Pursuant to Article 183 of the Banking Law of Republika Srpska (“Official Gazette of Republika Srpska”, No. 04/17, 19/18 and 54/19), Article 5, Paragraph 1, Item b, Article 20 and Article 37 of the Law on the Banking Agency of Republika Srpska ("Official Gazette of Republika Srpska", No. 59/13 and 04/17), and Article 6, Paragraph 1, Item b and Article 19, Paragraph 1, Item b of the Statute of the Banking Agency of Republika Srpska ("Official Gazette of Republika Srpska", No. 63/17), the Management Board of the Banking Agency of Republika Srpska, at its 36th session, held on 1 November 2021, adopted the

DECISION

ON

SUPERVISORY REVIEW AND EVALUATION PROCESS OF BANKS

Subject

Article 1

(1) This Decision defines the supervisory review and evaluation process of banks (hereinafter: SREP assessment) referred to in Article 5, Paragraph 3, Item 1 of the Decision on the method of conducting supervision and implementing supervisory measures.

(2) The Banking Agency of Republika Srpska (hereinafter: the Agency) shall implement the SREP assessment of banks based in Republika Srpska in accordance with the Methodology for supervisory review and evaluation process of banks.

Elements of SREP assessment

Article 2

(1) The SREP assessment is based on the assessment of the following four elements:

1) business model and profitability, whereby the level of risk is assessed,

2) management system and risk management system, whereby risk control assessment is performed,

3) individual risks related to capital: credit, market and operational risk and interest rate risk in the banking book, whereby the level and control of risk is assessed,

4) risk of short-term liquidity and risk of long-term funding sources, whereby the level and control of risk is assessed.

(2) In order to comprehensively review the risks to which the bank is exposed or may be exposed in its operations and to determine the bank's capital and liquidity needs, the results of the risk assessment referred to in Paragraph 1, Item 3 and 4 of this Article are supplemented by the results of the bank's internal capital adequacy assessment process (hereinafter: ICAAP), i.e. the bank's internal liquidity adequacy assessment process (hereinafter: ILAAP).

SREP assessment procedure

Article 3

(1) The SREP assessment procedure, i.e. the elements referred to in Article 2, Paragraph 1 of this Decision, shall be carried out through the following three phases:

1) data/information collection,

2) automatic procedure for determining the score, which serves as a starting point for determining the final score on the level and control of risk in the main assessment phase,

3) the main assessment, which is based on the expert assessment of the Agency, whereby the score of the level and control of risk is determined in the second phase may be worsened by two scores or improved by one score at this stage.

(2) The assessment of each individual element of the SREP assessment (hereinafter: SREP element) is based on qualitative and quantitative analyzes of factors related to that element, as well as on the analysis of the interconnection of that element with other SREP elements.

Method of determining

SREP elements score

Article 4

(1) For the purposes of determining the risk level scores of individual SREP elements referred to in Article 2, Paragraph 1, Item 1, 3 and 4 of this Decision, scores 1-4 shall be used, whereby:

1) score 1 implies a low level of risk, i.e. that no risk of significant impact on the bank has been identified, taking into account the determined level of risk,

2) score 2 implies a medium-low level of risk, i.e. that there is a medium-low risk of significant impact on the bank, taking into account the determined level of risk,

3) score 3 implies a medium-high level of risk, i.e. that there is a medium-high risk of significant impact on the bank, taking into account the determined level of risk,

4) score 4 implies a high level of risk, i.e. that there is a high risk of significant impact on the bank, taking into account the determined level of risk.

(2) For the purposes of determining the risk control scores of individual SREP elements referred to in Article 2, Paragraph 1, Items 2–4 of this Decision, scores 1-4 shall be used, whereby:

1) score 1 implies robust risk control, i.e. that no risk of significant impact on the bank has been identified, taking into account management, organization and controls. The risk management system, including risk control, is clearly defined and is fully proportional to the type, scope and complexity of the bank's operations;

2) score 2 implies adequate risk control, i.e. that there is a medium-low risk of significant impact on the bank, taking into account management, organization and controls. The risk management system, including risk control, is adequately defined and is sufficiently proportional to the type, scope and complexity of the bank's operations;

3) score 3 implies weak risk control, i.e. that there is a medium-high risk of significant impact on the bank, taking into account management, organization and controls. The level of risk management and risk control is weak and needs to be improved. The risk management system, including risk control, is poorly defined or not sufficiently proportional to the type, scope and complexity of the bank's operations,

4) score 4 implies inadequate risk control, i.e. that there is a high risk of significant impact on the bank, taking into account management, organization and controls. The level of risk management and risk control is low and needs to be significantly and/or improved immediately. Risks are inadequately mitigated and poorly controlled. The risk management system, including risk control, is not defined or is not proportional to the type, scope and complexity of the bank's operations.

