Decision on risk management
Pursuant to Article 101, paragraph (2), item (1) of the Credit Institutions Act (Official Gazette 159/2013) and Article 43, paragraph (2), item (9) of the Act on the Croatian National Bank (Official Gazette 75/2008 and 54/2013), the Governor of the Croatian National Bank hereby issues the

Decision on risk management

I GENERAL PROVISIONS

Subject matter

Article 1

This Decision specifies in detail the requirements regarding risk management, including as follows:

1) general risk management rules;
2) credit risk management rules;
3) market risk management rules; and
4) operational risk management rules.

Legal persons subject to the Decision

Article 2

(1) The provisions of this Decision shall apply to credit institutions which have their head offices in the Republic of Croatia and are authorised by the Croatian National Bank.

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

(3) A credit institution shall apply the provisions of this Decision on an individual and consolidated basis.

Definitions

Article 3

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

1) 'risk management system' means the overall organisational structure, rules, processes, procedures, systems and resources to identify, measure or assess, contain, monitor and report on risk exposure and overall risk management, and it shall imply the establishment of an adequate corporate governance and risk culture;

2) 'risk culture' shall at a minimum comprise general risk awareness across all levels of a credit institution as well as employee attitude and behaviour towards and in relation to risk and risk management, taking into account the risk appetite;
3) 'risk appetite' means the amount or level of risk which a credit institution considers acceptable to assume in implementing its business strategy and objectives in the existing business environment. The risk appetite shall involve declaring an intention to assume risk and determining risk tolerance in terms of the level of risk which a credit institution considers acceptable;

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

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

6) 'senior management' shall have the meaning as defined in Article 3, item (53) of the Credit Institutions Act;

7) 'stress testing' means a risk management technique used to assess the potential effects of specific events and/or changes in several risk factors on the financial position of a credit institution. Stress testing may be divided into scenario analysis and sensitivity analysis. 'Scenario analysis' means an assessment of the impact of a concurrent change in several risk factors on the financial position of a credit institution under clearly defined stress conditions. 'Sensitivity analysis' means an assessment of the impact of a specific risk factor on the financial position of a credit institution wherein the cause of stress is not identified. 'Reverse stress testing' means a form of stress testing which is based on the possible result of a near-default and identifies the circumstances in which this could take place;

8) 'operation support function' means the activities of a credit institution performed by the persons authorised to keep bookkeeping records and carry out other back office tasks;

9) 'front office function' means the activities of a credit institution performed by the persons authorised to contract risk-bearing transactions;

10) 'treasury back office function' means the activities of a credit institution performed by the persons authorised to conduct treasury back office operations and keep bookkeeping records of contractual transactions;


12) 'non-trading book' shall comprise all on-balance and off-balance sheet items of a credit institution which are not considered trading book positions under Article 4, paragraph (1), item (86) of Regulation (EU) No 575/2013;

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

14) 'placements' shall have the meaning as defined in the Decision on the classification of placements and off-balance sheet liabilities of credit institutions (Official Gazette 41A/2014);
15) 'securitisation' and the terms related to 'securitisation' shall have the meaning as defined in Article 4, paragraph (1), items (13) and (14) and items (61) to (67) of Regulation (EU) No 575/2013;

16) 'significant credit institution' means each credit institution whose average amount of assets at the end of the previous three business years reported in its audited financial statements exceeds seven billion kuna.

Definitions of risks

Article 4

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

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

2) 'market risks' shall include position risk, foreign-exchange risk and commodities risk:
   (1) 'position risk' means the risk of loss arising from a price change in financial instruments or, in the case of a derivative financial instrument, in underlying variables. Position risk is divided into specific and general risk;
   (2) 'foreign-exchange risk' means the risk of loss arising from a change in currency exchange rates and/or the price of gold;
   (3) 'commodities risk' means the risk of loss arising from a price change in the commodity;

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

4) 'interest rate risk in the non-trading book' means the risk of loss arising from potential changes in interest rates as they affect a credit institution's non-trading book positions;

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

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

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

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

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

10) 'country risk' means the risk that relevant bodies or the central bank will not be able or willing to settle the liabilities to other countries and creditors in these countries and that other debtors in the country in question will not be able to settle the liabilities to foreign creditors;

11) 'currency-induced credit risk' means the risk of loss to which a credit institution granting foreign currency placements or placements indexed to foreign currency is additionally exposed and which arises from a debtor's currency risk exposure;

