

Pursuant to Article 28, paragraph 7, Article 30, paragraph 4, Article 33, paragraph 6 and Article 36 of the Law on Banks (RS Official Gazette, Nos 107/2005, 91/2010 and 14/2015) and Article 15, paragraph 1 of the Law on the National Bank of Serbia (RS Official Gazette, Nos 72/2003, 55/2004 and 44/2010), the Executive Board of the National Bank of Serbia issues the following

## **D E C I S I O N**

### **ON RISK MANAGEMENT BY BANKS**

#### **I. BASIC PROVISIONS**

1. This Decision sets out detailed conditions and manner of identifying, measuring and assessing risks, other than risks governed by other National Bank of Serbia's regulations, to which a bank is exposed in its operations, as well as the management of these risks, including the method of calculating specific business indicators relating to risk management and setting limits pertaining to such risks.

2. In its operations, a bank is exposed or may be exposed to the following risks in particular:

- 1) liquidity risk;
- 2) credit risk, including residual risk, dilution risk, settlement/delivery risk and counterparty risk;
- 3) interest rate risk in the non-trading book;
- 4) foreign exchange risk and other market risks;
- 5) concentration risk, which particularly includes risks of exposure of the bank to a single person or a group of persons considered related persons;
- 6) investment risks;
- 7) risks relating to the country of origin of the entity to which a bank is exposed (country risk);
- 8) operational risk, including legal risk, model risk and risk resulting from inadequate management of information and other technologies relevant for the bank's operations;
- 9) risk of compliance of the bank's operations;
- 9a) risk of money laundering and terrorist financing;
- 10) strategic risk;
- 10a) excessive leverage risk;

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<sup>1</sup> Pursuant to the Decision on Minimum Information System Management Standards for Financial Institutions (RS Official Gazette, No 23/2013), Sections 17 and 18 and Sections 68–72 of the Decision on Risk Management by Banks cease to be valid on 1 January 2014.

## 11) other risks.

For the purposes of this Decision, risks referred to herein shall have the following meaning:

1) residual risk is the likelihood of occurrence of adverse effects on financial result and bank's capital due to the fact that credit risk mitigation techniques are less efficient than anticipated or their implementation does not have sufficient influence on the reduction of risks to which the bank is exposed;

2) dilution risk is the possibility of occurrence of adverse effects on the bank's financial result and capital due to the reduced value of purchased receivables as a result of cash or non-cash liabilities of the former creditor to the borrower;

3) settlement/delivery risk is the possibility of adverse effects on the bank's financial result and capital arising from unsettled transactions or counterparty's failure to deliver in free delivery transactions on the due delivery date;

4) counterparty credit risk is the possibility of adverse effects on the bank's financial result and capital arising from counterparty's failure to fulfil his part of the deal in a transaction before final settlement of cash flows of the transaction or settlement of monetary liabilities under that transaction;

5) compliance risk is the risk of regulatory sanctions, financial loss or reputational damage due to the bank's non-conformance with the law and other regulations, internal acts of the bank, business standards, anti-money laundering and terrorism financing procedures, and other acts regulating the bank's operations;

6) strategic risk is the possibility of adverse effects on the bank's financial result or capital due to absence of adequate policies and strategies, or due to their inadequate implementation, and due to changes in the environment in which the bank operates or failure of the bank to adequately respond to these changes;

7) legal risk is the risk of adverse effects on the bank's financial result and capital arising from court or out-of-court proceedings relating to the bank's operation (contracts and torts, labour relations, etc.).

## II. ESTABLISHING RISK MANAGEMENT SYSTEM OF A BANK

3. A bank shall establish a comprehensive and reliable system of risk management, integrated in all its business activities, which ensures that the bank's risk profile is always in line with the already established propensity to risks and tolerance to risks. The risk management system must be proportionate to the nature, volume and complexity of the bank's operations and/or its risk profile.

The risk management system within the meaning of paragraph 1 hereof shall be considered comprehensive and reliable if it enables the bank to manage risks it is or may be exposed to in connection with its business activities.

The risk management system within the meaning of paragraph 1 hereof shall be considered integrated in all business activities of the bank if the bank makes every business decision where it assumes certain risks (including conditions under which certain transactions are negotiated) taking into consideration prior assessment by employees in charge of risk management.

Business activities referred to in paragraph 1 hereof shall also imply activities undertaken by third parties on behalf of the bank (outsourcing).

The risk profile of the bank referred to in paragraph 1 hereof shall imply assessment of the bank regarding the structure and level of all risks it is or may be exposed to in its operation.

The bank's propensity to risks referred to in paragraph 1 hereof shall imply the risk level that the bank intends to assume in order to accomplish its strategies and policies, while tolerance to risks referred to in that paragraph shall imply the maximum acceptable risk level. The bank shall ensure that its propensity to risks and tolerance to risks are in line with the bank's strategic planning period.

4. The risk management system shall encompass:

- strategy, policies and procedures for risk management, i.e. for the identification, measurement, assessment, monitoring, control and mitigation of risks and reporting on them;
- adequate internal organisation/organisational structure of the bank;
- effective and efficient process of management of all risks the bank is or may be exposed to in its operation;
- adequate internal controls system;
- appropriate information system;
- adequate internal capital adequacy assessment process.

**Strategy, policies and procedures**

5. The risk management strategy shall consist of one or more documents regulating uniform and consistent management of bank's risks on a long-term basis, which define the attitude of the bank toward risks it is or may be

exposed to in its operation, including risks arising from the macroeconomic environment in which the bank operates.

The risk management strategy should be consistent with the bank's business policy and strategy.

6. The risk management strategy shall include in particular:

- summary and definitions of all risks the bank is or may be exposed to;
- long-term goals determined by the bank's business policy and strategy, as well as the propensity to risks defined in accordance with these goals;
- main principles of risk assumption and risk management;
- main principles of the internal capital adequacy assessment process.

In its business policy and strategy, the bank shall determine its long-term objectives concerning the level of distressed assets.

In its risk management strategy, the bank shall determine separately:

- 1) the criteria for establishing the bank's distressed assets, the basic principles of their management, and the highest acceptable level of the bank's distressed assets;
- 2) the basic principles of managing risks arising from bank FX-indexed dinar and FX exposures, the highest acceptable level of those exposures in total bank exposures, as well as long-term targets for this level;
- 3) the highest acceptable level of FX-indexed dinar and FX exposures, by exposure types, as well as long-term targets for this level.

For the purposes of this Decision, the bank's distressed assets shall mean exposures that the bank is required to classify in the group of non-performing exposures as defined by the decision governing the classification of bank balance sheet assets and off-balance sheet items.

The bank shall review its risk management strategy periodically and amend it as necessary, particularly in the case of significant changes in the bank's business policy and strategy and/or changes in the macroeconomic environment in which the bank operates.

7. Risk management policy shall consist of one or more bank documents which shall specifically regulate the following:

- manner of organising the risk management process in a bank and clear division between employees' responsibilities in all stages of that process;
- manner of assessment of the bank's risk profile and the methodology for identification, measuring and assessment of individual risk;
- measures for mitigation of individual risks and rules for their implementation;
- manner of monitoring and control of individual risks and establishment of the bank limits system;
- manner of decision-making and actions taken with regard to the overrun of set limits, and definition of exceptional circumstances where these overruns can be authorised within the legal framework;
- principles of functioning of the system of internal controls of the bank, manner and methodology for the implementation of the bank's internal capital adequacy assessment process;
- framework and frequency of stress testing, as well as the procedure in the cases of unfavourable results of stress tests.

By the documents referred to in paragraph 1 of this Section, the bank shall regulate separately the management of risks concerning distressed assets and FX-indexed dinar and FX exposures, in regard to the issues set out in indents 1–7 of that paragraph.

A bank shall review its risk management policies at least once a year or more frequently in case of significant changes in the bank's risk profile, and amend them as necessary.

8. Based on its risk management strategy and policies, a bank shall adopt and implement procedures for identification, measurement and/or assessment of risks which it is or may be exposed to, and for the management of these risks.

The bank shall in particular ensure with its procedures for risk identification that this identification is timely and comprehensive and shall also ensure the analysis of causes that lead to the occurrence of risks.

The procedures for measurement and/or assessment of risks shall in particular contain quantitative and/or qualitative methods based on which a bank may notice in due time any change in its risk profile, including the emergence of new risks.

Risk management procedures shall in particular contain a description of risk mitigation procedures, as well as the description of risk monitoring and control procedures.

The procedures referred to in paragraph 1 hereof which relate to distressed assets shall establish in particular:

- precisely defined activities, authorities and responsibilities relating to the early identification of borrowers facing financial difficulties and past due borrowers or borrowers in the default status, indicators for the transfer of activities involving these borrowers to the remit of the organisational unit referred to in Section 9, paragraph 4 hereof, including the activities and responsibilities for monitoring the status of these borrowers (e.g. by creating the watch list);
- precisely defined activities, authorities and responsibilities relating to communication with borrowers referred to in the first indent of this paragraph, including other creditors, if the bank assesses that it is possible to redefine borrower-creditor relations;
- precisely defined activities and measures to be taken or considered by the bank in relation to distressed asset management, including authorities and responsibilities for taking these activities and measures, as well as the deadlines for making decisions about these activities and measures, and the timeframe for their implementation, depending on the assessment of the borrower's capacity to settle its obligations towards the bank, and/or assessment of the financial condition/creditworthiness of the borrower/credit protection provider and the number of past due days in settling the borrower's obligations;
- the manner of determining the indicators for monitoring distressed assets and incorporating them in the overall corporate governance system and the risk management system (including the bank's recovery plan);
- precisely defined responsibilities concerning the reporting of the bank's competent bodies about the efficiency and effectiveness of the implementation of activities of collection and distressed asset management measures (including the explanation why particular measures were chosen) and the periodicity of such reporting.