(3) When determining the scores for individual risks related to capital or liquidity and funding sources referred to in Article 2, Paragraph 1, Item 3 and 4 of this Decision, and depending on the expert assessment of the authorized persons of the Agency, the following rules shall be applied for combining scores of risk level and risk control:

1) if the risk control is robust, the combined score may be one grade better than the score of the level of risk or the same as the score of the level of risk,

2) if the risk control is weak, the combined score may be one grade worse than the score of the level of risk or the same as the score of the level of risk,

3) if the risk control is inadequate, the combined score may be one or two grades worse than the score of the risk level.

(4) Notwithstanding Paragraph 3 of this Article, in the case where it is deemed most appropriate, the combined score of the level of risk and risk control for a particular risk may be determined as an intermediate score (e.g. if the score for individual risk is between 2 and 3, a score of 2.5 can be determined).

Business model and profitability

Article 5

(1) The Agency shall conduct an assessment of the business model in order to assess the business and strategic risks and determine the sustainability of the existing business model of the bank based on its ability to generate acceptable profit and implement its strategic and financial plans.

(2) When assessing the business model, the focus shall be on the business lines or products that are most important in terms of sustainability or future sustainability of the bank's existing business model and/or that are most likely to increase the bank's exposure to existing or new risks.

(3) The assessment of the bank's business model includes the assessment of:

1) short-term sustainability of the business model (or the bank's ability to generate an acceptable profit over the next 12 months),

2) long-term sustainability of the business model (or the bank's ability to generate an acceptable profit over the next three years) and

3) long-term sustainability of the business model during the entire business/economic cycle (or the bank's ability to generate an acceptable profit during the entire business/economic cycle, i.e. after a period of three years).

(4) The main profitability indicators considered when assessing the sustainability of the business model are return on assets after tax (ROA), cost/income ratio (CIR) and the ratio of net interest income after value adjustments and total net assets (NIA), but additional indicators are taken into account, such as: the ratio of administrative costs and net assets, the ratio of regular earnings, the ratio of profit before provisions and total average net assets, return on equity after tax (ROE) and similar. During the assessment, the profitability indicators of peer banks are also considered, as well as the indicators at the level of the banking sector of Republika Srpska.

(5) Based on the assessment referred to in Paragraphs 1–4 of this Article, the Agency shall form an opinion and determine the final score of the sustainability of the business model and profitability of the bank as follows:

Score	Opinion	Criteria
1	The business model and profitability pose a low level of risk to the bank's sustainability.	Risk level - The main indicators indicate satisfactory levels, as well as most additional indicators, both for the bank and in comparison with peer banks. - Other categories of significant risks do not pose an immediate threat to profitability. - The bank generates large and stable returns that are acceptable, while taking into account the risk appetite and funding structure. - There is no significant concentration of assets or unsustainable concentration of income sources. - The bank's financial projections are based on convincing assumptions about the future business environment. - Strategic plans are appropriate given the existing business model and the ability of the bank's management to implement them. - The bank has a competitive advantage over peer banks.
2	The business model and profitability pose a medium-low level of risk to the bank's sustainability.	Risk level - Most indicators indicate satisfactory levels, but the bank is not rated as the best among peer banks. - Other categories of significant risks generally do not pose an immediate threat to profitability. - Compared to a group of peer banks, the bank generates average returns that are mostly acceptable given its risk appetite and funding structure. - There is a certain concentration of assets or income sources. - The bank's financial projections are based on optimistic assumptions about the future business environment. - Strategic plans are acceptable given the existing business model and the ability of the bank's management to implement them, but not without risk. - There are certain pressures in terms of maintaining a competitive advantage in the target markets/products.
3	The business model and profitability pose a medium-high level of risk to the bank's sustainability.	Risk level - Certain main indicators indicate unsatisfactory levels, as well as certain additional indicators, but the bank was not rated as the worst compared to peer banks. - There is a suspicion that other categories of significant risks pose an immediate threat to profitability. - The bank generates returns that are often weak or volatile or rely on risk appetite or funding structure to achieve acceptable returns, which raises concerns for the Agency. - There is a significant concentration of assets or income sources. - The bank's financial projections are based on over-optimistic assumptions about the future business environment. - There is a possibility of non-execution of strategic plans given the existing business model and the ability of the bank's management to implement them. - The bank has a weak competitive advantage with respect to target markets/products, and the bank's market share is declining. There is a suspicion that the bank will fail to regain market share or that its decline will continue.
4	The business model and profitability pose a high level of	Risk level - Several key indicators indicate unsatisfactory levels, as well as several additional indicators, and the bank was rated as the worst compared to the group of peer banks.

	risk to the bank's sustainability.	- Other categories of significant risks pose an immediate threat to profitability. - The bank generates very weak and highly volatile returns or relies on an unacceptable risk appetite or funding structure to generate acceptable returns. - The bank has an excessive concentration of assets or an unsustainable concentration of income sources. - The bank's financial projections are based on very unrealistic assumptions about the future business environment. - Strategic plans are not feasible given the existing business model and the ability of the bank's management to implement them. - The bank has a very weak competitive advantage in terms of target markets/products, and is unlikely to be able to maintain market share and it will decrease.

