommendations for corrective measures taken, to be taken or suggested to address them; and

3) have adequate access to control functions and other relevant functions or, where necessary, external expert advice.

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

Item (1) has been amended in paragraph (4) pursuant to the provision of Article 7 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Risk committee

Article 13

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

1) advise and support the credit institution's supervisory board regarding the monitoring of the credit institution's overall current and future risk appetite and strategy, taking into account all types of risks, to ensure that they are in line with the business strategy, objectives, corporate culture and values of the credit institution;

2) oversee the implementation of the strategies for managing capital and all relevant risks, in particular liquidity, market, credit, operational and reputation risks, in order to assess their adequacy against the approved risk appetite and strategy;

3) provide the supervisory board with recommendations on necessary adjustments to the risk strategy resulting from, *inter alia*, changes in the business model of the credit institution, market developments or recommendations made by the risk control function;

4) provide advice on the appointment of external consultants that the supervisory board may decide to engage for advice or support;

5) analyse a number of possible scenarios, including stressed scenarios, to assess how the credit institution's risk profile would react to external and internal events;

6) oversee the alignment between material products and services offered to clients and the business model and risk assumption and management strategy of the credit institution;

7) assess the risks associated with the offered products and services and take into account the alignment between the prices assigned to and the profits gained from those products and services; and

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

Nomination committee

Article 14

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

1) prepare a description of duties and qualifications to perform the functions of a member of the management or supervisory board and the expected commitment to performing those functions; and

2) determine the target percentage of the less represented gender in a credit institution's management and supervisory boards and propose a strategy to increase the number of the less represented gender.

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

The introductory part of the sentence in paragraph (1) has been amended pursuant to the provision of Article 4 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 150/2024, which entered into force on 1 January 2025.

Risk culture and business conduct

Risk culture

Article 15

(1) A credit institution shall establish a risk culture based on high professional and ethical business standards.

(2) A credit institution shall prescribe in its internal bylaw the main features of the risk culture and adjust this culture to its risk assumption and management strategy and managing the risks and its risk profile.

(3) A credit institution shall ensure that all employees are informed about the risk culture and organise education for employees on the risk culture in such a way that employees at all levels are clearly informed of the authorities, roles and responsibilities assigned to them in the risk assumption and management process.

Corporate values and code of conduct

Article 16

(1) A credit institution shall adopt, promote and adhere to high ethical and professional standards and ensure the implementation of such standards through a code of conduct.

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

(3) A credit institution shall ensure the oversight of adherence to the standards referred to in paragraph (1) of this Article.

(4) A credit institution shall prescribe the standards referred to in paragraph (1) of this Article in policies which shall include the following:

1) the obligation that all the credit institution's activities are conducted in compliance with the applicable law and with the credit institution's corporate values;

2) expectations that the credit institution's activities will not go beyond the defined risk appetite and internal limits and the respective responsibilities of employees;

3) examples of acceptable and unacceptable behaviours linked in particular to financial misreporting and misconduct, economic and financial crime (e.g. fraud, money laundering and terrorist financing, anti-trust practices, financial sanctions, bribery and corruption, market manipulation, mis-selling and other violations of consumer protection laws, tax offences, whether committed directly or indirectly, etc.);

4) expectations that employees conduct themselves with honesty and integrity and perform their duties with due skill, care and diligence; and

5) expectations that employees are aware of the potential internal and external disciplinary

actions, legal actions and sanctions that may follow misconduct and unacceptable behaviours.

(5) A credit institution shall adequately:

1) ensure equal opportunities for all employees independent of their genders, including with regard to career perspectives;

2) aim to improve the representation of the underrepresented gender in positions within the management and supervisory boards as well as in the group of employees that have managerial responsibilities; and

3) implement gender neutral remuneration policies, recruitment policies, career development and succession plans, access to training and ability to apply for internal vacancies.

(6) The compliance function or another function defined by a credit institution shall monitor and review compliance with the standards referred to in paragraph (1) of this Article and establish a process for dealing with issues of non-compliance. The results of the review shall be regularly reported to a credit institution's management board.

(7) A credit institution shall ensure that all employees are made adequately aware of the standards referred to in paragraph (1) of this Article.

Article 16 has been amended pursuant to the provision of Article 8 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Conflict of interest policy at credit institution level

Article 17

(1) A credit institution shall adopt, implement and appropriately manage adequate policies to identify, assess, mitigate or prevent actual and potential conflicts of interest at credit institution level.

(2) A credit institution shall take adequate measures to prevent conflicts of interest from adversely affecting the interests of its clients.

(3) A credit institution shall adopt measures to manage or, where appropriate, mitigate conflicts of interest, which shall at a minimum include:

1) an appropriate segregation of duties, e.g. entrusting conflicting activities within the processing of transactions or when providing services to different persons, or entrusting supervisory and reporting responsibilities for conflicting activities to different persons;

2) establishing the physical separation of certain business lines or units; and

3) establishing adequate procedures for identifying and managing conflicts of interest that may arise from the conclusion of a legal arrangement as a result of which a credit institution would incur or increase its exposure to persons in a special relationship with the credit institution in accordance with Articles 146, 146a and 146b of the Credit Institutions Act.

Item (3) has been amended in paragraph (3) pursuant to the provision of Article 9 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Conflict of interest policy for employees

Article 18

(1) A credit institution shall adopt, implement and adequately manage effective policies to identify, assess, mitigate or prevent actual and potential conflicts between the interests of the

credit institution and the private interests of its employees, including members of the supervisory board.

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

1) economic interests (e.g. shares, holdings or similar economic interests in undertakings or entities that are the credit institution's clients, intellectual property rights, loans granted by the credit institution to an undertaking or entity owned by employees, membership in a body or ownership of a body or entity with conflicting interests);

2) personal or professional relationships with the owners of qualifying holdings in the credit institution;

3) personal or professional relationships with employees of the credit institution or entities included within the scope of prudential consolidation;

4) other employment and previous employment within the recent past;

5) personal or professional relationships with relevant external stakeholders (e.g. Being associated with material suppliers, consultancies or other service providers); and

6) political influence or relationships with politically exposed persons.

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

1) define the function responsible for receiving reports on actual or potential conflicts of interest of employees and processes for reporting and communication to that function;

2) differentiate between conflicts of interest that persist and need to be managed permanently and conflicts of interest that occur unexpectedly with regard to a single event (e.g. a transaction, the selection of service provider, etc.) and can usually be managed with a one-off measure; and

3) set out procedures, measures, documentation requirements and responsibilities for the identification and prevention of conflicts of interest, for the assessment of their materiality and for taking mitigating measures.

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

1) entrusting conflicting activities or transactions to different persons;

2) preventing employees who are also active outside the credit institution from having inappropriate influence within the credit institution regarding those other activities;

3) establishing the responsibility of employees to abstain from voting on any matter where the employee has or may have a conflict of interest or where the employee's objectivity or ability to properly fulfil duties to the credit institution may be otherwise compromised; and

4) establishing adequate procedures for transactions with related parties.

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

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

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

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

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

(1) A credit institution shall keep records of exposures to persons in a special relationship with the credit institution referred to in Article 146 of the Credit Institutions Act, including the following information:

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

(2) For exposures exceeding EUR 200 000, in addition to the information referred to in paragraph (1) of this Article, the records shall include the following additional information:

- 1) the percentage of the exposure and the percentage of the sum of all outstanding amounts of exposures towards the same person compared to:
 - the sum of its tier 1 capital and tier 2 capital and
 - common equity tier 1 capital of the credit institution;
- 2) whether the loan is part of a large exposure; and
- 3) the relative weight of the aggregated sum of all outstanding amounts of exposures towards the same person, calculated as a percentage by dividing the total outstanding amount by the total amount of all outstanding exposures to persons in a special relationship with the credit institution.

(3) A credit institution shall ensure that the documentation of exposures to persons in a special relationship with the credit institution is complete and updated.

(4) At the request of the Croatian National Bank or another competent authority, a credit institution shall submit the information referred to in paragraphs (1) and (2) of this Article.

Article 18a has been added pursuant to the provision of Article 10 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

The words “an amount equivalent to” have been deleted in the part of the introductory sentence of paragraph (2) pursuant to the provision of Article 19, paragraph (2) of the Decision on amendments to the Decision on governance arrangements, 145/2021, which enters into force on the date of introduction of the euro as the official currency in the Republic of Croatia.

Article 19

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

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

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

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

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

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

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

III INTERNAL CONTROLS SYSTEM AND CONTROL FUNCTIONS

Internal controls system

Article 20

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

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

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

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

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

1) the business lines and the compliance function, including the AML/CTF compliance function where it is a separate control function, at the group level; and

2) the persons responsible for the operation of control functions at the group level and the management board and the supervisory board of the credit institution.

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

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

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

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

Paragraphs (4) to (7) have been added pursuant to the provision of Article 11 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Control functions and a bylaw on the control function

Control functions and a bylaw on the control function

Article 21

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

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

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

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

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

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

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

7) the duties and responsibilities of the person responsible for the operation of each control function as a whole;

8) the measures for ensuring and monitoring professional qualification, adequate expertise and experience of the persons responsible for carrying out control functions;

9) the authorities and responsibilities of control functions associated with examination of outsourced activities in accordance with the provisions of relevant regulations governing outsourcing of credit institution's business activities, where applicable;

10) the right of access to all the relevant data, information, information systems and other resources necessary to carry out the activities;

11) the manner of cooperation with external auditors and supervisors; and

12) the reporting system.

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

1) the right of access to all business lines, organisational units and, where applicable, subsidiaries and undertakings included within the scope of accounting or prudential consolidation; and

2) where necessary, the right of direct reporting to the supervisory board and/or a supervisory board committee.