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

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

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

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

16) 'operations risk' means the risk of loss caused by the fact that a credit institution, due to its size, has a limited capacity to put in place sophisticated operational mechanisms, systems and controls;

17) 'model risk' means the risk of loss a credit institution may incur, as a consequence of decisions that could be principally based on the output of internal models, due to errors in the development, implementation or use of such models;

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

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

20) 'credit valuation adjustment risk' or 'CVA risk' shall have the meaning as defined in Article 381 of Regulation (EU) No 575/2013;
21) 'settlement risk' means the risk of loss of a credit institution due to difference in the agreed settlement price for a debt instrument, equity, foreign currency or commodity instrument and its current market value;

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

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

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

25) 'legal risk' means the risk which arises due to the possibility that failure to meet contractual obligations, initiated court proceedings against a credit institutions and business decisions taken which are found to be unenforceable might have a negative impact on the business operation or the financial position of a credit institution;

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

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

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

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

II GENERAL RULES FOR THE ESTABLISHMENT AND APPLICATION OF THE RISK MANAGEMENT SYSTEM

Risk management system

Article 5

(1) A credit institution shall establish and implement an effective and sound risk management system that is proportionate to the nature, scale and complexity of its activities and the risks inherent in its business model.
(2) A credit institution shall determine the key employees to be involved in the risk management system as well as their replacements.

(3) The management board and the supervisory board of a credit institution shall allocate sufficient time to consider all the risks to which a credit institution is or might be exposed in its operation.

**Strategies, policies, procedures and other internal bylaws on risk management**

**Risk assumption and management strategy**

*Article 6*

(1) A credit institution shall:

1) adopt a risk management strategy;
2) clearly determine and document the risk appetite; and
3) regularly align the risk management strategy with the business strategy.

(2) The risk assumption and management strategy shall be set out in one or several written documents which shall, at a minimum, include the objectives and fundamental principles of risk assumption and management and the credit institution's risk appetite. When determining the risk appetite, a credit institution shall take into account, in addition to quantitative information or model results, adequate qualitative information, such as for instance expert judgement.

**Policies and internal bylaws on risk assumption and management**

*Article 7*

(1) A credit institution shall adopt policies and other internal bylaws governing risk management.

(2) The policies and other internal bylaws on risks management shall be set out in one or several written documents which shall, at a minimum, include the following:

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

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

(4) A credit institution shall update the policies and other internal bylaws referred to in paragraph (2) of this Article at least on an annual basis and at each significant change in risk exposure and it shall ensure that they are applied at the level of the whole credit institution.
(5) The credit risk, market risks and operational risk management rules referred to in Title III of this Decision constitute the minimum requirements which a credit institution shall, in addition to the general rules on the risk management system establishment and implementation referred to in this Title, incorporate as appropriate into its internal bylaws on credit risk, market risks and operational risk management.

**Credit risk**

**Article 8**

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

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

(3) A credit institution shall set up a sound and efficient system for management and ongoing monitoring of portfolios and individual credit risk-bearing exposures and ensure its implementation, which includes:
   1) management of portfolios and individual credit risk-bearing exposures, identification and management of problem placements and distribution of exposures into groups based on recoverability; and
   2) carrying out value adjustments for on-balance sheet items and forming provisions for risk-bearing off-balance sheet items.

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

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

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

**Securitisation risks**

**Article 9**

(1) A credit institution shall adopt and implement sound policies and procedures for managing the risks arising from securitisation transactions in which the credit institution acts as the investor, originator or sponsor, including reputation risks arising from complex structures or products. The management of risks arising from securitisation transactions shall be based on the economic substance of the transaction.

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

**Residual risk**
Article 10

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

Concentration risk

Article 11

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

Market risks

Article 12

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

(2) A credit institution shall prescribe by means of the policies and procedures referred to in paragraph (1) of this Article at a minimum:
   1) the inclusion and active management of positions in the trading book; and
   2) a valuation system for trading book positions.

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

Interest rate risk in the non-trading book

Article 13

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

Operational risk

Article 14

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

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

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

Risk of excessive leverage

Article 15
(1) A credit institution shall adopt and implement sound policies and procedures for managing the risk of excessive leverage. Indicators for the risk of excessive leverage shall include the leverage ratio determined in accordance with Article 429 of Regulation (EU) No 575/2013 and mismatches between assets and liabilities.