The procedures referred to in paragraph 1 hereof which relate to FX-indexed dinar and FX exposures shall establish in particular:

- 1) precisely defined manner of monitoring and control of risks by type of exposures;
- 2) bank limits by types of exposure;
- 3) precisely defined activities and measures to be undertaken by the bank to achieve the targets referred to in Section 6 paragraphs 3, indents 2) and 3) of this Decision;
- 4) precisely defined activities and measures to be undertaken by the bank in order to reduce the total amount of FX-indexed dinar and FX loans which are not hedged against exchange rate risk resulting from the currency mismatch between the currency of the borrower's income and the currency of the loan;

5) precisely defined authorities and responsibilities for undertaking activities and measures referred to in indents 3) and 4) of this paragraph, deadlines and manner of making decisions about these activities and measures, and the timeframe for their implementation.

The bank shall review the regulations referred to herein at least once a year or more frequently in case of significant changes in the bank's risk profile, and amend them as necessary.

### **Internal organisation/organisational structure**

9. A bank shall establish such internal organisation/organisational structure by which the activities of risk management (middle office) and support activities (back office) would be functionally and organisationally separated from risk assumption (front office), with a clearly defined division of employees' tasks and duties that prevents conflict of interest.

The obligation of functional and organisational separation referred to in paragraph 1 hereof also means that the authorities and responsibilities in respect of tasks concerning risk management and/or support activities may not be entrusted to the executive board member who has already been entrusted with authorities and responsibilities in respect of tasks relating to risk assumption.

The division of employees' tasks and duties shall be deemed clearly defined if the following conditions are met:

- employees' tasks and duties can be unequivocally identified based on the bank's internal regulations governing organisation of its operation;
- employees are made aware of their tasks and duties;
- the process of adoption and implementation of decisions is documented.

The bank shall establish a separate organisational unit for distressed asset management, whose remit shall include activities and measures of distressed asset management – such unit shall be in functional and organisational terms separated from organisational units whose remit includes risk assumption.

The bank shall engage a sufficient number of employees with appropriate qualifications and professional experience in the organisational unit referred to in paragraph 4 hereof – these employees shall be tasked exclusively with distressed asset management. The size of this organisational unit shall be commensurate with the scope, type and complexity of activities

performed by the bank, the risk profile of the bank and the level of its distressed assets.

The bank shall ensure that the number of employees engaged in the identification, measurement and monitoring of the risk of money laundering and terrorist financing and in managing such risk is commensurate with the scope, type and complexity of the activities it performs, its risk profile and the degree of its exposure to the risk of money laundering and terrorist financing.

10. To ensure the implementation of business policy and strategy as well as the risk management strategy and policies, a bank shall enable adequate communication, exchange of information and cooperation at all organisational levels.

11. A bank shall engage an adequate number of employees with appropriate qualifications and professional experience in its risk management system, designate key employees tasked with managing the bank's risks, and maintain continuity in the implementation of the risk management strategy and policies at all times, depending on the volume, type and complexity of its activities.

In designating the key employees referred to in paragraph 1 hereof, the bank shall ensure that their position in the bank has a significant effect on risk management activities, including decision-making in relation to risk management.

12. A bank shall establish adequate remuneration policy for its employees, including benefits.

The policy referred to in paragraph 1 shall be deemed adequate if it is based on the implementation of the bank's business policy and strategy, as well as the risk management strategy and policies, and if it fosters reasonable and prudent assumption of risks.

Remuneration policy, including benefits, referred to in paragraph 1 hereof shall be deemed to foster reasonable and prudent assumption of risks if it takes into consideration all types of risks the bank is or may be exposed to in its various activities, while the system of rewards and/or bonuses shall be:

- based on the accomplishment of business objectives and symmetric, meaning that the total fund for bonuses and rewards is defined in accordance with the degree of accomplishment of business objectives (which implies a significant reduction or abolishment of that fund or a part thereof



referring to certain employees in the event the objectives have not been fulfilled as planned), and

- concurrent with the period to which the risk refers – the periods of payment of bonuses and rewards should correspond to that period.

Provisions of this Section shall apply accordingly to the remuneration of members of the bank's managing board.

### **Risk management process**

13. A bank shall establish an effective and efficient risk management process which encompasses mitigation, monitoring and control of risks that the bank is or may be exposed to and which it identified and measured and/or assessed.

Within the risk management process, the bank shall:

- identify risks it is or may be exposed to in its operation in a timely, comprehensive and continuous manner, and analyse the causes that lead to the occurrence of risks;

- regularly measure and/or assess the risks it identified in its operation, whereby the procedures for measuring and/or assessment of risks must contain appropriate quantitative and/or qualitative methods based on which the bank may timely notice any change in its risk profile, including the emergence of new risks;

- set clear criteria for decision-making and risk mitigation procedures relating to risk assumption, diversification, transfer, reduction and/or avoidance, having in view the bank's risk profile, propensity to risks and tolerance to risks.

- appropriately document the monitoring and control of risks, i.e. the frequency and manner of monitoring risks to which it is exposed, and the monitoring and control of limits within the established system of limits.

The bank shall assess the potential impact of relevant macroeconomic factors on risk exposure and consider these assessments when making important decisions related to risks.

### **Internal controls system**

15. A bank shall establish and implement an effective and efficient system of internal controls for the continuous monitoring of risks to which it is or may be exposed, including in particular:

- 1) risk management function;
- 2) compliance function;

### 3) internal audit function.

The system of internal controls represents a set of processes and procedures established to adequately control risks, monitor the effectiveness and efficiency of operations, ensure the reliability of the bank's financial and other data and information, as well as their compliance with regulations, internal acts and business standards, with the aim of ensuring the safety and soundness of the bank's operations.

The bank shall establish the functions of the internal controls system referred to in paragraph 1 hereof in such a way that the size and organisational and qualification structure of those functions correspond to the size of the bank, as well as the scope and type of activities the bank performs, and that the number and structure of employees enable the effective and efficient execution of those functions.

The bank shall ensure that the performance of the functions of the internal controls system referred to in paragraph 1 hereof is independent, as well as prevent any activities or circumstances that may negatively affect the objective operation of these functions.

The managers of the functions referred to in paragraph 1 hereof, if not members of the bank's management bodies, are considered to be key function holders within the meaning of the Law on Banks and the decision regulating the detailed conditions and manner of appointment of key function holders in a bank.

The bank's internal control system shall ensure timely informing of the bank's organisational units and persons responsible for risk management about identified deficiencies, as well as the implementation of measures to eliminate those deficiencies, and any necessary changes to the risk management system when needed.

16. A bank shall ensure that internal controls are an integral part of all day-to-day activities of its employees and that the employees, in conformity with good business practices, professional and ethical standards, understand the purpose and the importance of these controls and their own contribution to the effective implementation of those controls.

Using the internal controls system, the bank shall establish, where applicable, controls that restrict access to the bank's material property and/or ensure its safety. These controls shall include various forms of restriction of access to the bank's material property (e.g. multiple verifications or joint verifications by several persons), as well as taking periodic inventories of this property.

### **Information system**

17. A bank shall adopt and implement the strategy for development of the information system and a security policy for that system.

With the strategy of development of the information system the bank shall ensure that this system is at all times commensurate with the nature, volume and complexity of the bank's activities.

The information system security policy shall in particular refer to:

- 1) manner of ensuring the security of the system;
- 2) principles and procedures for ensuring:
  - confidentiality of data or that only authorised persons have access to them,
  - integrity of data, and/or their accuracy and completeness,
  - availability of data to authorised persons as necessary, including procedures enabling continuous performance of the bank's business operations in the case of system errors or failure;
- 3) division of tasks and duties relating to information technology, data from the information system and relevant documentation.

18. A bank shall ensure that the accounting system, other data processing systems, as well as the reporting system are an integral part of the bank's information system.

### **System of reporting on risks**

19. A bank shall establish a system of reporting on risks that will provide the relevant employees at all levels in the bank with timely, accurate and sufficiently detailed information necessary for making business decisions and efficient risk management, i.e. for safe and stable bank operation.

The information referred to in paragraph 1 hereof shall include in particular:

- information on the bank's risk profile and changes in its risk profile, classified according to various criteria (individual risks, geographical areas, currencies, the bank's organisational units, the bank's portfolios, types of transactions, counterparties, etc.);

- information on the risk category of the client, product, service and transaction with regard to the risk of money laundering and/or terrorist financing;
- data about significant losses;
- information on taken or planned measures for risk mitigation;
- information on overruns of set limits;
- information on changes in business indicators signalling a change in the bank's overall risk exposure;
- information on risks occurring as a consequence of introducing a new product, activity, process or system;
- information on risks occurring as a consequence of outsourcing.

### **Stress testing**

19a. A bank shall regularly, at least once a year, carry out stress testing at the level of individual materially significant risks to which it is exposed, at the level of portfolio and at the level of the bank.

The stress testing referred to in paragraph 1 hereof shall imply the assessment of potential effects of specific events and/or changes in a number of risk factors on the bank's capital, liquidity and financial result. Stress testing may be carried out by:

- 1) sensitivity analysis, which assesses the effects of changes in a specific risk factor on the bank's capital, liquidity and financial result, and/or
- 2) scenario analysis, which assesses the effects of concurrent changes in a number of risk factors on the bank's capital, liquidity and financial result in clearly defined exceptional (stress) circumstances.

If the stress testing referred to in paragraph 2 hereof does not ensure adequate assessment referred to in that paragraph, the bank shall use reverse stress testing as a form of stress testing that starts by defining the outcome (e.g. an event of default occurring soon) and identifies scenarios or a combination of scenarios and/or causes that may lead to that outcome, and its consequences.

The bank shall include in stress testing all significant risk factors specific to its business environment, including factors of the macroeconomic environment.

In its internal regulations, including those that govern the internal capital adequacy assessment process, the bank shall include the following:

- 1) use of various forms of stress testing and their objectives;
- 2) frequency of implementation of various types of stress tests;

3) authorisations, obligations and responsibilities in the stress testing process;

4) detailed description of methodologies of stress testing, including the application of models and expert opinions;

5) assumptions used in stress testing, including the bank's business activities and/or decisions made by the bank's governing body in case of materialisation of stress scenarios;

6) information system and system of reporting on risks that support the stress testing process.

The bank shall take into consideration the results of stress testing when revising and/or reviewing strategies, propensity to risks and/or tolerance to risks, system of limits, application of risk mitigation techniques, internal capital adequacy assessment process and plans of activities in case of unforeseen events.