Paragraph (2) has been added and paragraphs (2) to (6) have become paragraphs (3) to (7) pursuant to the provision of Article 12 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Persons carrying out control functions

Article 22

(1) A credit institution shall employ on a full time basis at least one person who has attained the title of auditor or internal auditor in accordance with the law governing audits or the rules and a programme of a professional organisation competent for professional education of internal auditors to carry out internal audits.

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

Control function work plan

Article 23

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

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

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

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

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

Control function activities

Article 24

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

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

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

Activities of the risk control function

Article 25

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

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

- 1) participating in the risk management strategy and policy development and review;
- 2) participating in the adoption of all major decisions related to risk management;
- 3) analysing the risks of new products, implementation of significant changes to existing products, including significant changes to related processes and systems, exceptional transactions, as well as the entry to new markets and dealing in new instruments;
- 4) risk analysis, including the identification, measurement and assessment of risks to which the credit institution is or might be exposed in its operation;
- 5) participating in the development, application and oversight of risk management methods and models;
- 6) making proposals and recommendations for improving the risk management system;
- 7) monitoring the risk profile and analysing it against the strategic goals and risk appetite;
- 8) carrying out stress testing;
- 9) evaluating possible ways to mitigate risks;

10) analysing breaches of risk appetite or limits, proposing remedial measures and informing the business units concerned and the management board, the supervisory board or the risk committee of the breaches and measures;

11) identifying and assessing the risks in transactions with related parties;

12) analysing, monitoring and reporting on the adequacy of the credit institution's internal capital and internal liquidity, and reviewing the strategies and procedures for the assessment of the necessary internal capital and internal liquidity;

13) reporting on risk management to the management board, the supervisory board and the relevant supervisory board committee, and other relevant persons; and

14) making other verifications necessary for adequate risk control.

(3) The risk control function shall inform the management board, the risk committee or the supervisory board of the assumptions used in and potential shortcomings of the risk models and analysis.

Activities of the compliance function

Article 26

(1) A credit institution shall have in place a compliance function to ensure that compliance risk is adequately identified, assessed and monitored.

(2) A credit institution shall, within its compliance function, ensure the carrying out of the following activities at a minimum:

1) identifying and assessing the compliance risk to which the credit institution is or might be exposed;

2) advising the management board and other responsible persons on the implementation of relevant laws, standards and rules, including informing them on developments in these areas;

3) assessing the effects that changes in relevant regulations will have on the operation of a credit institution;

4) verifying compliance of new products or new procedures with relevant regulations as well as amendments to such regulations in cooperation with the risk control function;

5) reporting on compliance risk to the management board, the supervisory board and the relevant supervisory board committee, and other relevant persons;

6) cooperating and exchanging information with the risk control function in relation to compliance risk and its management; and

7) providing advice as regards the preparation of training programmes related to compliance.

(3) An RC parent credit institution and an EU parent credit institution having its head office in the RC shall ensure:

1) that their subsidiaries and branches take steps to ensure that their operations are compliant with local laws and regulations; and

2) if local laws and regulations prevent the disclosure and exchange of information related to compliance monitoring between entities within the group, that subsidiaries and branches inform the person responsible for the operation of the compliance function or the person responsible for the operation of the compliance function of an RC parent credit institution and an EU parent credit institution having its head office in the RC.

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

Paragraph (4) has been added pursuant to the provision of Article 13 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Activities of the internal audit function

Article 27

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

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

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

(3) A credit institution shall ensure that the internal audit function evaluates the reliability of the credit institution's methods and techniques, and the assumptions and sources of information

used in its internal models, as well as the quality and use of qualitative risk identification and assessment tools and the risk mitigation measures taken.

Control function work reports

Article 28

(1) Control functions shall prepare work reports.

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

- 1) a report on the realisation of the annual work plan;
- 2) a list of all the planned work activities carried out;
- 3) a list of all the extraordinary work activities carried out;
- 4) a list of planned but not executed work activities, specifying the reasons for the non-execution;
- 5) a summary of the most important facts identified during controls, audits and other work activities carried out;
- 6) a general assessment of the adequacy and efficiency of the internal controls system in the areas covered by control or audit;
- 7) a general assessment of the adequacy and efficacy of the system for the management of individual risks or all risks in a credit institution; and
- 8) a report on the implementation of proposals, recommendations and measures for the elimination of illegalities, irregularities, deficiencies and weaknesses identified in the course of controls or audits and the reasons for their non-execution.

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

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

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

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

IV GENERAL RISK MANAGEMENT RULES

Risk management system

Article 29

(1) A credit institution shall establish and implement an effective and sound risk management system that is proportionate to the nature, scale and complexity of its activities and the risks inherent in its business model that is extending across all its business lines and organisational units.

(2) A credit institution shall ensure that decisions on risk assumption are adopted based on appropriate and clearly defined criteria and complete information.

(3) A credit institution shall determine the key employees and their deputies to be involved in the risk management system.

(4) A credit institution shall establish and appropriately document the risk management process, which shall also include defining the risk profile and aligning the risk profile with the risk appetite.

(5) A credit institution shall on an ongoing basis identify the risks to which it is or might be exposed in its operation and it shall analyse the causes of risk exposure.

(6) A credit institution shall regularly measure or assess the risks which it has identified in its operation. The risk measurement or assessment procedures must include appropriate quantitative and qualitative methods to measure or assess risks, which are also to enable the detection of changes in the credit institution's risk profile, including the emergence of new risks. The measurement and assessment of risk exposure may not be based only on model outputs or quantitative information.

(7) A credit institution shall:

1) clearly define decision-making criteria and procedures for the containment of risks, taking into account both the existing and desired risk profile and the risk appetite; and

2) appropriately document the risk containment method and risk containment, including the reasons for risk acceptance, mitigation, avoidance or transfer.

(8) A credit institution shall assess the potential impact of relevant macroeconomic trends and data on risk exposures and individual portfolios and include these assessments in significant decisions on risks.

(9) A credit institution shall establish such a risk reporting and monitoring system as to regularly provide the management board, the supervisory board and/or supervisory board committees, relevant organisational units and persons in the credit institution with timely, accurate and sufficiently detailed information on risk management required for making business decisions and ensuring its safe and stable operation.

(10) The information referred to in paragraph (9) of this Article shall at a minimum comprise the relevant information on exposure to individual risks and key risk indicators, including the information on the risk profile and changes therein, data on significant internal losses, information on the measures and activities that are to be or have been implemented to contain risk, information on exceeding the limits and other exemptions from compliance with internal bylaws, including the exemptions from the determined risk appetite, as well as the information on positive and negative changes in business indicators which suggest or might suggest a change in risk exposure.

(11) A credit institution shall adequately monitor the risks transferred to a third party, in particular concentration risk that may arise from such transfers.

Risk assumption and management strategy

Article 30

(1) A credit institution shall adopt a risk assumption and management strategy and clearly determine and document the risk appetite.

(2) The risk assumption and management strategy shall be set out in one or several written documents which shall at a minimum include the objectives and fundamental principles of risk assumption and management and the credit institution's risk appetite.

(3) When determining the risk appetite, a credit institution shall take into account, in addition to quantitative information or model results, adequate qualitative information, such as for instance expert judgement.

(4) A credit institution shall regularly align the risk assumption and management strategy with the business strategy, taking into account developments in the market where the credit institution operates and changes within the credit institution (e.g. changes in assets and revenue; any increase in the complexity of the credit institution's business; changes in the risk profile and operating structure; geographic expansion; mergers and acquisitions; and the introduction of new products or business lines).

Risk management duties and responsibilities of senior management

Article 31

Senior management shall:

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

General rules on the management of individual risks

Credit risk

Article 32

(1) A credit institution shall adopt and implement sound policies and procedures for credit risk management.

(2) A credit institution shall adopt decisions on credit granting based on sound and well-defined criteria and define the decision-making procedure for approving, amending, renewing and refinancing credits.

(3) A credit institution shall establish a sound and efficient system for management and ongoing monitoring of portfolios and individual credit risk-bearing exposures and ensure its implementation, which includes:

- 1) management of portfolios and individual credit risk-bearing exposures, identification and management of non-performing credit exposures and distribution of exposures into risk groups based on recoverability; and
- 2) carrying out value adjustments for on-balance sheet items and forming provisions for risk-bearing off-balance sheet items.

(4) A credit institution shall ensure that the diversification of its credit risk-bearing portfolios is in line with its credit strategy and target markets.

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

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

Securitisation risks

Article 33

(1) A credit institution shall adopt and implement sound policies and procedures for managing the risks arising from securitisation transactions in which the credit institution's acts

as the investor, originator or sponsor, including reputation risks arising from complex structures or products. The management of risks arising from securitisation transactions shall be based on the economic substance of the transaction.

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

Residual risk

Article 34

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

Concentration risk

Article 35

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

Market risks

Article 36

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

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

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

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

Interest rate risk in the non-trading book

Article 37

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

Operational risk

Article 38

(1) A credit institution shall adopt and implement sound policies and procedures for operational risk management, including model risk, the risks arising from outsourcing, and low-frequency high-severity events.

(2) A credit institution shall, for the purpose of operational risk management, define operational risk so as to articulate what constitutes operational risk for the credit institution. The definition shall at a minimum cover the risks of loss referred to in Article 4, paragraph (1), item (52) of Regulation (EU) No 575/2013.

(3) A credit institution shall adopt policies and contingency plans and business continuity plans ensuring its ability to operate on an ongoing basis and to limit losses in the event of serious disruption or discontinuation of operation.