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

Other risks
Article 16

A credit institution shall adopt and implement sound policies and procedures for managing strategic risk, reputation risk, country risk and other risks to which it is or might be exposed in its operation.

Risk culture
Article 17

(1) A credit institution shall set up a risk culture based on high professional standards and business ethics.

(2) A credit institution shall ensure that the employees at all levels are clearly informed of the powers, roles and responsibilities assigned to them in the risk management process.

Competences and responsibilities of the supervisory board, management board and senior management in risk management

Reporting to the supervisory board
Article 18

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

(2) The supervisory board shall determine the nature, the amount, the format and the frequency of the information on risks which it is to receive from relevant functions, persons and organisational units of the credit institution.

Competencies and responsibilities of the management board
Article 19

(1) The management board of a credit institution shall be responsible for:
   1) establishing clearly defined and consistent lines of responsibility for assuming and managing risks, including the separation of powers and responsibilities among the supervisory board, management board, committees appointed by it and senior management;
2) ensuring an adequate number of employees possessing knowledge and experience to be involved in the risk management system, asset valuation, use of external credit ratings and internal models for risks;
3) approving and periodically (at least on an annual basis) examining and aligning risk assumption and risk management strategies and policies;
4) setting up a risk culture in accordance with Article 17 of this Decision.

(2) The management board of the credit institution shall actively participate in the process of management of all significant risks.

Competencies and responsibilities of the senior management
Article 20

The senior management shall be directly accountable to the management board of a credit institution, in particular for:
1) implementing risk assumption and risk management strategy and policies;
2) establishing and maintaining the risk management process;
3) establishing procedures and compiling instructions and guidelines for carrying out the credit institution's business activities which result in risk exposures;
4) maintaining the efficiency of internal controls embedded in the risk management system; and
5) establishing adequate procedures to assess the impact of the introduction of new products on the credit institution's risk exposure.

Risk management process

Establishment of the risk management process
Article 21

(1) A credit institution shall establish a risk management process which includes a regular and timely risk identification, measurement or assessment, containment and monitoring, including reporting on the risks to which a credit institution is or might be exposed in its operation.

(2) A credit institution shall adopt a risk management methodology defining risk management criteria, methods and procedures.

(3) A credit institution shall appropriately document the risk management process.

(4) The risk management process shall also include clearly defining and documenting the risk profile and aligning the risk profile with the risk appetite.

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

Risk identification, measurement or assessment and risk containment
Article 22
(1) A credit institution shall on an ongoing basis identify the risks to which it is or might be exposed in its operation and it shall analyse the causes of risk exposure.

(2) A credit institution shall regularly measure or assess the risks which it has identified in its operation. When measuring and assessing risk exposure, the credit institution shall not rely exclusively on an external rating or a model not developed by the credit institution. The risk measurement or assessment procedures must include appropriate quantitative and/or qualitative methods to measure or assess risks, which are also to enable the detection of changes in the credit institution's risk profile, including the emergence of new risks.

(3) A credit institution shall clearly define decision-making criteria and procedures for the containment of risks, taking into account both the existing and desired risk profile and the risk appetite.

(4) A credit institution shall appropriately document the risk containment method and risk containment, including the reasons for risk acceptance, mitigation, avoidance or transfer.

**Risk monitoring and reporting**

**Article 23**

(1) A credit institution shall establish a system for regular monitoring of and reporting on its risk exposure and risk profile.

(2) A credit institution shall establish such a risk monitoring and reporting system as to provide all relevant credit institution management levels with timely, accurate and sufficiently detailed information required for making business decisions and ensuring its safe and stable operation.

(3) The information referred to in paragraph (2) of this Article shall at a minimum comprise the relevant information on exposures to individual risks, including the information on the risk profile and changes therein, data on significant internal losses, information on the measures and activities that are to be or have been implemented to contain risk, information on exceeding the limit and other exemptions from compliance with internal bylaws, including the exemptions from the determined risk appetite, as well as the information on positive and negative changes in business indicators which suggest or might suggest a change in risk exposure.

(4) A credit institution shall adequately monitor the risks transferred to a third party.

**New products**

**Article 24**

(1) The risk management of a credit institution shall also cover the risks arising from the conclusion of transactions relating to the introduction of new services or products, significant changes in the existing products or services, including the entrance to new markets and trading in new instruments.