The bank shall, at least once a year or more frequently in case of significant changes in the bank's risk profile, review the adequacy of implementation of stress testing and amend it as necessary, whereby it shall include at least the following:

1) frequency of stress testing and its compliance with the defined objectives of that testing;

2) need for further development and/or improvement of stress testing;

3) quality of data used for stress testing;

4) knowledge of relevant employees, in particular the governing body, about the performance and results of stress testing;

5) documentation evidencing the process and results of stress testing.

### **Internal capital adequacy assessment process (ICAAP)**

20. A bank shall implement the internal capital adequacy assessment process (ICAAP), i.e. determine the amount of total internal capital requirements in accordance with its risk profile, as well as determine the available internal capital and carry out its distribution.

Within the meaning of this Decision, total internal capital requirements are the amount of capital needed to cover all risks that a bank is exposed to or may be exposed to in its operation. An internal capital requirement for an individual risk is the amount of capital needed to cover an individual risk that a bank is exposed to or may be exposed to in its operation.

Within the meaning of this Decision, available internal capital is the amount of capital available to cover all risks that a bank is exposed to or may be exposed to in its operation.

### ***Capital management strategy and plan***

21. A bank shall establish a capital management strategy that ensures the maintenance of such level and structure of available internal capital that may support the expected rise in lending, future sources of funding and their use, dividends policy and any changes in the minimum capital requirement set forth by the decision regulating capital adequacy.

The bank shall establish a capital management plan, which shall in particular contain:

- strategic objectives and period for their attainment, taking into consideration the influence of the macroeconomic environment and phases of the business cycle;
- description of the available internal capital management process and planning of the adequate level of that capital, including the procedures and responsibilities for that process;
- manner of achieving and maintaining an adequate available internal capital level;
- restrictions regarding the available internal capital;
- presentation and explanation of effects of stress testing referred to in Section 26 hereof on internal capital requirements;
- contingency plan in the event of emergencies that may affect the amount of available internal capital.

The bank shall, based on the stress testing referred to in Section 26 hereof, assess the reliability and, as necessary, update the capital management plan so as to ensure that the internal capital requirements are met and/or appropriately covered.

22. A bank shall continuously implement the documented internal capital adequacy assessment process commensurate with the nature, volume and complexity of the bank's activities, in accordance with the risk management strategy and policies and with the capital management strategy.

A bank shall ensure that the process referred to in paragraph 1 hereof also meets the following conditions:

- it is based on risk identification and measurement and/or assessment;

- it ensures a comprehensive risk assessment, and monitoring of materially significant risks the bank is or may be exposed to in its operation;
- it ensures adequate available internal capital in accordance with the bank's risk profile;
- it is adequately incorporated into the bank's management and decision-making system;
- it is subject to regular analyses, monitoring and checking.

### ***Phases of the process***

23. A bank shall ensure that the internal capital adequacy assessment process encompasses the following phases:

- 1) identification of materially significant risks;
- 2) calculation of internal capital requirements for individual risks;
- 3) determination of total internal capital requirements;
- 4) comparison of the following elements:
  - capital calculated in accordance with the decision on capital adequacy of banks and the amount of available internal capital;
  - minimum capital requirements calculated in accordance with the above decision and internal capital requirements for individual risks;
  - sum of minimum capital requirements calculated in accordance with the above decision and total internal capital requirements.

24. A bank shall adopt an appropriate internal regulation setting out quantitative and qualitative criteria, and the thresholds based on which it identifies materially significant risks to be included in the internal capital adequacy assessment process, taking into consideration the type, volume and complexity of its activities, as well as the specific features of the markets in which it operates.

To identify risks referred to in paragraph 1 hereof, a bank shall analyse:

- 1) risks for which it calculates minimum capital requirements, in conformity with the decision on capital adequacy of banks;
- 2) risks that are not fully encompassed by minimum capital requirements in provision 1) hereof (credit-foreign exchange risk, residual risk, possible underestimation of credit risk due to the application of standardised approach, possible underestimation of operational risk due to the application of the base rate approach or standardised approach and/or alternative standardised approach);
- 3) liquidity risk, interest rate risk in the non-trading book, concentration risk, reputational risk and strategic risk;

4) risks arising from external factors, including the impact of the business and macroeconomic environment, as well as risks not mentioned in provisions 1)–3) hereof.

For the purposes of the internal capital adequacy assessment process, the bank may use its own definitions of risk that include at least the definitions of risk in accordance with this decision and the decision governing capital adequacy of banks, whereby it shall explain in detail any differences in definitions and document them appropriately.

A bank shall provide a documented explanation of its decision not to include certain risks in its internal capital adequacy assessment process.

25. The methodology for risk measurement and/or assessment for the purpose of the internal capital adequacy assessment process shall particularly regulate the following:

- use of approaches for the calculation of minimum capital requirements, in conformity with the decision on capital adequacy of banks;
- use of own approaches for the calculation of internal capital requirements for individual risks, including the manner of assessment of risks that cannot be accurately quantified, and the manner of implementation and explanation of potential adjustments in the calculation of internal capital requirements.

By applying the methodology referred to in paragraph 1 hereof, the bank shall calculate internal capital requirements for individual risks, whereby it shall appropriately document those calculations.

26. Within the internal capital adequacy assessment process, a bank shall carry out stress testing for all materially significant risks.

27. A bank shall calculate total internal capital requirements based on the sum of internal capital requirements for individual risks obtained by applying the methodology referred to in Section 25 hereof, whereby it shall separately present those capital requirements with and without the effects of the stress tests referred to in Section 26 hereof.

The bank shall identify and document the elements of available internal capital and the manner of its valuation, taking into account the availability of those elements for loss coverage on a going concern basis.

The bank shall maintain the available internal capital at least at the level of total internal capital requirements.



Available internal capital, internal capital requirements for individual risks and total internal capital requirements, obtained as a result of the internal capital adequacy assessment process, may differ from the bank's capital, minimum capital requirements and the sum of minimum capital requirements, calculated in accordance with the decision on capital adequacy of banks in which case the bank shall analyse and document these differences.

27a. A bank shall compile a report on the internal capital adequacy assessment process as at 31 December and submit it to the National Bank of Serbia on 31 March of the following year at the latest.

The ultimate parent company of the banking group that is supervised on a consolidated basis by the National Bank of Serbia shall compile a report on the internal capital adequacy assessment process as at 31 December and submit it to the National Bank of Serbia within the deadlines prescribed for the submission and publication of annual consolidated financial statements of the banking group with the external auditor's report.

The bank and/or ultimate parent company referred to in paragraph 2 hereof shall submit the reports referred to herein in electronic form.

The minimum content of the report referred to herein is established in Annex 1 which is integral to this Decision.

The National Bank of Serbia may in more detail prescribe by guidelines the content of the report referred to herein, and the documents submitted along with those reports by the bank and/or ultimate parent company referred to in paragraph 2 hereof.

***Incorporating the internal capital adequacy assessment process into the management and decision-making system***

28. A bank shall incorporate the internal capital adequacy assessment process into the bank management and decision-making system and/or use the results of these assessments in making business decisions and decisions referring to risk management, as well as in the establishment of the system of limits.

A bank shall regularly, at least once a year, check and review the internal capital adequacy assessment process and adjust it as necessary.

In addition to regular annual checking of the process referred to in paragraph 1 hereof, a bank shall review and adjust that process whenever it is exposed to new risks and significant changes – both in its strategic objectives and operating plans and in the external environment.

The internal audit of the bank shall assess the internal capital adequacy assessment process at least once a year.

### III. RISK MANAGEMENT BY BANKS

#### **Credit risk**

38. Credit risk is the possibility of occurrence of adverse effects on financial result and capital of the bank caused by the borrower's failure to fulfil its obligations to the bank.

A bank shall manage credit risk at the level of individual loan and at the level of the entire credit portfolio.

In order to assume credit risk and manage that risk, a bank shall establish an adequate credit process, which shall include the process of loan approval and the process of managing this risk.

39. Within the credit process, a bank shall establish:

- 1) criteria and principles for approving new loans and for extending forbearance in respect of existing loans, and particularly for deciding on the approval of loans representing large exposures of the bank;
- 2) rules for approving and monitoring loans at the level of individual borrowers and credit protection providers, at the level of a group of entities considered related, and at the level of entities related with the bank, in accordance with the loan amount and risk degree;
- 3) a set of possible forbearance measures to be applied in respect of loans considered distressed assets (for each segment), while at the same time ensuring that forbearance measures may not be used for temporary or permanent concealment of the actual degree of the risk of forborne exposures;
- 4) a set of activities to be undertaken in order to reduce the total amount of FX-indexed dinar and FX loans which are not hedged against exchange rate risk resulting from the currency mismatch between the currency of the borrower's income and the currency of the loan.

Within the meaning of this Decision, hedging against exchange rate risk resulting from the currency mismatch between the currency of the borrower's income and the currency of the loan means a natural hedge and financial

hedge. A natural hedge exists if the borrower's income and his loan commitment are in the same currency, and financial hedge exists if a bank concludes an appropriate contract with the borrower.

40. Before deciding to approve a loan, a bank shall assess the borrower's financial standing and creditworthiness, as well as the value and legal security of its credit protection and other relevant factors.

If a bank approves a loan under the conditions differing from market conditions, it shall establish procedures for approving and monitoring such loan and for undertaking relevant measures to mitigate credit risk arising from such lending.

41. A bank shall assess credit risk based on quantitative and qualitative criteria which take into consideration the characteristics of the specific borrower and lending and enable clear classification of lending into respective risk categories according to the degree of collectibility. A bank shall ensure continuous monitoring and verification of the adequacy of the classification of loans into these categories.

When determining the amount of allowances for impairment of balance-sheet assets and provisions for losses on off-balance sheet items, a bank shall take into consideration the assessment of credit risk.

A bank shall clearly document its credit risk assessment.

42. A bank shall establish efficient monitoring of lending with clearly defined procedures and frequency which enable it to undertake adequate measures to reduce credit risk in due time in case of deterioration of financial standing or creditworthiness of the borrower or credit protection provider, including measures that would provide hedging against exchange rate risk resulting from the currency mismatch between the currency of the borrower's income and the currency of the loan.