Management system and risk management system

Article 6

(1) The Agency shall assess the management system and the risk management system in order to assess the risks arising from inadequate management, organization and internal controls, and their impact on the bank's sustainability.

(2) When conducting the assessment of the management system and the risk management system, the following four key segments shall be assessed:

1) management system and risk management,

2) organizational structure,

3) risk management system and risk culture,

4) risk infrastructure, data and risk reporting.

(3) When conducting the assessment referred to in Paragraph 2 of this Article, it shall be assessed whether the bank has established:

1) a transparent organizational structure with clearly defined and consistent lines of competence and responsibility, in a manner that enables effective communication and cooperation of all organizational levels, including adequate flow of information in the bank, limits and prevents conflicts of interest and establishes a clear and documented decision-making process. Also, the manner and efficiency of the work of the bank's governing bodies and their boards is assessed;

2) an efficient and reliable risk management system, which includes efficient and reliable processes for identifying, managing, monitoring, mitigating and reporting on risk exposure, with a special assessment of the framework defining the bank's risk appetite, whether separation of risk management activities from risk exposure activities has been performed unambiguously, and whether an information system is provided that enables comprehensive and reliable collection of data necessary for monitoring and analysis of all risks to which the bank is exposed;

3) adequate corporate and risk culture that is proportional to the size of the bank, type and complexity of the bank's operations, or risk profile of the bank, and is based on good, clearly expressed values, which take into account the risk appetite;

4) adequate system of internal controls, which includes clear administrative and accounting procedures, and adequate control functions;

5) adequate strategies, policies and outsourcing processes that take into account the impact of outsourcing on the bank's operations and the risks associated with outsourcing;

6) remuneration policies and practices that are in line with the scope of the risk assumed and efficient and reliable risk management;

7) adequate ICAAP and ILAAP.

(4) Also, within the assessment of the management system and the risk management system, the findings and shortcomings identified during the assessment of recovery plans shall be considered.

(5) Based on the assessment referred to in Paragraphs 1–4 of this Article, the Agency shall form an opinion and determine the final score of the adequacy of the bank's management system and risk management system as follows:

Score	Opinion	Criteria
1	The shortcomings of the management system and the risk management system pose a low risk to the bank's sustainability.	<u>Risk control</u> - The bank has a robust and transparent organizational structure with clearly defined and consistent lines of competence and responsibility, including an unambiguous separation of risk management activities from risk exposure activities. - The bank has established adequate strategies, policies and processes for risk management and identification and avoidance of conflicts of interest. - The bank has adequate policies and strategies for outsourcing. - There is a good corporate culture and risk culture. - The composition and manner of functioning of the bank's governing bodies and their boards are adequate. - Remuneration policies and practices are in line with the risk strategy and long-term interests of the bank. - The risk management system and risk management processes, stress testing framework, capital and liquidity plans, as well as risk reporting are adequate. - The system of internal controls and the work of control functions are adequate. - The information system and business continuity mechanisms are adequate. - ICAAP and ILAAP are robust. - The bank's recovery plan is adequate.
2	The shortcomings of the management system and the risk management system pose a medium-low risk to the bank's sustainability.	<u>Risk control</u> - The bank generally has a robust and transparent organizational structure with clearly defined and consistent lines of competence and responsibility, and has provided an unambiguous separation of risk management activities from risk exposure activities. - The bank has established strategies, policies and processes for risk management and identification and avoidance of conflicts of interest, which are to a greater extent adequate. - The bank has policies and strategies for outsourcing, which are to a greater extent adequate. - Corporate culture and risk culture are generally good. - The composition and manner of functioning of the bank's governing bodies and their boards are generally adequate. - Remuneration policies and practices are to a greater extent in line with the bank's risk strategy and long-term interests. - The risk management system and risk management processes, the stress testing framework, capital and liquidity plans, as well as risk reporting are to a greater extent adequate. - The system of internal controls and the work of control functions are generally adequate. - The information system and business continuity mechanisms are generally adequate.