(2) A credit institution shall prescribe in its internal bylaws the criteria and procedures relating to the conclusion of transactions referred to in paragraph (1) of this Article and within them at a minimum:
1) define what it considers to be a new product and establish the processes and procedures for the introduction of new products;
2) define the powers and responsibilities for the approval and verification of new products; and
3) establish adequate control procedures to be implemented by the control functions of the credit institution.

(3) Prior to concluding a transaction referred to in paragraph (1) of this Article, a credit institution shall analyse, define and document all the relevant aspects of such a conclusion, including an analysis of the risk arising therefrom, and within this at a minimum:
1) describe the new product;
2) analyse the impact of the new product on its existing and future risk exposure, and capital adequacy and profitability;
3) ensure the required technical, organisational and human resources;
4) define the procedures to be used to manage the risks related to new products; and
5) comply with the accounting, tax and legal requirements, including those of the supervisory authority.

(4) A credit institution shall carry out an analysis of the risks inherent in new products, which shall include at a minimum:
1) an objective assessment of all the risks arising from new activities, using different scenarios;
2) an assessment whether the introduction of a new product leads to potential weaknesses in risk management and internal controls;
3) an assessment of the ability of the credit institution to manage a new risk efficiently.

Stress testing
Article 25

(1) Within risk management, a credit institution shall conduct stress testing at the level of significant risks to which it is exposed, at portfolio level and at the level of the whole credit institution and it shall ensure adequate resources for that purpose.

(2) In addition to the requirements referred to in Article 10 of the Decision on the internal capital adequacy assessment process for credit institutions (Official Gazette 20/2014), a credit institution shall include the following in its policies and procedures governing stress testing:
1) use of various forms of stress testing and their objectives;
2) a description of the stress testing methodology, including expert judgement; and
3) assumptions used in stress testing, which are related to business activities and management decisions.

(3) A credit institution shall, among others, include stress testing results in the following activities:
1) reviewing strategic planning;
2) reviewing the risk appetite;
3) reconsidering the funding policy;
4) reviewing internal limits;
5) use of risk mitigation techniques;
6) reviewing capital and liquidity adequacy; and
7) reviewing or developing activities related to contingency planning.

(4) A credit institution shall assess the appropriateness of stress testing at least on an annual basis and at each significant change in risk exposure and it shall cover the following:
   1) frequency of stress testing exercises and their compliance with objectives;
   2) the need for development work;
   3) the adequacy of informing relevant employees, committees established by the supervisory or management board, the management board and the supervisory board;
   4) the quality of used data and other information; and
   5) documentation of stress testing results.

III CREDIT RISK, MARKET RISKS AND OPERATIONAL RISK MANAGEMENT RULES

CREDIT RISK MANAGEMENT RULES

Organisational requirements

Article 26

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

(2) A credit institution shall establish a clearly defined and consistent organisational structure for the decision-making process on the granting of placements, ensuring:
   1) the establishment of criteria, policies and procedures for the granting of new placements and the refinancing and restructuring of existing placements;
   2) the establishment of rules on the granting of placements at the level of individual debtors and collateral providers and at the level of the group of clients connected with the debtors and collateral providers, depending on the placement amount and risk; and
   3) the establishment of the competences of the supervisory board, the management board and committees appointed by them, as well as of the powers to grant placements assigned to individual management levels, depending on the placement amount and risk.

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

(4) Exceptionally, where a credit institution grants placements which are materially insignificant with regard to credit risk, the granting procedure may be simplified by making decisions on the granting of placements within the front office function. In this case, the credit institution shall prescribe the identification criteria for materially insignificant placements, the rules governing the granting of these placements, including their classification based on similar characteristics, and the rules governing their monitoring on an aggregate basis which must be performed within the risk control function.
(5) Where a credit institution grants a placement under conditions differing from the general operating conditions, it shall determine the rules of procedure regarding the granting and monitoring of such placements and the implementation of adequate measures to reduce credit risk associated with these placements.

(6) A credit institution may not carry out value adjustments for on-balance sheet items or form provisions for risk-bearing off-balance sheet items within the front office function.

Credit process
Article 27

The credit process shall at a minimum include the following:
1) a placement granting process;
2) a placement monitoring process;
3) a credit portfolio analysis;
4) the treatment of non-performing placements;
5) a credit risk early warning system; and
6) a placement classification process according to the degrees of risk.

Placement granting process
Article 28

(1) Before granting a placement, a credit institution shall assess the creditworthiness of the debtor, taking into account its own criteria prescribed in an internal bylaw and the minimum requirements referred to in the Decision on the classification of placements and off-balance sheet liabilities of credit institutions.