A bank shall establish clearly defined procedures for monitoring of the use of funds approved for the contractually specified purposes, and determine the types of loans in terms of three-digit accounts stipulated by the decision on the chart of accounts and the content of accounts in the chart of accounts for banks, and/or individual loan products from the bank's offer, in respect of which the bank will conduct this monitoring.

The bank shall document monitoring of the use of funds approved for the contractually specified purposes within the meaning of paragraph 3 of this Section, on the basis of an individual loan approved to the borrower.

Monitoring of the quality of lending at the level of individual borrower by the bank shall primarily be based on the provision of up-to-date data on the borrower's financial standing and creditworthiness and on the market value of collateral. A bank shall monitor the fulfilment of contractual obligations by the borrower, and particularly the use of funds approved for the contractually specified purposes.

A bank shall establish the system of early warning for increased credit risk, which enables timely identification of borrowers with whom this increase occurred and which includes the definition of qualitative and quantitative indicators for early detection of increased credit risk.

A bank shall monitor lending from the time it is approved until the termination of the contract under which the bank is exposed to credit risk, and shall include monitoring of individual lending, borrower and credit protection instruments. In addition to regular monitoring, a bank shall particularly monitor all lending approved to borrowers who are in the status of default.

To ensure more efficient management of distressed assets, the bank shall carry out the segmentation of these assets based on clear criteria (e.g. exposure to legal and natural persons, purpose of lending, business branches, persons considered related, currency, collection phase, types of collateral etc.) – in accordance with the scope, type and complexity of the activities it performs, the risk profile of the bank and the level of its distressed assets.

42a. A bank may assign receivables from a legal entity, entrepreneur and farmer to another bank.

Notwithstanding paragraph 1 of this Decision, to reduce distressed assets, a bank may assign the following receivables from a legal entity, entrepreneur and farmer also to another legal entity:

- due receivables;
- receivables not yet due but considered non-performing within the meaning of the decision governing the classification of bank balance sheet assets and off-balance sheet items, and classified as non-performing exposures on the cut-off classification date which immediately precedes the submission of the notification referred to in paragraph 5 hereof.

A bank may assign receivables from a natural person – financial services consumer in accordance with the law governing the protection of financial services consumers.

Prior to decision-making on the assignment referred to in paragraphs 1–3 hereof, a bank shall assess the effect of the assignment on:

- the bank's credit risk-weighted assets, reserves for estimated losses and capital adequacy ratio;
- the amount and structure of the bank's NPLs, within the meaning of the decision on reporting requirements for banks;
- the bank's expenses and financial result;
- the bank's risk profile.

A bank shall notify the National Bank of Serbia of the intended assignment from paragraphs 1–3 hereof by no later than 30 days before concluding the relevant assignment agreement. The notification shall be supported by the following documentation:

- 1) decision of the bank's governing body on the assignment from those paragraphs;
- 2) main data about the person to which the bank intends to assign receivables (business name, seat and registry number, as well as data on the ownership structure and members of the governing bodies), with a designation whether the person is related to the bank;
- 3) draft agreement on assignment from those paragraphs, with the planned date of agreement conclusion and/or execution;
- 4) results of the assessment from paragraph 4 hereof;
- 5) data on gross book value of receivables to be assigned and the amount of allowances for impairment of those receivables;
- 6) data on whether the assignment from those paragraphs is performed against the payment of a fee, the absolute amount of that fee and/or percentage of the value of the receivable to be assigned less allowances for impairment, data on the origin of funds used to pay the fee for the assignment of the receivable, and if the bank is providing those funds indirectly or directly – data on the manner in which the funds were provided and the amount of funds in the specific assignment, as well as data on all bank's receivables to the person to which the bank intends to assign the receivable on the date of submission of the notification referred to herein;
- 7) data on the classification of receivables being assigned within the meaning of the decision governing the classification of bank balance sheet assets and off-balance sheet items for at least two last quarters.

Notwithstanding paragraph 5 hereof, in case of urgency, when the assignment of receivables referred to in paragraphs 1 to 3 hereof is necessary for the purpose of improving its financial position, a bank may request from the National Bank of Serbia the approval to submit the notification and documentation referred to in paragraph 5 hereof within the deadline shorter than the deadline from that paragraph, but no later than five

working days before the conclusion of the agreement on the assignment of receivables.

If the bank changes the planned date of conclusion and/or execution of the agreement from paragraph 5, provision 3) hereof after the notification from that paragraph, it shall inform the National Bank of Serbia thereof without delay.

A bank shall notify the National Bank of Serbia of the completed assignment from paragraphs 1–3 hereof by no later than five working days following the assignment.

The contents and form of the notification referred to in paragraphs 5 and 8 hereof are defined in Annex 2, which is printed along with this Decision and is integral to it.

The National Bank of Serbia shall submit the notification referred to in paragraphs 5 and 8 hereof in accordance with the National Bank of Serbia's guidelines which govern the electronic submission of data from the notification and which are published on the National Bank of Serbia's website.

The bank shall, in the period of 180 days from the day of submission of the notification referred to in paragraph 8 hereof, notify the National Bank of Serbia without delay of any change in data relating to the indirect or direct provision by the bank of funds used for paying the fee for the assigned receivable, and of all loans approved to the person to which the receivable is assigned after the submission of the notification referred to in paragraph 8 hereof.

42b. As regards forbearance measures referred to in Section 39, paragraph 1, item 3) hereof, the bank must assess whether extending forbearance to an individual borrower is sustainable and economically justified for the bank and the borrower, and must determine the forbearance plan and regularly monitor its implementation and effects.

When determining whether granting forbearance to a borrower – legal entity is economically justified, the bank must particularly provide and document:

- 1) detailed analysis of the reasons for the borrower's financial difficulties;
- 2) plan of consolidation of the borrower's financial position and operation and, if applicable, the plan of consolidation of its ownership structure;

3) projection of cash flows for the period of at least three following years, and/or the period of the envisaged duration of repayment in accordance with the forbearance plan if that period is shorter.

Given the information referred to in paragraph 2 hereof, the bank must prepare:

- 1) assessment of the feasibility of the proposed plan referred to in provision 2) of that paragraph;
- 2) analysis of possible forbearance measures and the explanation of the effects and advantages of the selected forbearance measure;
- 3) new repayment plan which will serve as the basis for further monitoring of the implementation of the forbearance plan.

When determining whether the extension of forbearance to a borrower – financial services consumer within the meaning of the law governing the protection of financial services consumers – is economically justified, the bank shall analyse in particular the reasons for the borrower's financial difficulties and possible forbearance measures, and shall explain the effects and advantages of the selected forbearance measure, and prepare the new repayment plan which will serve as the basis for further monitoring of the implementation of the forbearance plan.

The bank shall have an obligation to consider forbearance options in respect of the borrower referred to in paragraph 4 hereof before initiating collateral realisation.

The bank shall regularly, at least once in six months, monitor the implementation of the forbearance plan, taking into account the size and importance of forborne exposures relative to other exposures of the bank, including the specificities of the forbearance plan and the bank's activities envisaged by the plan.

43. A bank shall regularly analyse the structure and quality of its credit portfolio, including the assessment of concentration risk and residual risk, as well as the assessment of future changes in this portfolio.

The bank shall take into consideration the results of the analysis referred to in paragraph 1 hereof when defining its risk management strategy and policies in the segment relating to credit risk management.

44. For loans negotiated in a foreign currency or in dinars with a foreign currency clause, a bank shall assess credit FX risk, i.e. the effect of change in the dinar exchange rate on the borrower's financial standing and

creditworthiness, and shall in particular analyse the adequacy of the borrower's cash flows relative to the changed level of credit liabilities, under the assumption that certain changes in the dinar exchange rate will occur at the annual level.

Based on the results of the assessment and analysis of the adequacy the borrower's cash flows from paragraph 1 of this Section, the bank shall, in accordance with its internal acts, consider activities and measures which it may propose to the borrower in order to provide hedging against exchange rate risk resulting from the currency mismatch between the currency of the borrower's income and the currency of the loan.

The bank shall document the results of the assessment including the adequacy of cash flows analysis conducted in accordance with paragraph 1 of this Section, as well as the proposals made to the borrower within the meaning of paragraph 2 of this Section.

*Monitoring the quality of collateral and work of persons engaged in collateral valuation*

44a. The bank shall define in its internal regulations the types of collateral whose value shall be determined based on the valuation by an authorised valuer, the procedure of obtaining such valuation, the frequency of monitoring the quality of collateral, and/or re-valuation and the manner of determining the expected time of collection by collateral realisation.

The authorised valuer referred to in paragraph 1 hereof means the person who – in accordance with the law governing the profession of real estate valuers, and/or the law governing the conditions for expertise – is authorised to conduct valuation of a particular type of collateral, whereas this person may not be related to the borrower within the meaning of the Law on Banks, and may not be involved in the process of loan approval or sale of collateral.

The bank shall envisage a higher frequency of monitoring the value of collateral and/or obtaining a re-valuation in respect of receivables considered distressed assets and collateral obtained through foreclosure.

By its internal regulations referred to in paragraph 1 hereof, the bank shall define haircuts by the type of collateral, whereby the estimated market value of collateral is reduced to the expected value to be collected by collateral realisation in the future, taking account of the volatility of such market value, the possibility to realise such collateral and cash flows in respect of costs of its activation and sale (e.g. estimated court expense, taxes incurred by the seller, expenses of consultants, advertising and other costs),



the expected decline in the market value from the moment of valuation to the moment of planned realisation, and inherent valuation uncertainty. The bank shall regularly examine the haircuts in accordance with the changes in market conditions.

The bank shall ensure that its information system contains timely, accurate and sufficiently detailed information and data relating to collateral, to be able to make appropriate business decisions and efficiently manage the risks that it is exposed to in its operation.

44b. In regard to the selection of authorised valuers, the bank shall define in its internal regulations the criteria which relate to their impartiality, competence and integrity and which are consistent with the basic criteria laid down by the regulations governing the profession of valuers and internationally recognised standards in the field.