		- ICAAP and ILAAP are adequate. - The bank's recovery plan is to a greater extent adequate.
3	The shortcomings of the management system and the risk management system pose a medium-high risk to the bank's sustainability.	<u>Risk control</u> - The organizational structure of the bank and the lines of competence and responsibility are not completely transparent, and the bank has not fully ensured the unambiguous separation of risk management activities from risk exposure activities. - The bank has established strategies, policies and processes for risk management and identification and avoidance of conflicts of interest, which have certain shortcomings and/or are not applied consistently. - The bank has policies and strategies for outsourcing, which have certain shortcomings and/or are not applied consistently. - Corporate culture and risk culture have certain shortcomings. - There are certain shortcomings when it comes to the composition and functioning of the bank's governing bodies and their boards. - Remuneration policies and practices are not fully in line with the bank's risk strategy and long-term interests. - The risk management system and risk management processes, the stress testing framework, capital and liquidity plans, as well as risk reporting have certain shortcomings. - The system of internal controls and the work of control functions have certain shortcomings. - The information system and business continuity mechanisms have certain shortcomings. - ICAAP and/or ILAAP are weak or inadequate. - The bank's recovery plan is incomplete and certain material shortcomings have been identified, and there is a need for the bank to improve its recovery planning procedures.
4	The shortcomings of the management system and the risk management system pose a high risk to the bank's sustainability.	<u>Risk control</u> - The organizational structure of the bank and the lines of competence and responsibility are not transparent, and the bank has not provided an unambiguous separation of risk management activities from risk exposure activities. - The bank has established strategies, policies and processes for risk management and identification and avoidance of conflicts of interest, but they are not applied or are not adequate or they are not established at all. - The bank has policies and strategies for outsourcing that are not applied, are not adequate or have not been adopted. - Corporate culture and risk culture are not adequate. - The composition and manner of functioning of the bank's governing bodies and their boards are not adequate. - Remuneration policies and practices are not in line with the bank's risk strategy and long-term interests. - The risk management system and risk management processes, the stress testing framework, capital and liquidity plans, as well as risk reporting are inadequate. - The system of internal controls and the work of control functions are not adequate. - The information system and business continuity mechanisms are not adequate. - ICAAP and ILAAP are inadequate.

		- The bank's recovery plan is incomplete and significant material shortcomings have been identified, which indicates inadequate recovery planning procedures and calls into question the feasibility of the plan.

(6) Notwithstanding the score established in accordance with Paragraph 5 of this Article, the score of the management system and risk management system may not be better than 3 if the ICAAP and/or ILAAP is assessed as “inadequate”.

Capital related risks

Article 7

(1) In order to determine the total capital requirements of the bank, the Agency shall assess:

1) Risks related to capital, i.e.:

1. credit risk,
2. operational risk,
3. interest rate risk in the banking book, and
4. market risk, if it is assessed as significant for the bank;

2) Adequacy of the level and structure of capital, taking into account the results of the bank's ICAAP assessment.

(2) For the purposes of applying Paragraph 1, Item 1, Sub-item 4 of this Article, market risk shall be considered not significant if one of the following conditions is met:

1) the share of net earnings on financial assets and financial liabilities held for trading in total operating income is less than 0.5% or

2) the share of financial assets held for trading in total net assets is less than 0.5%.

(3) Notwithstanding Paragraph 2 of this Article, if the Agency assesses that a particular subcategory of market risk is significant (e.g. foreign exchange risk), only an assessment of that subcategory of market risk shall be performed.

(4) The total score of capital-related risks represents the weighted average of scores determined during the risk assessment referred to in Paragraph 1, Item 1 of this Article and the assessment of adequacy of the level and structure of capital referred to in Paragraph 1, Item 2 of this Article.

(5) For the purposes of determining the overall score in accordance with Paragraph 4 of this Article, a weight of 60% for credit risk, 20% for operational risk, 10% for interest rate risk in the banking book and 10% for capital adequacy shall be applied.

(6) Notwithstanding Paragraph 5 of this Article, in the case where market risk is significant for the bank, it shall be assigned a weight of 5%, while the weight for credit risk shall be reduced from 60% to 55%.

Credit risk

Article 8

(1) The Agency shall assess the credit risk arising from all exposures in the banking book, including off-balance sheet exposures. The assessment is primarily conducted at the level of portfolios and asset categories, and, if necessary, the Agency may conduct a more granular assessment at the level of individual debtors or transactions.

(2) When assessing credit risk, concentration risk must be included, while the following subcategories of credit risk are taken into account only if they are significant for the bank: credit and foreign exchange risk,

counterparty risk and settlement risk, country risk, residual risk, specialized lending risk and other significant risks.

(3) When assessing the level of credit risk, at least the following segments shall be considered:

1) amount of credit risk/activity exposure,

2) nature and composition of the loan portfolio, including its concentration,

3) trends of the loan portfolio,

4) quality of the loan portfolio,

5) credit risk parameters and

6) credit risk mitigation and value adjustment techniques, i.e. provisions to cover expected credit losses for off-balance sheet items.

(4) The main indicators used in assessing the level of credit risk are: the ratio of non-performing loans, the ratio of restructured loans, the ratio of new non-performing loans and income bearing loans, the Texas ratio, the coverage ratio of non-performing loans, the ratio of the sum of large exposures and regulatory capital, Herfindale index (sector concentration), but additional indicators are taken into account, such as: share of overdue loans in total loans, share of loans of credit risk level 2 in total loans, recovery ratio of non-performing loans, analysis of non-performing loans by number of days in arrears and similar. During the assessment, credit risk indicators of peer banks are also considered, as well as indicators at the level of the banking sector of Republika Srpska.