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

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

(4) A credit institution shall adopt a policy on eligible collateral and the methodology for assessing collateral value taking into account the minimum requirements referred to in the Decision on the classification of placements and off-balance sheet liabilities of credit institutions.

Placement monitoring process
Article 29

(1) The placement monitoring process shall include an assessment of the creditworthiness of the debtor and of the group of clients connected with the debtor as well as an assessment of the collateral quality during the legal relationship constituting the exposure.
(2) During the legal relationship constituting the exposure to credit risk, a credit institution shall monitor the operation of the debtor, as well as the quality, marketability, availability, value and validity of collateral for its claims taking into account the minimum requirements referred to in the Decision on the classification of placements and off-balance sheet liabilities of credit institutions.

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

(4) The placement monitoring must be established in such a manner as to enable a timely implementation of adequate measures to mitigate credit risk if the creditworthiness of the debtor or collateral provider deteriorates.

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

Credit portfolio analysis

Article 30

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

(2) The credit portfolio monitoring and analysis must be established in such a manner as to provide for timely implementation of adequate measures to mitigate credit risk.

Treatment of non-performing placements

Article 31

(1) A credit institution shall define the criteria for the increase in the degree of risk according to which a placement is to be considered as non-performing and classified within the scope of the non-performing placement monitoring function.

(2) A credit institution shall define the criteria for the treatment of non-performing placements, which must be specially monitored due to their increased degree of risk. A credit institution shall establish an ongoing and efficient function responsible for the monitoring and treatment of non-performing placements, independent from the activities performed by the front office function.

(3) A credit institution shall take legal action as necessary to activate and liquidate collateral for problem placements.

Treatment of restructured placements

Article 32
(1) A credit institution shall assess whether the restructuring of placements granted to an individual debtor is economically justified. If such restructuring of placements is economically justified, the credit institution shall establish an adequate restructuring plan and monitor its implementation and effects.

(2) When determining whether the restructuring of placements granted to a debtor is economically justified, a credit institution shall obtain:
   1) a detailed analysis of the reasons that led to difficulties in the operation of the debtor;
   2) a plan for the operational, financial and ownership restructuring of the debtor;
   3) a cash flow projection for the period of at least three years or the period defined in the restructuring plan.

(3) On the basis of the information referred to in paragraph (2), a credit institution shall make:
   1) an assessment of the feasibility of a plan for the operational, financial and ownership restructuring of the debtor;
   2) an analysis of possible methods of placement restructuring and the rationale for the chosen method;
   3) a new repayment plan for the placement which shall be the basis for monitoring the implementation of the placement restructuring plan.

(4) A credit institution shall monitor the implementation of the entire restructuring plan and of cash flows of the debtor on an ongoing basis and at a minimum on a quarterly basis.

(5) When restructuring placements, a credit institution shall take into account the minimum requirements referred to in the Decision on the classification of placements and off-balance sheet liabilities of credit institutions.

**Credit risk early warning system**

*Article 33*

(1) A credit institution shall establish a credit risk early warning system providing for a timely identification of debtors carrying an increased risk.

(2) A credit institution shall define adequate qualitative and quantitative early warning indicators of credit risk.

**Placement classification process**

*Article 34*

(1) In order to assess credit risk, a credit institution shall establish an adequate process of classifying placements into categories according to their recoverability, taking into account the minimum requirements referred to in the Decision on the classification of placements and off-balance sheet liabilities of credit institutions. The placement classification process shall be adequate if it is based on quantitative and, where possible, qualitative criteria, which take into account specific placement characteristics. These criteria are to provide for a clearly defined classification of placements into appropriate categories according to their recoverability.
(2) A credit institution shall ensure that the appropriateness of the process of classifying placements into categories according to their recoverability is monitored and revised on an ongoing basis.

(3) A credit institution shall carry out value adjustments for on-balance sheet items and form provisions for risk-bearing off-balance sheet items in accordance with International Accounting Standards and International Financial Reporting Standards, taking into account the minimum requirements referred to in the Decision on the classification of placements and off-balance sheet liabilities of credit institutions.