The bank shall establish and update at least once a year its own list of eligible authorised valuers, particularly mindful of whether in earlier valuations they applied international standards of valuation of real estate and other collateral, the accuracy of their earlier valuations (if applicable) and whether a penalty or other measure was pronounced in respect of some of them.

For the needs of an individual valuation, the bank shall define the duties and responsibilities of authorised valuers by the guidelines for carrying out valuation and preparation of the valuation report, and shall obtain from him a written statement whereby he confirms that he is familiar and agrees with such duties and responsibilities, that he is not in the conflict of interest (which particularly implies his participation in / ownership of property being valued and/or participation in the sale, lease or acquisition of such property in the name of the bank's client), and that – in case of real estate valuation, he shall fully and consistently comply with regulations governing the profession of real estate valuers and international standards in the field of real estate valuation.

The bank shall determine by its internal regulations the standard contents of the valuation report in accordance with the recognised standards of collateral valuation, which must contain in particular the assumptions used to establish the value of such collateral, the method of assessing its market value and the explanation of the choice of such method, data on a potential or oncoming change in the purpose of collateral (if applicable), the trend of market price movements and marketability of such collateral.

## **Market risks**

48. Market risks shall imply the possibility of occurrence of adverse effects on the bank's financial result and capital due to changes in the value of balance-sheet positions and off-balance sheet items arising from changes of prices in the market.

Market risks shall include foreign exchange risk, price risk on debt securities, price risk on equity securities and commodity risk, in accordance with the decision on capital adequacy of banks.

### ***Negotiating transactions***

49. A bank shall designate employees authorised to negotiate market transactions, type and limits of transactions which every employee shall be authorised to negotiate on behalf and for the account of the bank, manner of negotiating transactions as well as reporting on negotiated transactions.

Each negotiated transaction shall be recorded and all relevant information relating to that transaction shall be adequately documented and forwarded to persons responsible for market risk management.

The bank shall ensure that the organisational unit in charge of undertaking market risks discharges these tasks only on the bank's business premises and shall ensure the control of transactions relating to the assumption of these risks. Exceptionally, if the transactions are negotiated over the telephone, the bank shall be required, in conformity with the law, to ensure recording of all telephone conversations of employees in charge of negotiating transactions.

### ***Transactions recording and control***

50. Employees in the organisational unit in charge of support activities (back office) shall keep records of all received confirmations of transactions negotiated with a counterparty and shall check the timeliness and completeness of these confirmations. If the received confirmations have not been delivered in time, the bank shall notify the counterparty thereof without delay.

51. Regular control of the negotiating of market transactions in the bank shall encompass the control of:

- timeliness and completeness of documentation relating to a negotiated transaction;
- consistence of data on a negotiated transaction with counterparty confirmation, electronic trading systems and other relevant sources of data;

- consistence of negotiated terms and conditions of the transaction with market conditions;
- consistence of the negotiated transaction with the bank's trading rules and limits;
- consistence of transactions recording between persons authorised to negotiate transactions and other organisational units in the bank.

### ***Market risks assessment***

52. Assessment of exposure to market risks shall encompass in particular:

- all bank activities sensitive to changes in market conditions;
- all open positions arising from bank activities;
- exposure concentration in the trading book;
- liquidity of all financial markets in which the bank trades;
- volatility of market prices of financial instruments traded by the bank;
- correlation between market prices of different financial instruments traded by the bank;
- correlation between market and other risks, particularly credit and operational risk, as well as liquidity risk;
- complex financial instruments and financial derivatives;
- embedded options.

### ***Monitoring and control of market risks and reports on such risks***

53. A bank shall establish monitoring and control of market risks on a daily basis. Daily monitoring of market risks encompasses monitoring of all items in the trading book, the extent of use and exceeding of limits, as well as of the results of trading activities of the bank, with limits encompassing every negotiated transaction.

For its own use, a bank shall prepare reports on the examination of trading book items, which shall contain an overview of open positions by type of transaction, by type of risk and by organisational unit, as well as an overview of established limits and extent of their use. These reports shall contain a review of current and cumulative results at monthly and annual levels.

### **Concentration risk**

54. Concentration risk is a risk which arises, directly or indirectly, from the bank's exposure to the same or similar source of risk or same or similar type of risk.

Concentration risk shall refer to:

- large exposures;
- groups of exposures with the same or similar risk factors, such as economic sectors, geographic areas, types of products, etc.;
- credit hedging instruments, including maturity and currency mismatch between large exposures and instruments of credit hedging against these exposures.

A bank shall control concentration risk by establishing adequate limits of exposure which allow it to diversify its credit portfolio.

A bank shall implement concentration risk mitigation through active management of credit portfolio, as well as by adjusting the established limits.

### ***Large exposures***

55. The exposure within the meaning of Sections 55 to Section 59h hereof is the position of balance sheet assets or off-balance sheet item valued in the manner prescribed for the calculation of risk-weighted exposures for credit risk by applying the Standardised Approach in accordance with the decision governing capital adequacy of banks, without taking into account the risk weights and conversion factors.

Notwithstanding paragraph 1 hereof, the amount of exposure for financial derivatives under Annex 1 of the decision governing capital adequacy of banks shall be calculated in accordance with the selected method for calculation of the amount of exposure in respect of counterparty risk prescribed by that decision. A bank which received the consent of the National Bank of Serbia to apply the Internal Model Method may use such method to calculate the amount of exposure for repo transactions, securities or commodities lending or borrowing transactions, margin lending transactions and long settlement transactions.

Notwithstanding paragraph 1 hereof, a bank calculating capital requirements for items in the trading book in the manner prescribed for calculation of capital requirements for price risk, counterparty risk and settlement/delivery risk in accordance with the decision governing capital adequacy of banks, shall calculate the amount of exposure to a single person or a group of persons considered related in respect of items in the trading book as the sum of:

- net long positions arising from all financial instruments issued by the person concerned, where net positions for each financial instrument have been calculated in the manner prescribed for calculation of capital

requirements for price risk in accordance with the decision governing capital adequacy of banks;

- net positions arising from underwriting securities issue by the person concerned, calculated in accordance with the decision governing capital adequacy of banks;

- exposures to that person based on which the bank is exposed to settlement/delivery risk and counterparty risk, calculated in the manner prescribed for calculation of the amount of risk-weighted exposures for counterparty risk in respect of items in the trading book and capital requirements for settlement/delivery risk in accordance with the decision governing capital adequacy of banks.

In respect of positions referred to in paragraph 3, second indent hereof, a bank shall monitor and control exposures in respect of the underwriting securities issue from the moment of the occurrence of liability to the following business day in accordance with the nature of risks in the relevant markets.

56. Exposure to a single person shall be calculated as a sum of exposures in respect of items in the trading book and the non-trading book to that person calculated in accordance with Section 55 hereof.

Exposure to a group of persons considered related shall be calculated as the sum of exposures under paragraph 1 hereof to each of the persons making up such group.

A bank shall not include the following in the calculation of exposures referred to in paragraphs 1 and 2 hereof:

- exposures arising from spot purchase/sale of currencies in the period prior to the agreed settlement date, which shall not be longer than two business days from the date of payment;

- exposures arising from securities purchase/sale transactions in the period prior to the agreed settlement date, which shall not be longer than five business days from the date of payment or delivery of securities, whichever is earlier;

- exposures arising from bank clients' operations which do not last longer than until the next business day and occurring as a result of the provision of payment, settlement and clearing services in all currencies, as a result of correspondent transactions or the provision of services of settlement and clearing of securities and on the basis of custody operations;

- exposures arising from the provision of money transfer services, including the provision of other payment, settlement and clearing services in all currencies and correspondent banking, which shall be no longer than a business day – to persons in the financial sector providing such services;

- deductions from Common Equity Tier 1 capital, Additional Tier 1 capital and Tier 2 capital prescribed by the decision governing capital adequacy of banks.

When determining exposure to a single person or a group of persons considered related in respect of securitised positions, units or shares in open-ended investment funds and/or other exposures to underlying assets, a bank shall take into account the economic substance of the transaction and the risks inherent to it, in order to determine whether it constitutes an additional exposure in respect of such transactions.

57. A large exposure of a bank to a single person or a group of persons considered related means exposure amounting to at least 10% of the bank's capital, which represents the sum of its Tier 1 and Tier 2 capital in the amount of up to one third of its Tier 1 capital, calculated in accordance with the decision governing capital adequacy of banks.

Persons considered related referred to in paragraph 1 hereof have the meaning set out in the Law on Banks. To calculate large exposures, a natural or legal person shall be included in every group of persons considered related to which it belongs.

### ***Exposure limits***

58. Exposure of a bank to a single person or a group of related persons reduced in accordance with Sections 59b to 59h hereof shall not exceed 25% of the bank's capital calculated in accordance with Section 57, paragraph 1 hereof.

The sum of all large exposures of the bank shall not exceed 400% of the bank's capital, calculated in accordance with Section 57, paragraph 1 hereof.

59. Notwithstanding Section 58, paragraph 1 hereof, a bank may exceed the exposure limits referred to in that Section for items in the trading book, provided the following conditions are met:

- exposure to a single person or a group of related persons in respect of items in the non-trading book does not exceed those limits, i.e. the exposure fully arises from the trading book;
- the bank meets additional capital requirements for the amount in excess of such limits, calculated in accordance with Sections 59a and 59b hereof;

- if ten or fewer days have elapsed from the day such limit was exceeded, trading book exposure to such person or such group of related persons shall not exceed 500% of bank's capital, calculated in accordance with Section 57, paragraph 1 hereof;
- the total amount of all excesses of such limits lasting longer than ten days shall not exceed 600% of bank's capital, calculated in accordance with Section 57, paragraph 1 hereof.

A bank shall inform without delay the National Bank of Serbia of each limit excess referred to in Section 58 hereof and paragraph 1 of this Section, as well as the person or a group of related persons to which the exposure exceeding the limit relates.

The National Bank of Serbia may approve to a bank a deadline to meet the limits referred to in Section 58 hereof, if it assesses that this is justified and on condition that it received the notification referred to in paragraph 2 hereof.