(4) A credit institution shall, within the meaning of paragraph (3) of this Article, also adopt ICT policies and business continuity plans and ICT response and recovery plans for the technology it uses for the communication of information and ensure that those plans are established, tested and managed in accordance with Article 11 of Regulation (EU) 2022/2554 of the European Parliament and of the Council of 14 December 2022 on digital operational resilience for the financial sector and amending Regulations (EC) No 1060/2009, (EU) No

648/2012, (EU) No 600/2014, (EU) No 909/2014 and (EU) 2016/1011 (Text with EEA relevance) (OJ L 333, 27.12.2022).

Paragraph (3) has been amended and paragraph (4) has been added pursuant to the provision of Article 5 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 150/2024, which shall enter into force on 17 January 2025.

Liquidity risk

Article 39

(1) A credit institution shall adopt and implement appropriate strategies, policies, procedures and systems for liquidity risk management.

(2) The strategies, policies, procedures and systems referred to in paragraph (1) of this Article shall be considered appropriate provided they:

- 1) are proportionate to the complexity, risk profile, scope of operations and the defined risk tolerance of a credit institution;
- 2) ensure liquidity risk management during relevant periods including intraday;
- 3) ensure the management of liquidity risk in the domestic currency and in all foreign currencies;
- 4) ensure maintenance of adequate levels of liquidity buffers;
- 5) reflect the significance of a credit institution in each Member State in which it operates;
- 6) are adjusted to business lines, currencies, branches and legal persons; and
- 7) include adequate allocation mechanisms.

(3) A credit institution shall have a clearly defined liquidity risk tolerance in the form of liquidity risk exposure which it is ready to assume and which needs to enable a credit institution to manage its liquidity under normal conditions in such a way as to withstand protracted periods of stress. All relevant business lines need to be informed of the defined tolerance.

(4) A credit institution shall, taking into account the type, scope and complexity of operations, define the liquidity risk profile which ensures stable operations of a credit institution and a robust risk management system.

The words “in kuna” have been replaced by the words “in the domestic currency” pursuant to the provision of Article 18 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Risk of excessive leverage

Article 40

(1) A credit institution shall adopt and implement sound policies and procedures for managing the risk of excessive leverage. Indicators for the risk of excessive leverage shall include the leverage ratio determined in accordance with Article 429 of Regulation (EU) No 575/2013 and mismatches between assets and liabilities.

(2) A credit institution shall address the risk of excessive leverage in a precautionary manner by taking due account of potential increases in the risk of excessive leverage caused by reductions of the credit institution's own funds through expected or realised losses, in accordance with the accounting rules. To that end, the credit institution must be able to withstand a wide range of different stress events with respect to the risk of excessive leverage.

Other risks

Article 41

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

Article 41 has been amended pursuant to the provision of Article 14 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Risk assumption and management policies

Article 42

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

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

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

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

New products

Article 43

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

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

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

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

- 1) define what it considers to be a new product and significant change;
- 2) establish the processes and procedures for the introduction of new products;

3) define the powers and responsibilities for the approval and verification of new products;
and

4) establish adequate control procedures to be implemented by the control functions of the credit institution.

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

- 1) describe the new product;
- 2) analyse the impact of the new product on its existing and future risk exposure, and capital adequacy and profitability;
- 3) ensure the required organisational, technical and human resources;
- 4) define the procedures to be used to manage the risks related to new products; and
- 5) comply with the accounting, tax and legal requirements, including supervisory requirements.

(5) A credit institution shall carry out an analysis of the risks inherent in new products, which shall at a minimum include:

- 1) an objective assessment of all the risks arising from new activities, using different scenarios;
- 2) an assessment of whether the introduction of a new product leads to potential weaknesses in risk management and internal controls; and
- 3) an assessment of the ability of the credit institution to manage a new risk efficiently.

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

Paragraph (6) has been added pursuant to the provision of Article 15 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Stress testing

Article 44

(1) Within risk management, a credit institution shall carry out stress testing at the level of significant risks to which it is exposed, at portfolio level and at the level of the whole credit institution or, where applicable, the group of credit institutions, and it shall ensure adequate human, material and financial resources for that purpose.

(2) A credit institution shall include the following in its policies and procedures governing stress testing:

- 1) types of stress testing and their objectives;
- 2) the frequency of individual stress testing exercises;
- 3) internal governance arrangements, including defined, transparent and consistent lines of responsibility and processes;
- 4) in carrying out stress testing on a consolidated basis, a list of entities covered by the testing as well as the scope of testing carried out at the level of individual entities;
- 5) the infrastructure of the data used in stress testing;

6) a description of the stress testing methodology, including a description of internal models used for that purpose and links with the stress testing referred to in Article 77 of this Decision; and

7) assumptions used in stress testing, which are related to business activities and management decisions, as well measures provided for as a consequence of stress testing results and actions to be taken in cases of adverse stress testing results.

(3) The risk control function shall report to a credit institution's management board about the results of planned tests on an annual level.

(4) A credit institution shall enable analysis of stress testing results by the competent body and senior management of the credit institution.

(5) An RC parent credit institution and an EU parent credit institution having its head office in the RC shall carry out stress testing on a consolidated basis. All requirements of this Decision relating to the carrying out of stress testing of an individual credit institution shall apply *mutatis mutandis* to the carrying out of stress testing of a parent credit institution.

(6) In stress testing, a credit institution shall use sensitivity analysis, scenario analysis and reverse stress testing. In carrying out stress testing, account should be taken of the stage of the economic cycle of the economy and it should be ensured that it is not based only on historical experience, but should also consider hypothetical scenarios and external data sources. Stress testing exercises should include various impact intensities and at least one scenario must include a significant economic recession.

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

(8) A credit institution shall ensure that the stress testing procedure is supported by an adequate data infrastructure based on effective risk data aggregation and risk reporting.

(9) A credit institution shall include stress testing results at least in the following activities:

- 1) reviewing strategic planning;
- 2) reviewing the risk appetite;
- 3) reconsidering the funding policy;
- 4) reviewing internal limits;
- 5) use of risk mitigation techniques;
- 6) reviewing capital and liquidity adequacy; and
- 7) reviewing or developing activities related to contingency and recovery plans.

(10) A credit institution shall assess the appropriateness of stress testing regularly and at least on an annual basis, and at each significant change in risk exposure and it shall cover the following:

- 1) the frequency of stress testing exercises and their compliance with objectives;
- 2) the need for development work;
- 3) the adequacy of informing relevant employees, committees established by the supervisory or management board, the management board and the supervisory board;
- 4) the quality of used data and other information; and
- 5) documentation of stress testing results.

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

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

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Organisational requirements

Article 45

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

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

1) the establishment of criteria, policies and procedures for the granting of new exposures and the restructuring of existing exposures;

2) the establishment of rules on the granting of exposures at the level of individual debtors and collateral providers and at the level of the group of clients connected with the debtors and collateral providers, depending on the exposure amount and risk; and

3) the establishment of the competences of the supervisory board, the management board and boards appointed by them, as well as of the powers to grant exposures assigned to individual management levels, depending on the exposure amount and risk.

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

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

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

Credit process

Article 46

The credit process shall at a minimum include the following:

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

Credit exposure granting process

Article 47

(1) Before granting a credit exposure and before any material subsequent increase in the credit exposure amount and during the legal relationship giving rise to the credit exposure, a

credit institution shall assess the creditworthiness of the debtor and the timeliness in meeting the obligations to the credit institution and other creditors.

(2) Before granting a credit exposure, a credit institution shall assess the quality, marketability, availability, value and validity of the collateral. Where the collateral value to a great extent depends on the creditworthiness of a third-party collateral provider, the credit institution shall assess the creditworthiness of such collateral provider.

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

(4) A credit institution shall establish a sound process to assess the consumer's ability to meet obligations under the credit agreement and it shall review this process at regular intervals. When assessing the consumer's creditworthiness, a credit institution shall take into account consumer's committed and other non-discretionary expenditures at least by examining available credit registers and systems for collecting, exchanging and providing data, which have been organised by credit/financial institutions or in another appropriate way.

(5) When analysing the riskiness of an exposure, a credit institution shall primarily take into account the creditworthiness of the debtor and treat, as a rule, the collateral received for the exposure as the secondary collection source.

(6) A credit institution shall adopt a policy on eligible collateral and the methodology for assessing collateral value, taking into account the minimum requirements referred to in the Decision on the classification of exposures into risk categories and the method of determining credit losses.

Paragraph (7) has been added pursuant to the provision of Article 2 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2020, which entered into force on 1 January 2020.

Paragraph (7) has been deleted pursuant to the provision of Article 6 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 20 May 2023.

Risk exposure monitoring process

Article 48

(1) The risk exposure monitoring process shall include an assessment of the creditworthiness of the debtor and of the group of clients connected with the debtor as well as an assessment of the collateral quality during the legal relationship giving rise to the credit exposure.

(2) During the legal relationship giving rise to the credit exposure, a credit institution shall monitor the operation of the debtor, as well as the quality, marketability, availability, value and validity of the collateral for its claims, taking into account the minimum requirements referred to in the Decision on the classification of exposures into risk categories and the method of determining credit losses.

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

(4) A credit institution shall ensure that the monitoring of individual exposures is established in such a manner as to enable a timely implementation of adequate measures to mitigate credit risk if the creditworthiness of the debtor or collateral provider deteriorates.

(5) A credit institution shall adopt procedures prescribing the collection and monitoring of all relevant information which might point to an increase in the risk of the exposures and collateral, and a procedure of reporting this information to all authorised persons included in the credit risk management process, so that the risk of exposures could be reassessed.

Paragraph (6) has been added pursuant to the provision of Article 3 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2020, which entered into force on 1 January 2020.

Paragraph (6) has been deleted pursuant to the provision of Article 7 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 20 May 2023.