(5) When assessing the credit risk management system, i.e. controlling that risk, the following shall be assessed:

1) management, i.e. the manner of organization of the credit process and credit risk management,

2) risk appetite, including an assessment of the compliance of the bank's strategies and policies and other internal acts defining risk tolerance with the bank's business objectives and long-term interests,

3) credit risk management and internal control systems,

4) internal audit functions, i.e. staff qualifications of the internal audit function for assessing credit risk management, the quality of audit reports and the bank's compliance with internal audit recommendations.

(6) Based on the assessment referred to in Paragraphs 1–5 of this Article, the Agency shall form an opinion and determine the final score of the adequacy of the level and control of the bank's credit risk as follows:

Score	Opinion	Criteria
1	The level and control of credit risk pose a low risk to the bank's sustainability.	<u>Risk level</u> - The type and structure of credit risk exposure indicate low risk. - The level of credit risk concentration is low. - The level of restructured and non-performing exposures is low. - Credit risk arising from exposures allocated to credit risk levels 1 and 2 is low. - The coverage of exposure by value adjustments, i.e. provisions for coverage of expected credit losses for off-balance sheet items is very high. - Collateral exposure coverage and collateral quality are very high. <u>Risk control</u> - The organizational structure for credit risk is transparent, efficient and stable, with clearly defined levels of competence and responsibility at all operational, organizational, managerial and governing levels and compliance with the rules for preventing conflicts of interest. A clear operational and organizational separation of the transaction contracting function from the support and risk

		management function, including management and governance levels, is ensured. - The bank's credit risk strategy and policy, as well as the defined risk appetite, are in line with its business strategy. - The bank has established an efficient and reliable risk management system, which includes efficient and reliable processes and procedures for identifying, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure. - The system of internal controls for credit risk is adequate and reliable. - The bank has defined internal restrictions on exposure limits, which enable the reduction or limitation of exposure to credit risk and are in line with the strategy, policy and risk appetite. - The internal audit function is staffed to provide an assessment of credit risk management, the quality of audit reports is at a high level, and the bank continuously undertakes measures to implement the recommendations of internal audit.
2	The level and control of credit risk pose a medium-low risk to the bank's sustainability.	Risk level - The type and structure of credit risk exposure indicate medium-low risk. - The level of credit risk concentration is medium-low. - The level of restructured and non-performing exposures is medium-low. - Credit risk arising from exposures allocated to credit risk levels 1 and 2 is medium-low. - The coverage of exposure by value adjustments, i.e. provisions for coverage of expected credit losses for off-balance sheet items is adequate. - Collateral exposure coverage and collateral quality are adequate. Risk control - The organizational structure for credit risk is mostly transparent, efficient and stable, with clearly defined levels of competence and responsibility at all operational, organizational, managerial and governing levels and compliance with the rules for preventing conflicts of interest. A clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governance levels, is ensured. - The bank's credit risk strategy and policy, as well as the defined risk appetite, are in line with its business strategy, but there is a need for their improvement. - The bank has established an efficient and reliable risk management system, which includes efficient and reliable processes and procedures for identifying, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure, but there is a need for their improvement. - The system of internal controls for credit risk is to a greater extent adequate and reliable. - The bank has defined internal restrictions on exposure limits, which enable the reduction or limitation of exposure to credit risk and are in line with the strategy, policy and risk appetite. - The internal audit function is staffed to provide an assessment of credit risk management, the quality of audit reports is at adequate level, and the bank continuously undertakes measures to implement the recommendations of internal audit.
3	The level and control of credit risk pose a medium-high	Risk level - The type and structure of credit risk exposure indicate medium-high risk. - The level of credit risk concentration is medium-high. - The level of restructured and non-performing exposures is medium-high.

	risk to the bank's sustainability.	- Credit risk arising from exposures allocated to credit risk levels 1 and 2 is medium-high. - The coverage of exposure by value adjustments, i.e. provisions for coverage of expected credit losses for off-balance sheet items is not adequate and/or has significantly declining trend (excluding the effect of accounting write-off). - Collateral exposure coverage and collateral quality are not adequate and/or has significantly declining trend. <u>Risk control</u> - Deficiencies in the organizational structure for credit risk in terms of its transparency, efficiency and stability, and defined levels of competence and responsibility at some operational, organizational, managerial and governing levels, as well as certain shortcomings in compliance with rules to prevent conflicts of interest are identified. In all cases, a clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governing levels, is not ensured. - The bank's credit risk strategy and policy, and the defined risk appetite are mostly in line with its business strategy, but there is a need to improve them. - The bank has established a credit risk management system, which includes procedures for identifying, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure, but it needs to be improved in order to ensure greater efficiency and reliability. - The shortcomings of the internal control system for credit risk have been identified, and its improvement is needed. - The bank has defined internal restrictions on exposure limits, which enable the reduction or limitation of exposure to credit risk and are mostly in line with the strategy, policy and risk appetite. - The internal audit function is staffed to assess credit risk management, but the quality of audit reports needs to be improved, and although the bank is undertaking measures to implement internal audit recommendations, there are still a number of unexecuted recommendations.
4	The level and control of credit risk pose a high risk to the bank's sustainability.	<u>Risk level</u> - The type and structure of credit risk exposure indicate high risk. - The level of credit risk concentration is high. - The level of restructured and non-performing exposures is high. - Credit risk arising from exposures allocated to credit risk levels 1 and 2 is high. - The coverage of exposure by value adjustments, i.e. provisions for coverage of expected credit losses for off-balance sheet items is at a low level. - Collateral exposure coverage and collateral quality are extremely low. <u>Risk control</u> - The organizational structure for credit risk is inadequate in terms of its transparency, efficiency and stability, defined levels of competence and responsibility at operational, organizational, managerial and governing levels and significant deficiencies were identified in compliance with the rules for preventing conflicts of interest. A clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governance levels, is not ensured. - The bank's credit risk strategy and policy, as well as the defined risk appetite, are not in line with its business strategy. - The bank has not established a risk management system, which includes processes for identifying, assessing, i.e. measuring, limiting and mitigating,