***Additional capital requirements for large exposures from the trading book***

59a. The amount in excess of the exposure limit referred to in Section 59, paragraph 1, second indent hereof shall be calculated by selecting from all trading-book exposures to a single person or a group of related persons those exposures that are subject to the highest capital requirements for price and/or counterparty risk for items in the trading book and for settlement/delivery risk, calculated in accordance with the decision governing capital adequacy of banks, whose sum equals the excess referred to in Section 59, paragraph 1, first indent hereof.

Where ten or fewer days have elapsed since the excess over the limit referred to in paragraph 1 hereof occurred, additional capital requirement for the exposures selected in such manner, as set out in that paragraph, shall not exceed 200% of capital requirements referred to in that paragraph.

If the excess referred to in paragraph 1 hereof persists for more than ten days, the selected exposures referred to in that paragraph shall be allocated as specified in Table 1, in ascending order of capital requirements for price and/or counterparty risk for items in the trading book and settlement/delivery risk, calculated in accordance with the decision governing capital adequacy of banks. Additional capital requirement shall equal the sum of capital requirements for price and/or counterparty risk for items in the trading book and settlement/delivery risk, calculated in accordance with that decision for selected exposures, multiplied by the appropriate factor from Table 1.

Table 1

| <b>Excess over the limits</b><br>(as the percentage of bank's capital<br>calculated in accordance with Section<br>57, paragraph 1 of this Decision) | <b>Factors</b> |
|---|----------------|
| Up to 40%   | 200%           |
| From 40% to 60%   | 300%           |
| From 60% to 80%   | 400%           |
| From 80% to 100%  | 500%           |
| From 100% to 250%   | 600%           |
| Over 250%   | 900%           |

A bank may not, for the purpose of avoiding calculation of additional capital requirements referred to in paragraphs 2 and 3 hereof, act in the following ways:

- temporarily transfer to another person those exposures exceeding the limits referred to in Section 58 hereof or would exceed the limits if the exposures have been maintained for more than ten days;
- conclude and execute other transactions to close out such exposures referred to in the first indent of this paragraph or create new ones during the ten-day period.

A bank shall inform the National Bank of Serbia without delay of each transaction suspending the obligation to calculate additional capital requirements referred to in paragraphs 2 and 3 hereof.

### ***Eligible credit risk mitigation techniques***

59b. For the purposes of Sections 59d to 59h hereof, the term 'guarantee' shall also include credit derivatives recognised for credit risk mitigation in accordance with the decision governing capital adequacy of banks, other than CLN derivatives.

Where a bank calculates the exposure limit subject to Section 59d, paragraph 2 hereof, the requirements stipulated for the IRB approach in accordance with the decision referred to in paragraph 1 hereof shall apply to the recognition of funded credit protection, while a bank may not use as eligible collateral the receivables arising from transactions in respect of regular operations or transactions with contractual maturity up to one year, other physical collateral or exposures arising from transactions of property leasing to a third party, unless this is permitted in accordance with Section 59g hereof.



A bank shall analyse exposures to collateral providers, providers of unfunded credit protection and underlying assets for the purposes of Section 56, paragraph 3 hereof, in order to determine concentration risk and take, when needed, appropriate measures and inform the National Bank of Serbia of important findings and measures taken.

***Exemptions from calculation of exposure limits***

59c. A bank shall exempt from the calculation of exposure limits referred to in Section 58 hereof the following:

- exposures to governments, central banks, territorial autonomies, local self-government units, multilateral development banks, international organisations and public administrative bodies which are assigned, in accordance with the decision governing capital adequacy of banks, the credit risk weight of 0%, as well as exposures secured by their guarantees;

- exposures secured by cash and cash equivalents deposited with a bank or its parent or subsidiary company, cash received in respect of CLN derivatives issued by a bank, as well as loans and deposits subject to an agreement on balance-sheet netting, in accordance with the decision governing capital adequacy of banks;

- exposures arising from unfunded commitments under lines of credit (provided it was agreed that the client or a group of clients may withdraw the unfunded amount only if that will not result in limit excesses referred to in Section 58 hereof) and other off-balance sheet items in respect of which there can be no payment and which are classified into the low-risk category, in accordance with the decision governing capital adequacy of banks;

- exposures to counterparty which is the bank's parent or subsidiary company, the subsidiary of the bank's parent company or the company related to the bank through joint management, which are, in accordance with the decision referred to in the first indent hereof, assigned the risk weight of 0%, whereas the exposures not meeting these requirements, regardless of whether included in the calculation of the limit referred to in Section 58 hereof, shall be treated as exposures to a third party;

- exposures secured by certificates of deposit issued by the lending bank or the bank which is the parent or subsidiary company or subsidiary company of the lending bank and lodged with them;

- trade exposures to central counterparties and guarantee fund contribution to central counterparties;

- exposures to counterparty which is the bank's parent or subsidiary company, the subsidiary of the bank's parent company or the company related to the bank through joint management, subject to joint

consolidation conducted by the full consolidation method and subject to the same method of assessment, measurement and control of risk;

- exposures to territorial autonomies or local self-government units of the Republic of Serbia and member states of the European Union which are assigned, in accordance with the decision referred to in the first indent hereof, the risk weight of 20%, including exposures secured by their guarantees;

- exposures constituting receivables and other exposures to foreign banks operating on a non-competitive basis and approving or guaranteeing loans under laws or founding acts (articles of association), to promote specified sectors of the economy under some form of government oversight and restrictions on the use of loans, provided that the respective exposures arise from such loans that are passed on to beneficiaries via banks or from the guarantees of these loans;

- exposures constituting receivables and other exposures to banks, provided that those exposures do not constitute such banks' capital, do not last longer than the following business day and are not denominated in a major trading currency;

- 50% of exposure based on documentary credit and undrawn credit facilities assigned to the medium-risk category in accordance with the decision referred to in the first indent hereof;

- exposures to recognised exchanges.

In calculating the exposure limit referred to in Section 58 hereof, a bank may decide not to include the exposure to a counterparty which is a parent or subordinated company of the bank, a subordinated company of the bank's parent company or a company related to the bank through joint management – which is subject to joint consolidation implemented by the regulatory body of another state in the manner harmonised with relevant regulations of the National Bank of Serbia and relevant international standards, if the following conditions have been met:

- 1) given the characteristics of a concrete legal transaction, the risk of the exposure is significantly diminished;

- 2) this is justified by specific circumstances in a concrete case.

A bank intending not to include the exposures referred to in paragraph 2 hereof in the calculation of the exposure limit referred to in Section 58 hereof shall inform the National Bank of Serbia thereof in advance, and shall submit to it the documentation about the fulfilment of conditions referred to in that paragraph, along with a detailed explanation.

The National Bank of Serbia shall assess the fulfilment of conditions referred to in paragraph 2 hereof based on the documentation submitted by a

bank and other documentation it considers necessary, whereafter it shall inform the bank about its assessment.

***Calculating the effect of the use of credit risk mitigation techniques***

59d. To calculate the exposure limit referred to in Section 58 hereof, instead of the exposure calculated in accordance with Sections 56 and 57 hereof, a bank may use the fully adjusted exposure value ( $E^*$ ) calculated by applying the comprehensive method, in accordance with the decision governing capital adequacy of banks.

Notwithstanding paragraph 1 hereof, if the consent for the IRB approach which the bank obtained from the National Bank of Serbia in accordance with the decision governing capital adequacy of banks also relates to the use of the AIRB approach, for the purpose of calculation of exposure limits a bank may use its own assessments of effects of collateral in the form of financial assets on the amount of exposure only if the following conditions are met:

- 1) in addition to minimum requirements for the LGD parameter set out by that decision, a bank adequately assesses the impact of collateral in the form of financial assets on the amount of exposure;
- 2) the methodology for assessment of effects of collateral in the form of financial assets on the amount of exposure is consistent with the methodology used by the bank for its own assessments of the LGD parameter for the calculation of the amount of risk-weighted assets, in accordance with that decision.

A bank which obtained the consent referred to in paragraph 2 hereof and which does not calculate the amount of its exposures applying the method referred to in that paragraph may apply the financial collateral comprehensive method or the method referred to in Section 59g, paragraph 1, the second indent hereof for the recognition of credit protection instruments in calculating exposure values.

A bank which reduces the amount of exposure in the manner set out in paragraphs 1 and 2 hereof for the purpose of calculation of exposure limits shall:

- carry out regular stress tests of credit risk concentration, including the value of collateral; the stress tests must be appropriate for risk assessment and must include risks arising from potential changes in market conditions that could negatively affect the bank's capital adequacy, including

risks relating to the possibility of collateral settlement in adverse economic conditions;

- reduce the value of collateral by the corresponding amount if stress tests indicate that the amount obtained by the realisation of that collateral is lower than the amount determined by application of the comprehensive method referred to in paragraph 1 hereof or by own assessments referred to in paragraph 2 hereof.

The bank referred to in paragraph 4 hereof shall regulate by its internal regulations the following:

- management of risks arising from maturity mismatches between exposures and any credit protection on those exposures;
- bank's response in the event that a stress test indicates a lower recognisable value of collateral than taken into account while making use of the financial collateral comprehensive method or the method referred to in paragraph 2 hereof;
- concentration risk arising from the application of credit risk mitigation techniques.

### ***Exposures arising from mortgage lending***

59e. For the calculation of exposure values for the purposes of Section 58 hereof, a bank may reduce the value of an exposure or any part of an exposure fully secured by mortgage, which is assigned in accordance with the decision governing capital adequacy of banks the risk weight of 35% for residential property, and/or 50% for commercial immovable property, but at most by 50% of the market value of such immovable property, if the following conditions are met:

- exposures or any part of an exposure are fully secured by mortgage on property;
- mortgage as collateral is recognised for credit risk mitigation in accordance with the decision governing capital adequacy of banks, while the value of immovable property is established as stipulated by that decision.