Credit risk exposure analysis

Article 49

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

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

Early warning system

Article 50

(1) A credit institution shall:

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

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

Treatment of non-performing credit exposures

Article 51

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

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

- 1) the method of determining, measuring, monitoring and overseeing non-performing credit exposures as well as measures to avoid the origination of non-performing credit exposures in the credit institution's assets;

2) objectives in terms of time and value established regarding the treatment of non-performing credit exposures and exposures subject to forced collection proceedings;

3) strategic objectives of the credit institution associated with non-performing credit exposures in short-term, mid-term and long-term periods;

4) implementation of the operational plan for the treatment of non-performing credit exposures; and

5) complete integration of the strategy for the treatment of non-performing credit exposures in credit institution's management processes, including the regular monitoring and independent oversight of such treatment.

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

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

1) a monitoring and restructuring strategy;

2) a strategy for active reduction of non-performing credit exposures;

3) a change in the type of exposure or a swap of credit exposure for debtor's equity; and

4) different legal options such as bankruptcy or out-of-court settlement.

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

(6) In its policies for the treatment of non-performing credit exposures granted to consumers, a credit institution shall take into account consumer protection regulations.

(7) Within its policies for the treatment of non-performing credit exposures, a credit institution shall:

1) prescribe policies, methods and frequency of evaluating movable or immovable property collateral, oversight and control of such valuation, and criteria for appraisers of collateral; and

2) prescribe the criteria, procedure and decision-making levels for a full or partial accounting write-off of the claims against the debtor with non-performing credit exposures.

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

Treatment of restructured credit exposures

Article 52

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

1) the process and procedures for granting restructuring measures, the method of making decisions on restructuring measures, including the persons and functions involved in the process, where the credit institution shall take into account measures that would enable sustainable repayment of debt and avoid cases of forced collection;

2) the use of specific short-term and long-term restructuring measures depending on the reasons why credit exposures have been identified as non-performing credit exposures;

3) a description of available restructuring measures; and

4) information that are taken into account when deciding on the justification of restructuring measures, the process and procedures for monitoring and overseeing restructuring measures.

(2) Based on the performance results of implemented restructuring measures, a credit institution shall regularly update policies for the treatment of restructured credit exposures.

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

(4) When determining whether the restructuring of credit exposures to an individual debtor or a group of debtors is economically justified, a credit institution shall obtain:

1) a detailed analysis of the reasons that led to difficulties in the operation of the debtor or, where applicable, a group of debtors;

2) a plan for the operational, financial and ownership restructuring of the debtor; and

3) a cash flow projection for the period defined in the restructuring plan.

(5) On the basis of the information referred to in paragraph (4) of this Article, a credit institution shall make:

1) an assessment of the feasibility of a plan for the operational, financial and ownership restructuring of the debtor, where applicable;

2) an analysis of possible methods of credit exposure restructuring and the rationale for the chosen method; and

3) a new repayment plan for the exposure which shall be the basis for monitoring the implementation of the credit exposure restructuring plan.

(6) Prior to approval of any restructuring measure, a credit institution shall assess the creditworthiness of a debtor or, where applicable, a group of debtors.

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

Credit exposure classification process

Article 53

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

Content of and keeping records on credit exposures

Article 54

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

1) basic data on debtors (first and last name, address or company name, head office, number of employees, ownership structure, first and last name of management board members, connection of a debtor with other persons in case a debtor belongs to a group of connected clients within the meaning of Article 4, paragraph (1), item (39) of Regulation (EU) No 575/2013);

2) a credit contract and/or a contract on other credit exposures;

3) main debtors and creditors of every debtor to whom credit institution's exposure is individually significant;

- 4) where applicable, financial reports of a debtor for the last three years;
- 5) an analysis and assessment of a financial and economic position of a debtor, including internal rating of a debtor;
- 6) for individually significant exposures, evidence, if any, of impairment of debtor's financial assets, analysis and assessment of debtor's future cash flows relative to his liabilities;
- 7) proposal for approval of a credit exposure, opinion of an expert service, and a decision of the credit institution's body competent for such approval;
- 8) analytical bookkeeping records of on-balance and off-balance sheet items relating to an individual debtor of a credit institution;
- 9) documentation concerning instrument of collateral;
- 10) documentation on initiated forced collection proceedings, including records on court proceedings initiated by a credit institution in order to collect its receivables;
- 11) records on court proceedings that may be initiated against a credit institution in relation to that credit exposure;
- 12) documentation related to the treatment of restructured credit exposures referred to in Article 52 of this Decision; and
- 13) other documentation that may complement the information on the debtor's financial position.

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

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

Paragraph (1) has been amended so that after item (12) a new item (13) has been inserted and the former item (13) has become item (14) pursuant to the provision of Article 4 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2020, which entered into force on 1 January 2020.

Item (13) has been deleted and the former item (14) became item (13) in paragraph (1) pursuant to the provision of Article 8 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 20 May 2023.

Personal data processing

Article 55

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

(2) When assessing the debtor's creditworthiness in accordance with this Decision, for the purpose of ensuring the accuracy of personal data and unambiguous identification of a person in all cases prescribed in credit institution's internal policies adopted pursuant to the Credit Institutions Act and this Decision, a credit institution shall be authorised to process personal data by collecting copies of relevant personal identification documents and other public documents

issued by competent government authorities, applying adequate technical and organisational measures to protect the rights and freedoms of the persons whose data is being collected.

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

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

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

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

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

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

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

Article 56

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

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

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

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

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

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

1) the identification of debtors exposed to the risks referred to in paragraph (1) of this Article;
2) the calculation of impairment of and provisions for exposures subject to the risks referred to in paragraph (1) of this Article in case of changes in currency exchange rates or interest rates;
and

3) linking credit exposures and underlying hedging instruments used by the credit institution, where applicable.

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

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

Concentration risk

Article 57

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

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

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

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

Country risk

Article 58

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

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

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Organisational requirements

Article 59

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

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

Transaction contracting

Article 60

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

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

1) a transaction has been contracted based on a clearly defined and justified client request, with the agreed on deviation from market conditions clearly specified in the documentation accompanying the transaction; and

2) each transaction which has not been contracted in line with market conditions must be accompanied by a clearly specified description of the deviation from market conditions and the reasons for it.

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

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

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

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

Paragraph (4) has been deleted and the former paragraphs (5) to (7) have become paragraphs (4) to (6) pursuant to the provision of Article 9 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 20 May 2023.

Transaction recording and control

Article 61

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

(2) A credit institution shall verify whether the certificates for contractual transactions received from the counterparty are timely and complete. The receipt of certificates for contractual transactions from the counterparty is to fall within the scope of the treasury back office function.

A credit institution shall without delay notify the counterparty of untimely received or incomplete transaction certificates.

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

- 1) the completeness of documentation on a contractual transaction and its timely forwarding to the treasury back office function;
- 2) the consistency of contractual transaction data with contractual transaction certificates, electronic trading systems certificates and other sources;
- 3) whether contractual transactions are in line with market conditions;
- 4) the deviations from internal trading rules; and
- 5) the consistency of the front office function transaction records with those of other independent organisational units.

Market risk exposure analysis

Article 62

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

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

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

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

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

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

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

1) interest and interest-sensitive income and expense as well as the economic value of on-balance and off-balance sheet items under various interest rate scenarios;

2) foreign exchange and foreign exchange-sensitive income and expense as well as the economic value of on-balance and off-balance sheet items under various exchange rate scenarios; and

3) other market factors and market-sensitive income and expense as well as the economic value of on-balance and off-balance sheet items under various market scenarios.

Market risk monitoring

Article 63

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

1) trading positions and the volatility of their prices;

2) utilisation and excesses of the limits; and

3) trading results.

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

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

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

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

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

VIA RULES ON THE MANAGEMENT OF INTEREST RATE RISK ARISING FROM NON-TRADING BOOK ACTIVITIES

IRRBB management system

Article 63a

The IRRBB management system shall include at least the following:

1) overall strategy for the management of IRRBB;

2) written policies and procedures for the management of IRRBB;

- 3) systems used by the credit institution to identify, assess and manage IRRBB; and
- 4) limit systems that ensure that IRRBB exposures are in line with a credit institution's risk appetite and the overall approach to IRRBB measurement and management.

Terms specific for IRRBB

Article 63b

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

1) 'interest rate sensitive instruments' means assets, liabilities and off-balance-sheet items in the non-trading book, excluding assets deducted from common equity tier 1 (CET1) capital;

2) 'net interest income measures' means the measures of changes in expected future profitability within a given time horizon resulting from interest rate movements, in case of IRRBB; or from credit spread changes, in case of CRSBB. Net interest income measures encompass interest income and interest expenses;

3) 'economic value (EV) measures' means measures of changes in the net present value of the interest rate sensitive instruments over their remaining life resulting from interest rate movements. EV measures reflect changes in value over the remaining life of the interest rate sensitive instruments, i.e. until all positions have run off;

4) 'economic value of equity (EVE) measures' means a specific form of EV measure where equity is excluded from the cash flows;

5) 'conditional cash flow modelling' means cash flow modelling under the assumption that the timing and amount of cash flows is dependent on the specific interest rate scenario, i.e. it is assumed that the timing of cash flows of options, of instruments with embedded, explicit options and of instruments of which the maturity depends on clients' behaviour, is modelled conditional on the interest rate scenario;

6) 'unconditional cash flow modelling' means cash flow modelling under the assumption that the timing and amount of cash flows is independent of the specific interest rate scenario;

7) 'run-off balance sheet' means a balance sheet where existing non-trading book positions amortise and are not replaced by any new business;

8) 'dynamic balance sheet' means a balance sheet incorporating future business expectations, adjusted for the relevant scenario in a consistent manner;