Treatment of concentration risk

Article 35

(1) A credit institution shall adopt adequate rules to identify and measure concentration risk, which shall at a minimum include the following:
   1) the identification and measurement of concentrations associated with individual persons and groups of connected clients;
   2) the identification and measurement of concentrations associated with a group of exposures connected by common risk factors, such as the same economic sector, geographic region or activities, or the application of risk mitigation techniques; and
   3) the identification and measurement of concentrations associated with the overall credit portfolio.

(2) A credit institution shall adopt adequate methodologies to monitor and mitigate concentration risk. These methodologies shall at a minimum include the following:
   1) an active management of credit portfolio diversification;
   2) a determination of concentration limits; and
   3) credit risk transfer or mitigation, including the direct sale of placements, transfer of placements or credit risk through securitisation and use of credit derivatives and collateral.

Treatment of country risk

Article 36

(1) A credit institution which grants placements to debtors having their head office or domicile outside the Republic of Croatia shall have in place sound policies and procedures to identify, measure, monitor and control the risk of the countries in which the debtors have their head office or domicile.

(2) The country risk monitoring shall include an assessment of the probability of default by the counterparty having its head office or domicile outside the Republic of Croatia arising from country-specific economic and political factors, and an assessment of the feasibility of contracts which have provided a basis for individual placements and of the possibility of liquidating the collateral under the laws of the country in question in a specific period.

MARKET RISKS MANAGEMENT RULES

Organisational requirements

Article 37
(1) A credit institution shall ensure that the front office function is clearly separated, operationally and organisationally, from the risk control function and the treasury back office function, up to the level of the management board.

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

Transaction contracting

Article 38

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

(2) A credit institution shall ensure that transactions are arranged in line with market conditions. Exceptionally, a credit institution may contract transactions which are not in line with market conditions, provided that the following conditions are met:
   1) a transaction has been contracted based on a clearly defined and justified client request, with the agreed on deviation from market conditions clearly specified in the documentation accompanying the transaction; and
   2) each transaction which has not been contracted in line with market conditions must be accompanied by a clearly specified description of the deviation from market conditions and the reasons for it.

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

(4) A credit institution shall ensure that trading is conducted only in its business premises.

(5) A credit institution shall define in an internal bylaw the employees authorised to contract transactions, the type and value of the transactions such employees may contract, the transaction contracting methods and the system of reporting on contractual transactions.

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

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

(8) A credit institution shall ensure that the employees authorised to contract transactions enter transaction data into the information system using their own identification marks. The time of data entry and employee identification mark must be automatically generated.
Transaction recording and control
Article 39

(1) A credit institution shall ensure that each contractual transaction is adequately recorded and immediately included into internal reports on contractual transactions.

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

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

Market risk exposure analysis
Article 40

(1) When analysing its market risk exposure, a credit institution shall at a minimum take into account the following:
   1) all credit institution activities sensitive to changes in market factors, also taking into account trading book and non-trading book positions;
   2) the development and liquidity of relevant financial markets and market price volatility of financial instruments;
   3) actual and projected mismatches and open positions arising from credit institution activities;
   4) risk concentration in the trading book;
   5) correlations between market prices of various financial instruments;
   6) correlations with other risks to which the credit institution is exposed, e.g. credit risk and liquidity risk;
   7) complex financial instruments;
   8) embedded options; and
   9) profit and capital simulations under various scenarios, including the maximum loss quantification under extreme market conditions.

(2) When analysing its interest rate risk exposure, a credit institution shall, in addition to the elements referred to in paragraph (1) of this Article, take into account various aspects of interest rate risk, including, at a minimum, the risk arising from:
   1) changes in the yield curve and the correlations between various yield curves which are relevant for credit institution activities; and
   2) the possible execution of embedded interest rate options.
(3) When analysing its foreign exchange risk exposure, a credit institution shall, in addition to the elements referred to in paragraph (1) of this Article, at a minimum take into account the following:
   1) the impact of adverse exchange rate fluctuations on the value of the open foreign exchange position; and
   2) changes in carrying values of the credit institution's foreign currency positions arising from changes in the exchange rates.

(4) A credit institution shall regularly assess the profit and capital simulations in relation to its actual performance. The simulations shall relate to the following:
   1) interest and interest-sensitive income and expense as well as the economic value of on-balance and off-balance sheet items under various interest rate scenarios;
   2) foreign exchange and foreign exchange-sensitive income and expense as well as the economic value of on-balance and off-balance sheet items under various exchange rate scenarios; and
   3) other market factors and market-sensitive income and expense as well as the economic value of on-balance and off-balance sheet items under various market scenarios.