59f. A bank may treat an exposure to a counterparty that results from a reverse repurchase agreement under which the bank has acquired mortgage on immovable property of third parties as a number of individual exposures to each of those third parties, if the following conditions are met:

- the counterparty is a bank;
- the exposure is fully secured by liens on the immovable property of such third parties which the bank is able to exercise;

- a bank has ensured that the conditions referred to in Section 59e, the second indent hereof are met;
- a bank acquires the receivables that the counterparty has against third parties in the event of default, insolvency or liquidation and/or bankruptcy of the counterparty;
- a bank informs the National Bank of Serbia of the total amount of exposures to all other banks that are treated in accordance with this paragraph.

If the conditions referred to in paragraph 1 hereof have been met, a bank shall assume that it has an exposure to each of those third parties for the amount of the receivable that the counterparty has on the third party instead of the corresponding amount of the exposure to the counterparty. The remainder of the exposure to the counterparty, if any, shall continue to be treated as an exposure to the counterparty.

### ***Substitution method***

59g. Where an exposure to a debtor is guaranteed by a third party or secured by collateral issued by a third party, a bank may:

1) treat the portion of the exposure secured by the guarantee of a third party as the exposure to that person and not to the debtor, provided that the unsecured exposure to the provider of unfunded credit protection is assigned an equal or lower risk weight than a risk weight of the unsecured exposure to the debtor, in accordance with the decision governing capital adequacy of banks;

2) treat the portion of the exposure secured by recognised collateral (at the level of market value of such collateral) as the exposure to such third party and not to the debtor, provided that the exposure is secured by collateral and that the collateralised portion of the exposure is assigned an equal or lower risk weight than a risk weight of the unsecured exposure to the debtor, in accordance with the decision referred to in the first indent hereof.

A bank shall not use the approach referred to in paragraph 1, the second indent hereof if there is a mismatch between the maturity of the exposure and the maturity of credit protection.

A bank may apply both the financial collateral comprehensive method and the substitution method referred to in paragraph 1, the second indent hereof only where it is permitted to use both the financial collateral comprehensive method and the financial collateral simple method for the purposes of calculation of capital requirements in accordance with the decision referred to in paragraph 1 hereof.

59h. If a bank applies the method referred to in Section 59g, paragraph 1, the first indent hereof:

- where the guarantee is denominated in a currency different from that in which the exposure is denominated, the amount of the exposure deemed to be covered shall be calculated in accordance with the provisions on the treatment of currency mismatch for unfunded credit protection referred to in the decision governing capital adequacy of banks;
- mismatch between the maturity of the exposure and the maturity of credit protection shall be treated in accordance with the provisions on the treatment of maturity mismatch referred to in the decision from the first indent hereof;
- partial coverage may be recognised in accordance with the treatment set out in the decision from the first indent hereof.

### **Bank's investment risks**

60. Bank's investment risks shall include the risks of its investments in other legal entities and in fixed assets and investment property.

Bank's investment in a single non-financial sector entity shall not exceed 10% of its capital. Such investment shall imply investment based on which the bank acquires a stake in shares of a non-financial sector entity.

Bank's total investments in non-financial sector entities and in fixed assets and investment property of the bank shall not exceed 60% of the bank's capital, provided that this limit does not apply to the acquisition of shares for the purpose of their resale within six months from the date of their acquisition.

### **Country risks**

61. Country risk is a risk relating to the country of origin of the person to which the bank is exposed, i.e. risks of possible adverse effects on the financial result and capital of the bank due to the bank's inability to collect receivables from such person for reasons arising from political, economic or social circumstances in such person's country of origin.

If the bank lends to persons headquartered or residing outside the Republic of Serbia, it shall include country risk in the risk management system.

62. Country risk shall include the following risks:

- political-economic risk, which shall imply the possibility of losses arising from the bank's inability to collect receivables due to the restrictions established by regulations of government and other authorities of the borrower's country, as well as general and systemic circumstances in the country;
- transfer risk, which shall imply the possibility of losses arising from the bank's inability to collect receivables in a currency that is not the official currency of the borrower's country, due to the restrictions on payment of obligations to creditors from other countries in a specific currency, established by regulations of government and other authorities in the borrower's country of origin.

63. A bank shall determine and periodically revise the limits of exposure to country risk individually, by borrower's country of origin, and on a regional basis, and establish the relevant level of allowances for impairment and provisions by country.

### **Operational risk**

64. Operational risk shall be the risk of possible negative effects on the bank's financial result and capital due to omissions (unintentional and intentional) in employees' work, inadequate internal procedures and processes, inadequate management of information and other systems, system development errors, inappropriate application or use of internal models, and unforeseen external events.

65. A bank shall identify and assess events and sources which may give rise to losses relating to operational risk, taking into consideration all significant internal and external factors.

A bank shall determine the level of materially significant risks in respect of operational risk and to scrutinise them, as well as assess events that may result in such losses.

65a. A bank shall notify the National Bank of Serbia without delay about the occurrence of events which may trigger or have triggered losses.

Natural disasters and similar events, and attempted perpetration or perpetration of an act labelled as a criminal offence by law (e.g. theft, grand larceny, robbery, fraud etc.) shall be considered the events within the meaning of paragraph 1 hereof.

The notification referred to in paragraph 1 hereof shall contain in particular: the title and description of the event, starting date of the event, ending date of the event if applicable, the date of learning about the event,

estimated amount of loss, and undertaken and/or planned activities concerning the event.

66. A bank shall measure or assess its exposure to operational risk taking into consideration the possibility and/or frequency of occurrence of that risk, as well as its potential effect on the bank, with special emphasis on events which are unlikely to occur but may cause significant material losses.

When measuring or assessing operational risk, a bank shall particularly assess whether it is or may be exposed to this risk in respect of introduction of new products, activities, processes and systems, and it shall also assess outsourced activities.

67. Employees in charge of managing operational risk shall monitor the exposure to this risk by type, causes and significance of events, including risks concerning new products, activities, processes and systems, and outsourced activities. These employees shall regularly report to the bank management on the exposure to this risk and measures undertaken to mitigate the risk.

68. To ensure continuity of the bank's operation, its managing board shall adopt the Business Continuity Plan (hereinafter: BCP), as well as the Disaster Recovery Plan (hereinafter: DRP), which ensure smooth and continuous functioning of all important systems and processes of the bank, as well as limitation of losses in emergency situations.

The executive board of the bank shall be responsible:

- for BCP and DRP implementation, as well as for training and informing employees of their role and responsibilities in case of emergencies;
- changes to BCP and DRP in accordance with business changes, including changes in products, activities, processes and systems, changes in the environment, as well as in line with the bank's business policy and strategy;
- regular testing of BCP and DRP, including adequate documentation to evidence the results of testing and their inclusion in the reporting to the bank's managing board.

69. To ensure business continuity, a bank shall:

- 1) define key business activities (including outsourced activities), resources and systems necessary for the performance of business processes, as well as their interdependence and relationships;
- 2) determine critical time for certain business processes, i.e. period after which these processes have to be re-established;



3) assess risks that may result in interruption of business continuity in the bank and affect its financial standing and/or reputation;

4) assess the likelihood of occurrence and importance of effects of risks referred to in provision 3) hereof on the bank's business continuity;

5) adopt a recovery strategy in which it will lay down the following main goals it has to achieve in case of interruption of its operation:

- recovery priorities,
- acceptable level of activity,
- acceptable level of risks and techniques for mitigation of identified risks,
- recovery time, i.e. period until resumption of regular business processes, which should be shorter than critical time.

70. BCP shall contain in particular:

- description of procedures in case of interruption of operation;
- list of all resources necessary for restoring business continuity;
- appointment of teams that would be responsible for resuming operation in case of unforeseen events;
- clearly defined duties and responsibilities of teams referred to in the third indent hereof and of individual team members, as well as the plan of internal and external communication lines;
- backup location in case of interruption of operation and inability to resume business processes on the primary location.

71. DRP shall ensure the possibility of restoring and recovering the information technology system to its original status before the interruption of operation, including procedures for creating and storing backup copies of all data necessary for restoring processes that support this system.

DRP shall contain in particular:

- procedures for information technology system recovery in case of disaster;
- priorities for recovery of information technology resources;
- appointment of teams that would be responsible for recovery of the information technology system;
- clearly defined duties and responsibilities of teams referred to in the third indent hereof and of individual team members;
- backup location for recovery of the information technology system.

72. In case of occurrence of circumstances that require the implementation of BCP and DRP, the bank shall notify the National Bank of

Serbia, within one day, of all relevant facts and circumstances relating thereto.

***Risks arising from introduction of new products/services***

73. A bank shall timely include in its risk management system all risks that arise from the introduction of new products, services and activities relating to the bank's processes and systems (hereinafter: new product).

New products shall also imply significantly changed products, services and activities relating to the bank's processes and systems.

A bank shall set forth in its internal regulations the process of introduction of new products and significant changes to existing products, which also includes the development of new markets, and significant changes to related processes (e.g. outsourcing of new activities to the same or new service provider) and systems (e.g. changes in the part of information technologies), including those changes which result from extraordinary transactions (e.g. changes in processes in case of bank's status changes). A bank must regulate this process in the manner which ensures that the introduction of new products is in line with the risk management strategy, risk propensity and adequate limits.

The regulations referred to in paragraph 3 hereof shall govern in particular:

- the nature of new products;
- decision-making about the introduction of these products, i.e. all issues a bank takes into account before deciding to enter new markets and introduce new products;
- the manner of checking compliance of the introduction of a new product with relevant regulations;
- obligation to consider the accounting treatment of a new product;
- obligation to consider the manner of determining the price of a new product (price formation mechanism);
- manner of determining the impact of the introduction of a new product on the bank's risk profile, capital adequacy and profitability.

Before introducing a new product, in line with the regulations referred to in paragraph 3 hereof, a bank shall undertake the following:

- conduct an analysis of all risks that may arise as a consequence of such introduction;
- analyse the effect of such introduction on the bank's risk profile, capital adequacy and profitability in different scenarios;

- analyse the effect of such introduction on the possibility of adequate management of risks arising in this respect, and the bank's internal controls system;
- establish the accounting treatment of a new product, which implies elements, the method of calculation and method of recording all receivables, liabilities, expenditure and revenue arising in respect of the new product, and which enables monitoring during its life cycle;
- establish the price formation mechanism for the new product;
- obtain a reasoned opinion of the organisational unit whose remit includes bank's risk management about the impact of such introduction on the bank's risk profile;
- obtain a reasoned opinion of the organisational unit whose remit includes compliance about whether such introduction is aligned with the regulations referred to in paragraph 3 hereof.