9) 'constant balance sheet' means a balance sheet including off-balance-sheet items in which the total size and composition are maintained by replacing maturing or repricing cash flows with new cash flows that have identical features with regard to the amount, repricing period and spread components;

10) credit spread sensitive instruments encompass assets, liabilities and off-balance-sheet items in the non-trading book, which are sensitive to credit spread changes (excluding assets deducted from common equity tier 1 capital (CET1), e.g. real estate or intangible assets or equity exposures in the non-trading book);

11) 'net interest income measures after the market value changes' means net interest income measures after the market value changes of instruments have been accounted for/taken into account depending on accounting treatment either through fair value measures or nGAAP;

12) 'retail' means a natural person or a small and medium-sized enterprise (SME), where the SME would qualify for the retail exposure class under the Standardised or IRB approaches for credit risk, or a company which is eligible for the treatment set out in Article 153, paragraph (4) of Regulation (EU) No 575/2013 and where the aggregate deposits by that SME or company on a group basis do not exceed EUR 1 million;

13) 'transactional deposits and accounts' means retail non-maturity deposits where regular transactions are carried out (e.g. where salaries are regularly credited) or those retail non-maturity deposits which are non-interest bearing even in a high interest rate environment. Other retail deposits shall be considered as held in a non-transactional account;

14) 'IRRBB measures' means economic value measures and net interest income measures after market value changes, applied in the context of the sensitivity to changes in interest rates;

15) 'CSRBB measures' means economic value measures and net interest income measures after market value changes, applied in the context of the sensitivity to changes in market credit/liquidity spreads.

Item (2) has been amended and items (10) to (15) have been added pursuant to the provision of Article 10 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 30 June 2023.

General provisions

Article 63c

(1) A credit institution shall manage risks arising from its IRRBB exposures that affect both its earnings and economic value.

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

(3) A credit institution shall also consider its general level of sophistication and internal approaches to risk management to make sure that its approaches, processes and systems for the management of IRRBB are coherent with its general approach to risk management and its specific approaches, processes and systems implemented for the purpose of the management of other risks.

(4) A credit institution shall determine net interest income based on which the effect of the interest rate movements or credit spread is calculated, based on interest income and expenses. For this purpose, a credit institution shall also consider market value changes of instruments, depending on the accounting treatment either shown in the profit and loss account or directly in equity (e.g. through other comprehensive income). A credit institution shall take into account the increase or reduction in the amount of profit and loss and capital over short- and medium-term horizons resulting from interest rate or credit spread movements.

(5) The change in the net interest income shall be the difference between expected net interest income under a shock or stress scenario from a going-concern perspective and expected net interest income under a base scenario. The market value change of instruments shall be the difference between expected market value under a shock or stress scenario from a going-concern perspective and expected market value under a base scenario at the end of the assessed horizon.

Paragraphs (4) and (5) have been amended pursuant to the provision of Article 11 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 30 June 2023.

Overall strategy for the management of IRRBB

Article 63d

(1) A credit institution shall consider the following as the interest rate sensitive instruments defined in Article 63b, item (1):

- 1) non-performing exposures;
- 2) interest rate derivatives; and
- 3) other off-balance-sheet items such as interest rate sensitive loan commitments.

(2) 'Non-performing exposures' means exposures defined in Article 47a, paragraph (3) of Regulation (EU) No 575/2013.

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

(4) An RC parent credit institution and an EU parent credit institution having its head office in the RC shall ensure that internal governance arrangements and processes for the management of IRRBB are consistent and well integrated on a consolidated and a sub-consolidated basis.

Paragraph (2) has been amended pursuant to the provision of Article 12 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 30 June 2023.

Responsibilities of the management board

Article 63e

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

1) establish a system to take appropriate actions to identify, measure, monitor and control IRRBB, consistent with the approved strategies and policies by setting:

1. appropriate limits on IRRBB, including ensuring compliance with those limits, and procedures for approvals of necessary exceptions;

2. systems and standards for measuring IRRBB, valuing positions and assessing performance, including procedures for updating interest rate shock and stress scenarios and key underlying assumptions driving the IRRBB analysis;

3. a comprehensive IRRBB reporting and review process; and

4. effective internal controls and management information systems (MISs);

2) approve major hedging or risk-taking initiatives in advance of implementation; positions related to internal risk transfers between the non-trading book and the trading book should be properly documented;

3) establish a system of regular reporting to the management board, at least quarterly, on the level and changes in the credit institution's IRRBB exposure; and

4) ensure that the validation of IRRBB measurement methods and assessment of corresponding model risk are included in the policies reviewed and approved by the management board.

(2) A credit institution's management board may designate an organisational unit, committee or employees responsible for IRRBB control and management and it shall ensure that senior management, expert individuals or an asset and liability management committee (ALCO) designated for the actions referred to in paragraph (1) of this Article are appointed in a

documented, clear and transparent manner and it shall set them clear objectives and responsibilities.

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

Risk appetite

Article 63f

(1) A credit institution shall determine its risk appetite for IRRBB in terms of the acceptable impact of fluctuating interest rates on both earnings and economic value.

(2) A credit institution with significant exposures to gap risk, basis risk or option risk shall determine its risk appetite in relation to each of these material sub-types of IRRBB and it shall establish limits for each of these sub-types.

Risk appetite framework

Article 63g

(1) A credit institution's management board shall adopt clearly defined risk appetite statements that are implemented through comprehensive risk appetite frameworks, i.e. policies and procedures for limiting and controlling IRRBB.

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

(3) In defining its risk appetite, a credit institution shall take account of earnings risks that may arise as a consequence of the accounting treatment of transactions in the non-trading book. The risk to earnings may not be limited to interest income and expenses: the effects of changes in interest rates on the market value of instruments that, depending on accounting treatment, are reflected either through the profit and loss account or directly in equity (via other comprehensive income), should be taken into account separately. A credit institution shall also take into account the earnings impact related to embedded optionalities in fair value instruments under ongoing interest rate shocks and stress scenarios, as well as the potential impact on the P&L accounts of hedging interest rate derivatives if their effectiveness was hampered by interest rate changes.

System of limits

Article 63h

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

1) policy limits appropriate to the nature, size, complexity and capital adequacy of the credit institution, as well as its ability to measure and manage its risks;

2) aggregate limits that clearly articulate the acceptable amount of IRRBB should be applied on a consolidated basis and, as appropriate, at the level of individual affiliates;

3) systems to ensure that positions that exceed, or are likely to exceed established limits receive prompt management attention and are escalated without delay; there should be a clear policy on who will be informed, how the communication will take place and the actions which will be taken in response; and

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

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

Policies and processes for the management of IRRBB

Article 63i

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

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

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

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

12) the degree of granularity employed in measurement calculations (e.g. use of time buckets); and

13) the internal definition of commercial margins and adequate methodology for internal treatment of commercial margins.

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

Internal controls

Article 63j

(1) A credit institution shall undertake regular reviews and evaluations of its internal controls systems and IRRBB management processes to ensure compliance with established policies and procedures.

(2) The reviews and evaluations referred to in paragraph (1) of this Article shall be conducted regularly by individuals or organisational units that are independent of the function under review.

(3) An internal audit function shall establish a regular review of IRRBB identification, measurement, monitoring and control processes.

Ensuring data quality

Article 63k

(1) A credit institution shall support the management of IRRBB in a timely and accurate manner through the IT systems and applications used to:

- 1) carry out, process and record business events;
- 2) identify, measure and aggregate IRRBB exposures; and
- 3) prepare reports.

(2) The systems referred to in paragraph (1) of this Article shall:

1) be capable of fully and clearly recording all transactions, taking into account their IRRBB characteristics;

2) offer sufficient flexibility to accommodate a reasonable range of shock and stress scenarios and any additional scenarios;

3) enable the measurement, assessment and monitoring of the contribution of individual transactions to overall exposure;

4) be able to compute economic value and earnings-based measures of IRRBB, as well as other measures of IRRBB based on the interest rate shock and stress scenarios; and

5) incorporate supervisory-imposed constraints on internal risk parameter assumptions.

(3) IT systems should be able to gather detailed information on the repricing date(s) of a given transaction, interest rate type or index, any options (including early repayment or redemption) and the fees relating to the exercise of these options.

(4) A credit institution shall have in place adequate organisational controls of IT systems to prevent the loss of data used by IRRBB applications, and to control changes to the coding used in those applications, so as to ensure, in particular:

1) the reliability of input data and parameters, and the integrity of processing systems for IRRBB models;

2) that the likelihood of errors occurring in the IT system is minimised; and

3) that adequate measures are taken if market disruptions or slumps occur.

(5) A credit institution shall implement appropriate processes that ensure that the data entered into the IT system is correct and establish appropriate mechanisms to verify the correctness of the aggregation process and the reliability of model results.

(6) A credit institution shall identify potential reasons for discrepancies and irregularities that may arise at the time of data processing and have procedures in place to handle those discrepancies and irregularities, including procedures for the mutual reconciliation of positions to enable these discrepancies and irregularities to be eliminated.

(7) An RC parent credit institution and an EU parent credit institution having its head office in the RC shall ensure that the data used to feed models measuring the IRRBB across the group is consistent with the data used for financial planning.