Trading book
Article 41

As regards trading book positions, a credit institution shall, in addition to the requirements referred to in Article 105 of Regulation (EU) No 575/2013, at a minimum establish the following:
   1) that each excess of the limits is immediately identified and that the reports on the excesses of established limits are prepared on a daily basis;
   2) that price volatility of trading book positions is monitored on a regular basis;
   3) that open positions, which are divided into spot positions, forward positions and option positions, are measured and monitored on an ongoing basis, taking into account individual risks arising from these positions and their value, maturity and complexity.

Market risk monitoring
Article 42

(1) The monitoring of risks arising from trading activities shall comprise daily monitoring of data on:
   1) trading positions;
   2) utilisation and excesses of the limits; and
   3) trading results.

(2) A credit institution shall establish a system of limits for restricting exposures to measurable market risks.

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

(5) A credit institution shall establish a system of reporting to the senior management and, if it deems necessary, to the management board, on all excesses of the established limits.

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

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

**OPERATIONAL RISK MANAGEMENT RULES**

**Management system**

**Article 43**

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

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

**Operational risk definition, events and sources**

**Article 44**

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

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

**Operational risk management**

**Article 45**

(1) The operational risk management of a credit institution shall in particular cover business changes, including new products, activities, processes and systems, operational risk occurring in project management and outsourcing of business activities as well as significant risks inherent in the existing products, activities, processes and systems.
(2) When identifying, measuring or assessing operational risk, a credit institution shall take into account all relevant internal and external factors, and cover the operational risk or events which have resulted in losses and the operational risk to which it is exposed, but which has not resulted in losses.

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

(4) In order to appropriately manage operational risk, and in accordance with the Credit Institutions Act, the regulations adopted under that act and other regulations, a credit institution shall in particular ensure the following:
   1) an appropriate management of the information system and information system risk;
   2) an appropriate management of outsourcing-related risks;
   3) an appropriate management of compliance risk and legal risk;
   4) an appropriate business continuity management; and
   5) the establishment of an appropriate system for the prevention of money laundering and terrorist financing.

Operational risk determination and analysis
   Article 46

A credit institution shall immediately carry out a detailed analysis of significant operational risk losses or operational risk which it has identified and implement adequate measures to reduce and/or limit the consequences of the events or to contain risk, and it shall report thereon to the management board and other relevant bodies and/or persons.

Monitoring and reporting on operational risk exposures
   Article 47

A credit institution shall, as applicable, at a minimum include the following in the regular monitoring of and reporting on operational risk exposures:
   1) the type of loss or risk;
   2) the causes and sources of the events or risks;
   3) the scope and significance of the events or risks; and
   4) the measures which are to be or have been implemented to reduce and limit the consequences of the events or to contain risk.

Business continuity management
   Article 48

(1) A credit institution shall establish a business continuity management process to ensure business continuity and limit losses in the event of serious disruption or discontinuation of operation.

(2) Within business continuity management, a credit institution shall identify and define key/vital business activities, processes, systems (including those that are outsourced) and the level of service which the credit institution must maintain or timely restore and, in this regard:
1) assess the impact of their disruption or discontinuation on the credit institution operation and identify related risks; and
2) define the priorities, time frame and strategy to maintain/restore the identified key business activities, processes, systems and service level.

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

Plans
Article 49

(1) A credit institution shall adopt a business continuity plan to ensure business continuity, i.e. to timely restore key business activities, processes, systems and service level and to limit the losses in the event of serious disruption or discontinuation of operation.

(2) A credit institution shall regularly revise the business continuity plan in line with business changes, including changes in the products, activities, processes and systems, changes in the environment, and in line with its business strategy and objectives.

(3) A credit institution shall continue, as appropriate, to regularly test the business continuity plan and document test results.

Reporting on business continuity planning
Article 50

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

(2) A credit institution shall, in the event of circumstances requiring the activation of the business continuity plan, without delay notify the Croatian National Bank on all the relevant facts and circumstances pertaining to that matter.

IV TRANSITIONAL AND FINAL PROVISIONS

Cessation of the effect of the previous Decision
Article 51

On the date of the entry into force of this Decision, the Decision on risk management (Official Gazette 1/2009, 41/2009, 75/2009, 2/2010 and 160/2013) shall cease to have effect.

Entry into force
Article 52

This Decision shall be published in the Official Gazette and shall enter into force on the eighth day after the day of its publication.