When deciding on the introduction of a new product, a bank shall take into consideration the results of the analysis and/or opinions referred to in paragraph 5 hereof.

A bank shall notify the National Bank of Serbia of the introduction of a new product at least 30 days before the planned introduction and shall enclose with the notification the following documents:

- analyses and/or opinions referred to in paragraph 5 hereof, with accompanying documentation;
- overview of the price formation mechanism for a new product, as well as a model contract on the new product to be concluded between the bank and the client, and the representative sample of such product, which contain all elements based on which it is possible to determine the conditions to use a particular financial service (particularly an overview of the types and levels of all fees and other costs borne by clients);
- decision on the introduction of the new product referred to in paragraph 6 hereof;
- if the bank intends to advertise a new product – the information about the manner in which advertising will take place, and the proposal of the advertising message, in accordance with the decision governing the advertising of financial services.

The deadline from paragraph 7 hereof shall be calculated from the date of submission of complete documentation specified therein.

If following the notification referred to in paragraph 7 hereof the National Bank of Serbia requires supplementary documentation, it may set an

appropriate deadline before whose expiry the bank may not submit the supplementary documentation.

The deadline referred to in paragraph 9 hereof shall not be longer than six months.

A bank shall establish and keep single records of the introduction of new products, if applicable, by different business lines and portfolios.

A bank shall submit the excerpt from the records referred to in paragraph 11 hereof to the National Bank of Serbia semi-annually, as at 30 June of the current year – by no later than 31 July of the current year, and/or as at 31 December of the current year – by no later than 31 January of the following year.

The excerpt from the records referred to in paragraph 12 hereof shall be determined in Annex 2a which is printed along with this Decision and makes its integral part.

A bank shall submit the excerpt from the records referred to in paragraph 12 hereof in accordance with the National Bank of Serbia's guidelines which govern the electronic submission of data from the excerpt from the records and which are published on the National Bank of Serbia's website.

### ***Change of tariff at which a bank charges fees for the provision of payment services***

73a. By means of its relevant internal acts, a bank must regulate in particular the process of adoption and/or amendments to its acts which regulate the fees it charges for the provision of payment services (hereinafter: tariff), specifically the following:

- the process of adopting the decision on tariff change and all issues that a bank takes into account before adopting the decision on tariff change;
- price formation mechanism for the provision of services contained in the tariff;
- manner (methodology) of carrying out the analysis of justifiability of the planned tariff change;
- manner of checking whether the intended tariff change is in line with relevant regulations.

The tariff change referred to in paragraph 1 hereof shall be considered each change to the valid tariff in line with which a bank would charge a fee for the provision of payment services that is higher than the fee it charges for

those services in accordance with the valid tariff, and/or each introduction of new fees relative to the fees determined by the valid tariff.

Within the meaning of this Section, payment services means all payment services as defined by the law governing those services, regardless of whether they are provided based on the payment services framework contract or the single payment transaction contract within the meaning of that law, as well as other services provided to the payment service user in relation with the payment account, and/or within the package of services related to that account (i.e. notifications on initiated or executed payment transactions, issuance of cheques, change of personalised security features of a payment instrument, checking the account balance etc.).

Before changing the tariff, in accordance with acts referred to in paragraph 1 hereof, a bank must undertake the following activities:

- carry out a detailed analysis of the planned tariff change which shall contain in particular: a comparative overview of the tariff before and after the intended change, manner of notifying payment service users of the intended tariff change, estimate of justifiability of the planned tariff change with reasons for raising the current prices, applied mechanisms of formation of increased prices, a detailed structure of costs by type and changes in those costs wherefore a bank proposes the tariff change (e.g. change in costs in relation to participation in payment systems, and/or card payment systems within the meaning of the law governing multilateral interchange fees and special operating rules for card-based payment transactions), and the estimate of impact of the tariff change on the bank's profitability;
- obtain a reasoned opinion of its organisational unit in charge of compliance about the alignment of that change with relevant regulations and the bank's internal acts.

Before adopting the decision on tariff change, a bank shall take into account the analysis results and the opinion referred to in paragraph 4 hereof.

A bank must notify the National Bank of Serbia of the tariff change by no later than 45 days before the planned adoption of the change and submit to it, along with the notification, the analysis and data, as well as the opinion referred to in paragraph 4 hereof (hereinafter: documentation).

The deadline referred to in paragraph 6 hereof shall start from the submission of complete documentation.

If following the notification referred to in paragraph 6 hereof the National Bank of Serbia requires supplementary documentation, it may set an

appropriate deadline before whose expiry the bank may not submit the supplementary documentation.

The deadline referred to in paragraph 8 hereof shall not be longer than six months.

### **Risk of money laundering and terrorist financing**

78a. The risk of money laundering and terrorist financing is the risk of potential negative effects on the bank's financial result, capital or reputation due to the bank being used for the purposes of money laundering and/or terrorist financing and/or the financing of the proliferation of weapons of mass destruction.

The risk of money laundering and terrorist financing arises particularly from the bank's failure to harmonise its operation with law, regulations and its internal regulations governing the prevention of money laundering and terrorist financing, and/or from the inconsistency of its internal regulations governing the actions taken by the bank and its employees concerning the prevention of money laundering and terrorist financing.

#### ***Manner of identifying, measuring, assessing and managing the risk of money laundering and terrorist financing***

78b. The management of the risk of money laundering and terrorist financing shall not be within the scope of the bank's dedicated organisational unit responsible for risk management in accordance with the Law on Banks, but rather within the scope of another separate organisational unit.

In its established risk management system, a bank shall include in particular:

- the conditions and process of appointing persons in charge exclusively of the implementation of obligations arising from laws and other regulations which govern the prevention of money laundering and terrorist financing, which are also responsible for the submission of reports to the bank's executive board and the initiation and proposal of appropriate measures to upgrade the system for the prevention and detection of money laundering and/or terrorist financing;
- obligation of all of the bank's organisational units to provide assistance and support to persons from the first indent of this paragraph when performing activities set out in that indent;
- the process of preparing the analysis of the risk of money laundering and terrorist financing, which also includes the manner in which

such analysis is taken into account when deciding on the assumption of other risks (e.g. credit risk) and/or introduction of new products of the bank;

- procedures and mechanisms for identifying suspicious transactions and/or clients and procedures for the submission of information, data and documents to the competent authority;
- keeping records on clients, business relationships and transactions, protection and keeping data from these records;
- protection from unauthorised disclosure of data on persons referred to in the first indent of this paragraph, and other procedures which may affect smooth performance of their duties.

The persons referred to in paragraph 2 hereof shall assist the bank's governing bodies in understanding the risk of money laundering and terrorist financing and in managing such risk, and shall ensure the upgrade and continuous implementation of the risk management strategy, policies and procedures in the segment relating to such risk.

The bank shall provide the persons referred to in paragraph 2 hereof with appropriate personnel, material, information-technical and other conditions for work, including on-going professional training and development.

78c. For the purposes of identification, measurement and assessment of the risk of money laundering and terrorist financing, the bank shall prepare risk analysis for each group or type of clients, business relationship, service and/or transaction.

The bank shall ensure that the process of the identification, measurement and assessment of the risk of money laundering and terrorist financing includes at least the following activities:

- 1) determining client acceptability in accordance with the degree of the risk of money laundering and terrorist financing when establishing a business relationship and over its duration;
- 2) establishing the category of the risk of clients, services, products and transactions according to risk factors relative to the risk of money laundering and terrorist financing;
- 3) due diligence and checking the consistency of the client's activities with the nature of the business relationship and the usual scope and type of its business transactions, including a possible change in its risk category;
- 4) determining products or services that banks will not provide to clients of a particular risk category.

When assessing the exposure to the risk of money laundering and terrorist financing, the bank shall take into account in particular the complexity

of the bank's organisational structure, the number of employees directly in charge of performing activities relating to the prevention of money laundering and terrorist financing relative to the total number of employees, number of employees in direct contact with clients, the manner of organising tasks and responsibilities, and the periodicity of employing new personnel and the quality of training.

### **Excessive leverage risk**

78d. The risk of excessive bank leverage is the risk of potential negative effects on the bank's financial result and capital due to the existing or potential level of leverage, which may lead to changes in the execution of the bank's business plan, such as the enforced sale of assets resulting in losses or adjustments to the value of the bank's remaining assets.

The bank shall establish policies and procedures for identification, measurement, monitoring and managing the risk of excessive leverage.

Indicators of the risk of excessive bank leverage are the leverage ratio, calculated in accordance with the provisions of the guidelines governing the method of calculating the total exposure amount of the bank included in the leverage ratio calculation, and the mismatch between the bank's assets and liabilities.

The bank shall manage the risk of excessive leverage with particular care, taking into account the potential increase of this risk due to a reduction in capital as a result of expected or realised losses in accordance with accounting standards, whereby the bank must be able to withstand a range of different stress events related to this risk.

## **IV. TRANSITIONAL AND FINAL PROVISIONS**

80. From the date this Decision enters into force, the bank shall test the implementation of its provisions to be prepared to fully harmonise its operation with these provisions by 31 December 2011 at the latest.

A bank shall notify the National Bank of Serbia of the results of testing conducted within the meaning of paragraph 2 hereof by submitting, by 20 October 2011 at the latest, a report as at 30 September 2011 on VI-LI and VI-GPL forms, prescribed by the decision on reporting requirements for banks.

81. This Decision repeals the Decision on Risk Management by Banks (RS Official Gazette, Nos 129/2007, 63/2008 and 112/2008) and the Decision on Liquidity Risk Management by Banks (RS Official Gazette, No 18/2011) as of the date of its application.



82. This Decision shall enter into force on the eighth day following its publication in the RS Official Gazette and shall apply as of 31 December 2011.

NBS Executive Board No 42  
16 June 2011

Belgrade

Chairperson  
Executive Board of  
the National Bank of Serbia  
Governor  
National Bank of Serbia

Dr Dejan Šoškić