Internal reporting

Article 63l

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

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

1) summaries of the aggregate IRRBB exposures, including information on exposures to gap, basis and option risk; the reports should contain explanations of all major assets, liabilities, cash flows, and strategies that are driving the level and direction of IRRBB;

2) compliance with policies and limits;

3) key modelling assumptions, such as characteristics of non-maturity deposits (hereinafter referred to as 'NMDs'), prepayments on fixed rate loans, early withdrawals of fixed term deposits, drawing of commitments, currency aggregation and treatment of commercial margins;

4) details of the impact of key modelling assumptions on the measurement of IRRBB in terms of both economic value measures and earnings measures, including changes in assumptions under various interest rate scenarios;

5) details of the impact of interest rate derivatives on the measurement of IRRBB, in terms of both economic value measures and earnings measures;

6) details of the impact of fair value instruments, including Level 3 assets and liabilities as defined by the International Financial Reporting Standard 13 Fair Value Measurement (IFRS 13), on the measurement of IRRBB in terms of both economic value measures and earnings measures;

7) results of stress tests referred to in Article 63r of this Decision, the shocks referred to in Article 63p of this Decision, the supervisory outlier test referred to in Article 63v of this Decision and assessments of sensitivity to key assumptions and parameters; and

8) summaries of the reviews of IRRBB policies, procedures and adequacy of the measurement systems, including any findings of internal and external auditors or other equivalent external parties.

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

1) assessments of modelled prepayment losses against historical realised losses; and

2) identification of portfolios that may be subject to significant mark-to-market movements.

IRRBB model governance

Article 63m

(1) A credit institution shall ensure that the validation of IRRBB measurement models and the assessment of corresponding model risk are integrated within the governance processes and policies independently of their development. The model validation policy should be integrated within the governance processes for model risk management and should specify:

1) individuals and/or organisational units responsible for the development, validation, documentation, implementation and use of models; and

2) the model oversight responsibilities as well as policies including the development of initial and ongoing validation procedures, evaluation of results, approval, version control, exception, escalation, modification and decommission processes.

(2) The model validation framework should include the following four core elements:

1) evaluation of conceptual and methodological soundness, including developmental evidence;

2) ongoing model monitoring, including process verification and benchmarking;

3) outcomes analysis, including back-testing of key internal parameters (e.g. stability of deposits, loan prepayment rates, early redemptions of deposits, pricing of instruments); and

4) thorough assessment of any expert opinions and judgements used in internal models; and

5) validation of diversification assumptions.

(3) The management board and/or senior management shall approve the review and validation results and any recommendations on model usage. A credit institution shall organise ongoing model review, process verification and validation at a frequency that is consistent with the level of model risk determined by the management board.

(4) In the ongoing review process, a credit institution shall establish a set of exception trigger events that obligate the model reviewers to notify the management board and/or senior management in a timely fashion, in order to determine corrective actions and restrictions on model usage. Within the ongoing model review, there should be a clear control process of model versions and appropriate authorisations.

(5) A credit institution may outsource the development and/or validation of IRRBB models. Before using a third-party model, a credit institution shall carry out a procedure in accordance with the provisions of relevant regulations governing outsourcing of business activities of credit institutions. A credit institution shall ensure there is adequate documentation on its use of third-party models, including any specific customisation.

(6) A credit institution may rely on third-party IRRBB models to manage and control IRRBB, provided that these models are adequately customised to properly reflect the specific characteristics of the credit institution in question. The credit institution should fully understand the underlying analytics, assumptions and methodologies of the third-party models and ensure that they are adequately integrated into the credit institutions' overall risk management systems and processes.

(7) A credit institution shall include model inputs or assumptions, whether stemming from internal model processes or from third parties, in the validation process, and document and explain model specification choices as part of the validation process.

Item (5) has been added in paragraph (2) pursuant to the provision of Article 13 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 30 June 2023.

IRRBB measurement

Article 63n

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

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

1) the overall impact of key modelling assumptions on the measurement of IRRBB in terms of both economic value measures and earnings measures; and

2) the IRRBB of their non-trading book interest rate derivatives where relevant for the business model.

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

1) a transparent methodology for identifying the risk-free rate at inception of each instrument; and

2) a methodology that is applied consistently across all interest rate sensitive instruments and all business units.

(4) A credit institution shall include commercial margins when calculating earnings measures.

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

(6) When measuring its exposure to IRRBB, a credit institution shall develop and use its own assumptions and calculation methods and may not purely rely on the calculation and outcomes of the supervisory outlier tests referred to in Article 63v of this Decision. A credit institution shall fully integrate the supervisory outlier tests into the internal framework for the management of IRRBB and shall use them as complementary tools for measuring exposure to IRRBB.

Methods for IRRBB measurement

Article 63o

(1) A credit institution shall identify and measure all components of IRRBB referred to in Article 4, paragraph (1), items (33) to (36).

(2) For measuring and monitoring of IRRBB, a credit institution shall use at least one earnings-based measure and at least one economic value measurement method that, in combination, capture all components of IRRBB. Credit institutions in categories 1 and 2 under the document "Supervisory review and evaluation process (SREP)" published on the Croatian National Bank website, and institutions with complex or sophisticated business models, shall use multiple measurement methods.

Interest rate shock scenarios for ongoing management

Article 63p

(1) A credit institution shall regularly measure its exposure to IRRBB in terms of changes in economic value and earnings under various interest rate shock scenarios for potential changes in the level and shape of the interest rate yield curves, and to changes in the relationship between different interest rates (i.e. basis risk). A credit institution shall perform the measurement at least quarterly and more frequently in times of increased interest rate volatility or increased IRRBB levels.

(2) Taking account of the proportionality principle, a credit institution may apply a conditional or unconditional cash flow modelling approach.

(3) A credit institution shall assess exposures in each currency in which it has positions in interest rate sensitive instruments. For the material currency exposures, the interest rate shock scenarios should be currency-specific and consistent with the underlying economic characteristics.

(4) When selecting interest rate shock scenarios, a credit institution shall consider the following:

1) that interest rate shock scenarios be commensurate with the nature, scale and complexity of its activities as well as its risk profile, taking into account sudden and gradual parallel and non-parallel shifts and changes in the yield curves; scenarios should be based on the historical movements and behaviour of interest rates, as well as simulations of future interest rates;

2) interest rate scenarios should reflect changes in the relationships between key market rates in order to address basis risk;

3) the prescribed interest rate-shock scenarios as referred to in Article 181, paragraph (5), item (1) of the Credit Institutions Act;

4) any additional interest rate shock scenarios required by the Croatian National Bank; and

5) that the validity of diversification assumptions is appropriately stressed.

(5) In low interest rate environments, a credit institution shall also consider negative interest rate scenarios and the possibility of asymmetrical effects of negative interest rates on its interest rate sensitive instruments.

(6) A credit institution shall use the results of interest rate shock scenarios as a basis in the decision-making at appropriate management level. This includes strategic or business decisions, the allocation of internal capital, and risk management decisions, as well as establishing and reviewing the policies and limits for IRRBB.

Item (3) has been amended and item (5) has been added in paragraph (4) pursuant to the provision of Article 14 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 30 June 2023.

Interest rate stress scenarios

Article 63r

(1) A credit institution shall perform IRRBB testing at least annually and more frequently in times of increased interest rate volatility and increased IRRBB levels.

(2) A credit institution shall perform reverse stress tests in order to:

1) identify interest rate scenarios that could severely threaten its capital and earnings; and

2) reveal vulnerabilities arising from its hedging strategies and the potential behavioural reactions of its customers.

(3) In testing vulnerabilities under stressed conditions, a credit institution shall use larger and more extreme shifts and changes in interest rates than those used for the purpose of ongoing management, including at least the following:

- 1) substantial changes in the relationships between key market rates (basis risk);
- 2) sudden and substantial shifts in the yield curve (both parallel and non-parallel);
- 3) breakdowns of key assumptions about the behaviour of asset and liability classes;
- 4) changes in key interest rate correlation assumptions;
- 5) significant changes to current market and macro conditions and to the competitive and economic environment, and their possible development; and
- 6) specific scenarios that relate to the individual business model and profile of the credit institution.

(4) A credit institution shall use the results of interest rate stress scenarios as a basis in the decision-making at appropriate management level. This includes strategic or business decisions, the allocation of internal capital, and risk management decisions, as well as establishing and reviewing the policies and limits for IRRBB.

(5) In cases where balance sheet instruments have significant repricing restrictions (e.g. caps and floors) a credit institution should prudently consider, if material, the effect that the renewal of said instruments would have when replaced with others with comparable features, regardless of the run-off assumption. This must be done for a prudent time horizon and considering its business model.

Paragraph (5) has been added pursuant to the provision of Article 15 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 30 June 2023.

Measurement assumptions

Article 63s

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

(2) A credit institution shall, in relation to both economic value and earnings-based measures of IRRBB, take into account assumptions made for the purpose of risk quantification in relation to at least the following areas:

- 1) the exercise of interest rate options (automatic or behavioural) by both the credit institution and its customer under specific interest shock and stress scenarios;
- 2) the treatment of balances and interest flows arising from NMDs;
- 3) the treatment of fixed term deposits with risk of early redemption;
- 4) the treatment of fixed rate loans and fixed rate loan commitments;
- 5) the treatment of own equity in internal economic value measures; and
- 6) the implications of accounting practices for the measurement of IRRBB, and in particular hedge-accounting effectiveness; and
- 7) validation of diversification assumptions.

(3) A credit institution shall review significant measurement assumptions at least annually, and more frequently during rapidly changing market conditions.

Item (7) has been added in paragraph (2) pursuant to the provision of Article 16 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 30 June 2023.

Behavioural assumptions for customer accounts with embedded customer optionality

Article 63t

(1) In assessing the implications of optionality, a credit institution shall take into account:

- 1) the potential impact on current and future loan prepayment speeds arising from the interest rate scenario, underlying economic environment and contractual features, and the various dimensions influencing the embedded behavioural options;
- 2) the elasticity of adjustment of product rates to changes in market interest rates; and
- 3) the migration of balances between product types as a result of changes in their features, terms and conditions.