		monitoring and reporting on risk exposure or the established system is inadequate. - The system of internal controls for credit risk is unreliable. - Internal restrictions on exposure limits are not in line with the strategy, policy and risk appetite. - The internal audit function is understaffed to provide an assessment of credit risk management, the quality of audit reports is not adequate, the internal audit failed to cover all risk areas and/or its recommendations have not been implemented by the bank continuously.

Market risk

Article 9

(1) The assessment of market risk refers to those balance sheet and off-balance sheet items that may lead to negative effects on the financial result and capital of the bank due to the changed market price, and is obligatory conducted if the Agency, based on criteria referred to in Article 7, Paragraphs 2 and 3 of this Decision, has determined that market risk or a certain category of market risk is significant for the bank.

(2) When assessing the market risk at least the following subcategories of market risk shall be covered, if they are significant for the bank: foreign exchange risk, position risk and commodity risk.

(3) When assessing the level of market risk, at least the following segments shall be considered:

1) type and structure of bank activities related to market risk, including analysis of exposure concentration,

2) analysis of profitability of market activities at the level of the bank and at the level of business lines (e.g. activities of trading in equity instruments, activities of trading in foreign exchange, etc.),

3) capital requirements to cover market risk,

4) stress testing.

(4) The main indicators used when assessing the level of market risk are: the share of net earnings on financial assets and liabilities held for trading in total operating income, the ratio of capital requirements for market risk and regulatory capital, but additional indicators are also taken into account, including internal indicators used by the bank to monitor market risk. During the assessment, market risk indicators of peer banks are also considered, as well as indicators at the level of the banking sector of Republika Srpska.

(5) When assessing the market risk management system, i.e. control of that risk, the following shall be assessed:

1) management, i.e. the manner of organization of the market risk management function,

2) market risk appetite, including the assessment of the compliance of the bank's strategies and policies and other internal acts defining risk tolerance with the bank's business objectives and long-term interests,

3) market risk management and internal control systems,

4) internal audit function, i.e. staff qualifications of the internal audit function for assessing market risk management, the quality of audit reports and the bank's compliance with internal audit recommendations.

(6) Based on the assessment referred to in Paragraphs 1–5 of this Article, the Agency shall form an opinion and determine the final score of the adequacy of the level and control of market risk of the bank as follows:

Score	Opinion	Criteria
1	The level and control of market risk pose a low risk to the bank's sustainability.	Risk level - The type and structure of market risk exposure indicate low risk. - The level of market risk concentration is low. - Volatility of revenues/expenditures based on market risk exposure is very low. - The indicators used by the bank to monitor market risk are adequate and reliable, which leads to an appropriate assessment of the level of risk. Risk control - The organizational structure for market risk is transparent, efficient and stable, with clearly defined levels of competence and responsibility at all operational, organizational, managerial and governing levels and with compliance of the rules for preventing conflicts of interest. A clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governing levels, is ensured. - The bank's strategy and policy of market risk, and the defined risk appetite are in line with its business strategy. - The bank has established an efficient and reliable market risk management system, which includes efficient and reliable processes and procedures for identifying, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure. - The system of internal controls for market risk is adequate and reliable. - The bank has defined internal restrictions on exposure limits, which enable the reduction or limitation of exposure to market risk and are in line with the strategy, policy and risk appetite. - The internal audit function is staffed to provide an assessment of market risk management, the quality of audit reports is at a high level, and the bank continuously undertakes measures to implement the recommendations of internal audit.
2	The level and control of market risk pose a medium-low risk to the bank's sustainability.	Risk level - The type and structure of market risk exposure indicate a medium-low risk. - The level of market risk concentration is medium-low. - Volatility of revenues/expenditures based on market risk exposure is low. - Particular indicators used by the bank to monitor market risk are not adequate and/or reliable, leading to an underestimation of risk levels to a lesser extent, but the bank has undertaken activities to address the shortcomings. Risk control - The organizational structure for market risk is mostly transparent, efficient and stable, with clearly defined levels of competence and responsibility at all operational, organizational, managerial and governing levels and with compliance of the rules for preventing conflicts of interest. A clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governing levels, is ensured. - The bank's strategy and policy of market risk, and the defined risk appetite are in line with its business strategy, but there is a need for their improvement. - The bank has established an efficient and reliable market risk management system, which includes efficient and reliable processes and procedures for identifying, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure, but there is a need for their improvement.