(2) A credit institution shall have policies in place governing the setting of, and the regular assessment of, the key assumptions for the treatment of on- and off-balance-sheet items that have embedded options in their interest rate risk framework. This means that a credit institution shall:

- 1) identify all material products and items subject to embedded options that could affect either the interest rate charged or the behavioural repricing date (as opposed to contractual maturity date) of the relevant balances;
- 2) have appropriate pricing and risk mitigation strategies (e.g. use of derivatives) to manage the impact of optionality within the risk appetite, which may include early redemption penalties chargeable to the customer as an offset to the potential break costs (where permitted);
- 3) ensure that modelling of key behavioural assumptions is justifiable in relation to the underlying historical data, and based on prudent hypotheses;
- 4) be able to demonstrate that it has accurate modelling (back-tested against experience);
- 5) maintain appropriate documentation of assumptions in its policies and procedures, and have a process for keeping them under review;
- 6) understand the sensitivity of its risk measurement outputs to these assumptions, including undertaking stress testing of the assumptions and taking the results of such tests into account in internal capital allocation decisions; and
- 7) perform regular internal validation of these assumptions to verify their stability over time and to adjust them if necessary.

Behavioural assumptions for customer accounts without specific repricing dates

Article 63u

In making behavioural assumptions about accounts without specific repricing dates for the purposes of interest rate risk management, a credit institution shall:

- 1) identify 'core' balances, i.e. deposits that are stable and unlikely to reprice even under significant changes in interest rate environment, and/or other deposits whose limited elasticity to interest rate changes could be modelled by the credit institution;
- 2) provide that modelling assumptions for these deposits reflect depositor characteristics (e.g. retail/wholesale) and account characteristics (e.g. transactional/non-transactional), in such a way that:
 1. retail transactional deposits include non-interest-bearing and other retail accounts whose remuneration component is not relevant in the client's decision to hold money in the account;
 2. retail non-transactional deposits include retail accounts whose remuneration component is relevant in the client's decision to hold money in the account;
 3. wholesale deposits include accounts from corporate and other wholesale clients, excluding interbank accounts or other fully price-sensitive ones;

3) assess the potential migration between deposits without specific repricing dates and other deposits that could modify, under different interest rate scenarios, key behavioural modelling assumptions;

4) consider potential constraints on the repricing of retail deposits in low or negative interest rate environments;

5) ensure that assumptions about the decay of core and other modelled balances are prudent and appropriate in balancing the benefits to earnings against the additional economic value risk entailed in locking in a future interest rate return on the assets financed by these balances, and the potential forgone revenue under a rising interest rate environment;

6) not exclusively rely on statistical or quantitative methods to determine the behavioural repricing dates and the cash flow profile of NMDs; the determination of appropriate modelling assumptions for NMDs shall include the collaboration of different experts within a credit institution (e.g. risk management and risk control department, sales and treasury);

7) have appropriate documentation of these assumptions in its policies and procedures, and a process for keeping them under review;

8) understand the impact of the assumptions on its own chosen risk measurement outputs and internal capital allocation decisions, including by periodically calculating sensitivity analyses on key parameters (e.g. percentage and maturity of core balances on accounts and pass-through rate) and the measures using contractual terms rather than behavioural assumptions to isolate the impact of assumptions on both economic value and earnings; and

9) undertake stress testing to understand the sensitivity of the chosen risk measures to changes in key assumptions, taking the results of such tests into account in internal capital allocation decisions.

Supervisory outlier test

Article 63v

Deleted.

Title VI.A and Articles 63a to 63v have been added pursuant to the provision of Article 3 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 67/2019, which entered into force on 20 July 2019.

Article 63v has been deleted pursuant to the provision of Article 17 of the Decision on amendments to the Decision on governance arrangements, Official Gazette, 51/2023, which entered into force on 30 June 2023.

VII OPERATIONAL RISK MANAGEMENT RULES

Management system

Article 64

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

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

Operational risk events and sources

Article 65

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

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

Operational risk management

Article 66

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

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

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

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

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

The word "ICT" and the brackets have been deleted in paragraph (1), item (2) pursuant to the provision of Article 16 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

The word "and" has been deleted at the end of item (6), item (7) has been amended and item (8) has been added pursuant to the provision of Article 6 of the Decision on amendments to the Decision on governance arrangements (Official Gazette 150/2024, which entered into force on 1 January 2025).

Analysis of significant losses

Article 67

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

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

Monitoring and reporting on operational risk exposures

Article 68

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

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

Business continuity management

Article 69

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

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

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

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

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

Paragraph (3) has been added pursuant to the provision of Article 17 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Business continuity plan

Article 70

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

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

(2) The recovery plan referred to in paragraph (1), item (2) of this Article may be part of a general recovery plan in accordance with the Decision on recovery plans of credit institutions (Official Gazette 110/2022; hereinafter referred to as 'Decision on recovery plans').

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

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

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

Paragraph (2) has been amended pursuant to the provision of Article 18 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 20 May 2023.

Reporting on business continuity planning

Article 71

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

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

VIII LIQUIDITY RISK MANAGEMENT RULES

Management system

Article 72

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

1) the assumptions on the behaviour of assets, liabilities and off-balance sheet items of a credit institution and the assumptions on other relevant circumstances so as to ensure their appropriateness in terms of the credit institution's activities and market conditions;

2) procedures for the provision of information to the management board and senior management on stress testing results and the response in cases of adverse stress testing results;

3) procedures for adequate supervision of encumbered assets providing the management with timely information on the amount and type of encumbered assets and the relevant sources of encumbrance (e.g. repo transactions), the amount and credit quality of unencumbered assets which are subject to encumbrance, listing specifically the volume of assets available for encumbrance and the amount and type of additional encumbrances due to stress (potential encumbrance);

4) examination of different possibilities or instruments for liquidity risk mitigation, including systems of limits and liquidity buffers, so as to enable the credit institution to withstand various stress events; and

5) ensuring diversification of the structure of funding and access to sources of funding.

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

(3) A credit institution operating with foreign currencies shall conduct an analysis of liquidity in foreign currencies and an analysis of mutual convertibility of foreign currencies.

For the purposes of this Title, 'convertible currencies' means the currencies of the G-10 countries, the European Economic Area (EEA), Australia and New Zealand.

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

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

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

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

Paragraph (3) has been amended pursuant to the provision of Article 19 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 20 May 2023.

Policies

Article 73

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

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

The words “in kuna” have been replaced by the words “in the domestic currency” pursuant to the provision of Article 18 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Mechanism for the allocation of liquidity costs, benefits and risks

Article 74

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

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

1) the impact of current market conditions, i.e. direct costs of funding (e.g. market cost of securing funds, base yield curve), and other direct costs of funding (e.g. the bid/ask spread, transaction price, the cost of physical transfer of cash, etc.);

2) the conditions in which the credit institution operates (e.g. credit quality, funding sources availability);

3) different behaviour characteristics of individual products from liquidity point of view (e.g. The cost of early withdrawal, products available through e-banking or products with irregular cash flows); and

4) indirect costs of sources of funding (e.g. the cost of liquidity mismatch, the cost of liquidity buffer, the cost of additional collateral, etc.).

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

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

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

Net cash flow measuring and monitoring

Article 75

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

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

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

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

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

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

Sources of funding and market access

Article 76

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

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

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

Stress testing

Article 77

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

- 1) prescribe and adopt procedures for the implementation and analysis of different stress testing exercises and their frequency (at least annually), taking into account credit institution-specific (internal), market-wide (outside) scenarios and factors and combined alternative scenarios;
- 2) prescribe that testing be conducted under shorter and protracted stressed conditions;

3) determine a schedule of stress testing when making plans for the following year; and

4) provide for alternative scenarios for liquidity positions and instruments for liquidity risk mitigation and at least once a year review assumptions on which the decisions on sources of funding are based. Those alternative scenarios relate in particular to off-balance sheet items and other contingent liabilities, including securitisation special purpose entities or other special purpose entities, as determined in Regulation (EU) No 575/2013, in relation to which a credit institution acts as a sponsor or ensures material liquid support.

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

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

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

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

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

Contingency and liquidity recovery planning of a credit institution

Article 78

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

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

1) early warning indicators which serve to identify the emergence of a crisis and the designation of the persons responsible for monitoring and reporting on these indicators (e.g. breaches of internal limits, a fall in deposits, a fall in stock prices, higher funding costs compared to other credit institutions, credit institution's credit rating change, difficulties in accessing funds in the money market, asset quality or profitability deterioration);

2) duties and responsibilities of individual employees in case of liquidity shortfall in a credit institution (such as those in charge of client and public relations, relations with key market participants, shareholders and central banks);

3) procedures which ensure timely and relevant provision of information to senior management and the management board of a credit institution for the purposes of decision-making in crisis situations;

4) procedures and processes ensuring liquidity to cover current liquidity deficits and the timeframes within which individual actions have to be taken (e.g. sale of assets, establishment of new funding lines) under normal and stressed conditions;

5) a strategy for potential asset encumbrance arising from different stress situations (a decline in a credit institution's credit quality, a decline in the value of pledged assets or increased margin calls);

6) identification, size and reliability of all sources of funding, indicating the order of use under different stress situations; and

7) circumstances warranting the execution of contingency plans and contact data (address, telephone, e-mail address and similar data) and the location of persons responsible for the execution of the plan.

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

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

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

IX MANAGING RISKS ARISING FROM EXPOSURES TO SHADOW BANKING ENTITIES

Definitions

Article 79

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

1. 'banking services and activities' as defined by Article 2 of the Commission Delegated Regulation (EU) 2023/2779 of 6 September 2023 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria for the identification of shadow banking entities referred to in Article 394(2) of Regulation (EU) No 575/2013 (OJ L, 12.12.2023); hereinafter referred to as 'Commission Delegated Regulation (EU) 2023/2779';

2. 'exposure to shadow banking entities' means the sum of all credit institution's exposures to individual shadow banking entities pursuant to Part Four of Regulation (EU) No 575/2013 equal to or in excess of 0.25% of the credit institution's tier 1 capital as defined in Article 25 of Regulation (EU) No 575/2013, where the value of a credit institution's exposure to an individual shadow banking entity is calculated by taking into account the effects of the credit risk mitigation in accordance with Articles 399 to 403 of Regulation (EU) No 575/2013 and exemptions in accordance with Article 400 and Article 493 of Regulation (EU) No 575/2013;

3. 'shadow banking entities' means undertakings as defined in Article 1 of Commission Delegated Regulation (EU) 2023/2779.

The letters h) to r) have been amended in item (4), sub-item (3) pursuant to the provision of Article 20 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 51/2023, which entered into force on 20 May 2023.

Article 79 has been amended pursuant to the provision of Article 1 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 28/2024, which entered into force on 16 March 2024.

Identification of exposures to shadow banking entities

Article 80

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

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

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

1) procedures to identify all exposures to shadow banking entities, all potential risks to which the credit institution is exposed on the basis of those exposures and the potential impact of those risks;

2) procedures to manage, control and mitigate the risks arising from exposures to shadow banking entities, where it is necessary to clearly define analyses to be performed regarding the business of a shadow banking entity to which an exposure arises and credit institution's employees to perform such analyses, the potential risks to the credit institution and the likelihood of contagion stemming from these risks;

3) a determination of the risk appetite as regards the risks arising from exposures to shadow banking entities based on the procedures referred to in item (1) of this paragraph;

4) internal limits for exposures to shadow banking entities;

5) procedures and measures a credit institution will implement in the event of a breach of the internal limits;

6) a robust process for determining interconnectedness between shadow banking entities, and between shadow banking entities and the credit institution. This process should in particular address situations where interconnectedness cannot be determined, and set out appropriate mitigation techniques to address potential risks stemming from this uncertainty;

7) effective procedures and reporting processes to the management board, the supervisory board and all the relevant levels of credit institution's management regarding exposures to shadow banking entities within the institution's overall risk management system; and

8) the stress testing methodology.

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

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

institution shall adequately incorporate the policies referred to in paragraph (2) of this Article to the policies referred to in Article 48, item (4) of the Credit Institutions Act.

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

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

Paragraph (4), which enters into force on the date of the entry into force of the regulatory technical standard adopted by the European Commission pursuant to Article 4, paragraph (4) of Regulation (EU) No 575/2013, has been amended pursuant to the provision of Article 2 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 28/2024.

Duties of the management board

Article 81

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

1) approve and review the credit institution's risk appetite to exposures to shadow banking entities, including individual internal limits and aggregate internal limits set in line with Articles 82 and 83 of this Decision;

2) approve and review the risk management process to manage exposures to shadow banking entities, including analysis of risks arising from those exposures, risk mitigation techniques and potential impact on the credit institution under stressed scenarios;

3) review the credit institution's exposures to shadow banking entities (on an aggregate and individual basis) as a percentage of total exposures and expected and incurred losses; and

4) ensure the setting of the limits referred to in Articles 82 and 83 of this Decision is documented, including any changes to them.

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

Individual internal limit

Article 82

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

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

1) the regulatory status of the shadow banking entity, in particular whether it is subject to any type of prudential or supervisory requirements;

2) the financial situation of the shadow banking entity including at least its capital amount and quality, leverage and liquidity position;

3) information available about the portfolio of the shadow banking entity, in particular non-performing loans;

4) available evidence about the adequacy of the credit analysis performed by the shadow banking entity on its portfolio, if applicable;

5) whether the shadow banking entity will be vulnerable to asset price or credit quality volatility;

6) concentration of banking services and activities relative to other business activities of the shadow banking entity;

7) interconnectedness as outlined in Article 80, paragraph (3), item (6) of this Decision; and

8) any other relevant factors identified by the credit institution in accordance with Article 80, paragraph (3), item (1) of this Decision.

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

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

The words “eligible capital” have been replaced by the words “tier 1 capital” pursuant to the provision of Article 18 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

Item (6) has been amended in paragraph (2) pursuant to the provision of Article 3 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 28/2024, which entered into force on 16 March 2024.

In paragraph (2), item (3), the Croatian word translated as “non-performing” is replaced by another Croatian word, with no relevance to the English translation, pursuant to the provision of Article 7 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 150/2024, which entered into force on 1 January 2025.

Aggregate internal limit

Article 83

(1) A credit institution shall set and apply an aggregate internal limit on total exposure to all shadow banking entities relative to its tier 1 capital.

(2) When setting an aggregate internal limit, a credit institution shall take into account the following:

1) its business model, the risk management framework as outlined in Article 80, paragraph (3), item (2) of this Decision and the risk appetite as outlined in Article 80, paragraph (3), item (3) of this Decision;

2) the size of its current exposures to shadow banking entities relative to its total exposure and relative to its total exposure to financial sector entities subject to prudential and supervisory requirements; and

3) interconnectedness as outlined in Article 80, paragraph (3), item (6) of this Decision.

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

The words “eligible capital” have been replaced by the words “tier 1 capital” pursuant to the provision of Article 18 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

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

Article 84

(1) If a credit institution is not able to meet the requirements referred to in Article 80 of this Decision or the requirements referred to in Article 81 of this Decision, it shall set an aggregate internal limit on exposures to shadow banking entities in the amount not exceeding 25% of its tier 1 capital.

(2) If a credit institution can meet the requirements referred to in Article 80 of this Decision and the requirements referred to in Article 81 of this Decision, but cannot gather sufficient information to enable it to set internal limits referred to in Articles 82 and 83 of this Decision, it shall set the aggregate internal limit on exposures to such entities in the amount not exceeding 25% of its tier 1 capital. For exposures to the remaining shadow banking entities, a credit institution shall set individual internal limits and an aggregate internal limit in accordance with Articles 82 and 83 of this Decision.

(3) In the case referred to in paragraph (2) of this Article, the maximum amount of a credit institution's exposure to all shadow banking entities shall not exceed the lower of the following amounts:

1) the aggregate internal limit in accordance with Article 83 of this Decision related to exposures to the remaining shadow banking entities for which individual internal limits have been set; or

2) the sum of the amount of 25 and the amount of individual internal limits set for the remaining shadow banking entities.

(4) If the total credit institution's exposure to all shadow banking entities exceeds the amount set by the aggregate internal limit referred to in paragraph (1) or (2) of this Article, an excess of the limit shall not include trading book exposures of the credit institution in accordance with Article 395, paragraph (5) of Regulation (EU) No 575/2013.

The words "eligible capital" have been replaced by the words "tier 1 capital" pursuant to the provision of Article 18 of the Decision on amendments to the Decision on governance arrangements, Official Gazette 145/2021, which entered into force on 6 January 2022.

X TRANSITIONAL AND FINAL PROVISIONS

Cessation of the effect of decisions

Article 85

(1) On the date of the entry into force of this Decision, the Decision on risk management (Official Gazette 1/2015 and 94/2016), the Decision on liquidity risk management (Official Gazette 105/2016) and the Decision on the internal controls systems (Official Gazette 1/2015) shall cease to have effect.

(2) Credit institutions shall adjust to the requirements of Article 11, paragraph (2) of this Decision by 30 June 2019 at the latest.

Entry into force

Article 86

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

Article 4

(1) On the date of the entry into force of this Decision, the provisions of Articles 1 to 4 and Article 8 of the Decision on the management of interest rate risk in the non-trading book (Official Gazette 120/2016 and 14/2017) shall cease to have effect.

(2) Credit institutions shall adjust to the requirements of this Decision by 31 December 2019.

(3) This Decision shall enter into force on the eighth day after the day of its publication in the Official Gazette.

Decision on amendments to the Decision on governance arrangements

(Official Gazette 145/2020)

Article 5

(1) The provisions of this Decision shall relate to all agreements concluded after the entry into force of this Decision.

(2) This Decision shall enter into force on the eighth day after the day of its publication in the Official Gazette.

Decision on amendments to the Decision on governance arrangements

(Official Gazette 145/2021)

Article 19

(1) In Article 3 of this Decision, in the part amending Article 3, item (20) of the Decision, the words "an amount equivalent to" are deleted.

(2) In Article 10 of this Decision, in the part of the introductory sentence of Article 18a, paragraph (2) of the Decision, the words "an amount equivalent to" are deleted.

Article 20

(1) This Decision shall be published in the Official Gazette and shall enter into force on the eighth day after the day of its publication, with the exception of the provisions of Article 19 of this Decision, which shall enter into force on the date of introduction of the euro as the official currency of the Republic of Croatia.

(2) Credit institutions shall adjust their policies to this Decision by 30 April 2022 at the latest.

Decision on amendments to the Decision on governance arrangements

(Official Gazette 51/2023)

Article 21

This Decision shall enter into force on the eighth day after the day of its publication in the Official Gazette, with the exception of the provisions of Articles 10 to 17 of this Decision, which shall enter into force on 30 June 2023.

Decision on amendments to the Decision on governance arrangements

(Official Gazette 28/2024)

Article 4

This Decision shall enter into force on the eighth day after the day of its publication in the Official Gazette, with the exception of the provisions of Article 2 of the Decision, which shall enter into force on the date of the entry into force of the regulatory technical standard adopted by the European Commission pursuant to Article 4, paragraph (4) of Regulation (EU) 575/2013.

Decision on amendments to the Decision on governance arrangements

(Official Gazette 150/2024)

Article 8

This Decision shall be published in the Official Gazette and shall enter into force on 1 January 2025, with the exception of the provisions of Article 5 of this Decision, which shall enter into force on 17 January 2025.