		- The system of internal controls for market risk is to a greater extent adequate and reliable. - The bank has defined internal restrictions on exposure limits, which enable the reduction or limitation of exposure to market risk and are in line with the strategy, policy and risk appetite. - The internal audit function is staffed to provide an assessment of market risk management, the quality of audit reports is at an adequate level, and the bank continuously undertakes measures to implement the recommendations of internal audit.
3	The level and control of market risk pose a medium-high risk to the bank's sustainability.	<u>Risk level</u> - The type and structure of market risk exposure indicate a medium-high risk. - The level of market risk concentration is medium-high. - Volatility of revenues/expenditures based on market risk exposure is moderate. - Deficiencies have been identified in the main indicators used by the bank to monitor market risk, which leads to a significant underestimation of risk levels. <u>Risk control</u> - Deficiencies in the organizational structure for market risk in terms of its transparency, efficiency and stability, and defined levels of competence and responsibility at some operational, organizational, managerial and governing levels have been identified, as well as certain shortcomings in compliance with rules to prevent conflicts of interest. A clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governing levels, is not ensured in all cases. - The bank's strategy and policy for market risk, and the defined risk appetite are mostly in line with its business strategy, but there is a need to improve them. - The bank has established a market risk management system, which includes procedures for identifying, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure, but it needs to be improved in order to ensure greater efficiency and reliability. - The shortcomings of the internal control system for market risk have been identified, and its improvement is needed. - The bank has defined internal restrictions on exposure limits, which enable the reduction or limitation of exposure to market risk and are mostly in line with the strategy, policy and risk appetite. - The internal audit function is staffed to assess market risk management, but the quality of audit reports needs to be improved, and although the bank is undertaking steps to implement internal audit recommendations, there are still a number of unexecuted recommendations.
4	The level and control of market risk pose a high risk to the bank's sustainability.	<u>Risk level</u> - The type and structure of market risk exposure indicate high risk. - The level of market risk concentration is high. - Volatility of revenues/expenditures based on exposure to market risk is high. - The main indicators that the bank uses to monitor its market risk are not adjusted or have significant shortcomings, which leads to a very significant underestimation of risk levels. <u>Risk control</u> - The organizational structure for market risk is inadequate in terms of its transparency, efficiency and stability, the defined levels of competence and responsibility at operational, organizational, managerial and governing levels,

		and significant shortcomings in compliance with the rules for preventing conflicts of interest have been identified. There is no clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governing levels. - The bank's strategy and policy for market risk, and the defined risk appetite are not in line with its business strategy. - The bank has not established a market risk management system, which includes procedures for determining, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on the bank's risk exposure, or the established system is inadequate. - The system of internal controls for market risk is unreliable. - Internal restrictions on exposure limits are not in line with strategy, policy and risk appetite. - The internal audit function is not staffed to assess market risk management, the quality of audit reports is not adequate, the internal audit has not covered all risk areas and/or its recommendations are not implemented by the bank continuously.

Operational risk

Article 10

(1) The Agency shall assess the operational risk through all business lines and business activities of the bank, taking into account the findings of the assessment of other SREP elements.

(2) When assessing operational risk, reputational risk, information and communication technology (ICT) risk and conduct risk must be included, while the following subcategories of operational risk are taken into account only if they are significant for the bank:

1) internal fraud,

2) external fraud,

3) relations with employees and safety at the workplace,

4) damage to tangible assets and

5) execution, delivery and process management.

(3) The Agency assesses reputational risk within the operational risk assessment due to significant interdependence of operational and reputational risk, but the results of the reputational risk assessment are not reflected in the operational risk score, but, if relevant, are taken into account when determining the score for business model and/or liquidity risk.

(4) In addition to assessing the operational risk subcategories referred to in Paragraph 2 of this Article, the Agency shall assess the significance of operational risk arising from outsourced services and whether they may affect the bank's ability to process transactions and/or provide services, as well as an assessment of the management of the system for anti-money laundering and terrorism financing.

(5) The assessment of the level of operational risk to which the bank is exposed or could be exposed implies a comprehensive understanding of the business model, activities, risk culture and environment in which the bank operates, and includes at least the identification of:

1) types and levels of operational risk,

2) significance of operational risk,

3) significance of operating losses,

4) concentration of losses by type of event and business lines.

(6) The main indicators used in assessing the level of operational risk are: the share of capital requirements for operational risk in total capital requirements, the ratio of total losses from operational risk and capital requirements for operational risk and the ratio of total losses from operational risk and the relevant indicator, but additional indicators are also taken into account, such as the sum of the five largest gross and net losses, the number of incidents or harmful events, regardless of whether a loss was suffered or not, the accuracy of reporting to the Agency's and similar. During the assessment, the operational risk indicators of peer banks are also considered, as well as the indicators at the level of the banking sector of Republika Srpska.

(7) When assessing the operational risk management system, i.e. controlling that risk, the following shall be assessed:

1) management, i.e. the manner of organization of the operational risk management function,

2) risk appetite, including the assessment of the compliance of the bank's strategies and policies and other internal acts defining risk tolerance with the bank's business objectives and long-term interests,

3) operational risk management and internal control systems,

4) internal audit function, i.e. staff qualifications of the internal audit function for assessing operational risk management, the quality of audit reports and the bank's compliance with internal audit recommendations.

(8) Based on the assessment referred to in Paragraphs 1–7 of this Article, the Agency shall form an opinion and determine the final score of the adequacy of the level and control of the bank's operational risk as follows:

Score	Opinion	Criteria
1	The level and control of operational risk pose a low risk to the bank's sustainability.	<u>Risk level</u> - The level of losses suffered by the bank in recent years was not significant (with a period of at least three years) or was significantly reduced compared to the previous period. - Losses based on operational risk refer to only a few categories of events of higher intensity and low amount. - The significance of operational risk arising from outsourced services is negligible. - Low level of ICT risk. - A small number of customer complaints. - Low level of risk arising from money laundering activities. - Negligible level of non-compliance of the bank in accordance with regulations. - Absence of corporate events (e.g. mergers/acquisitions) in the last year. <u>Risk control</u> - The organizational structure for operational risk is transparent, efficient and stable, with clearly defined levels of competence and responsibility at all operational, organizational, managerial and governing levels and with compliance with the rules for preventing conflicts of interest. A clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governing levels, is ensured. - The strategy and policy of the bank's operational risk, as well as the defined risk appetite are in line with its business strategy.

		- The bank has established an efficient and reliable operational risk management system, which includes efficient and reliable processes and procedures for identifying, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure. - The system of internal controls for operational risk is adequate and reliable. - The bank has defined internal restrictions on exposure limits, which enable the reduction or limitation of exposure to operational risk and are in line with the strategy, policy and risk appetite. - The internal audit function is staffed to provide an assessment of operational risk management, the quality of audit reports is at a high level, and the bank continuously undertakes measures to implement the recommendations of internal audit.
2	The level and control of operational risk pose a medium-low risk to the bank's sustainability.	<u>Risk level</u> - The level of losses suffered by the bank in recent years was medium-low and a significant increase is not expected. - Losses based on operational risk refer mostly to events of higher intensity and low amount. - The significance of operational risk arising from outsourced services is low. - Medium-low level of ICT risk. - Medium-low amount of customer complaints. - Medium-low level of risk arising from money laundering activities. - Low level of non-compliance in accordance with regulations. - Presence of corporate events (e.g. mergers/acquisitions) in the last year, however the bank has good previous results in relation to performing similar activities. <u>Risk control</u> - The organizational structure for operational risk is mostly transparent, efficient and stable, with clearly defined levels of competence and responsibility at all operational, organizational, managerial and governing levels and with compliance with the rules for preventing conflicts of interest. A clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governing levels, is ensured. - The strategy and policy of the bank's operational risk, as well as the defined risk appetite are in line with its business strategy, but there is a need for their improvement. - The bank has established an efficient and reliable operational risk management system, which includes efficient and reliable processes and procedures for identifying, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure, but there is a need for their improvement. - The system of internal controls for operational risk is adequate and reliable to a greater extent. - The bank has defined internal restrictions on exposure limits, which enable the reduction or limitation of exposure to operational risk and are in line with the strategy, policy and risk appetite. - The internal audit function is staffed to provide an assessment of operational risk management, the quality of audit reports is at an adequate level, and the bank continuously undertakes measures to implement the recommendations of internal audit.
3	The level and control of operational	<u>Risk level</u> - The level of losses suffered by the bank in recent years was medium-high, but a significant increase is not expected.

	risk pose a medium-high risk to the bank's sustainability.	- Losses based on operational risk refer to a few categories of events of higher intensity and low amount. - Adequate management of outsourced activities, but they have an effect on key business areas. - Medium-high level of ICT risk. - Medium-high amount of customer complaints. - Medium-high level of risk arising from money laundering activities. - Medium level of non-compliance in accordance with regulations. - Presence of at least on corporate event or more smaller ones in the last year. <u>Risk control</u> - Deficiencies in the organizational structure for operational risk in terms of its transparency, efficiency and stability, and defined levels of competence and responsibility at some operational, organizational, managerial and governing levels, as well as certain shortcomings in compliance with rules of preventing conflicts of interest have been identified. A clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governing levels, is not ensured in all cases. - The strategy and policy of the bank's operational risk, and the defined risk appetite are mostly in line with its business strategy, but there is a need to improve them. - The bank has established an operational risk management system, which includes procedures for identifying, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure, but it needs to be improved in order to ensure greater efficiency and reliability. - The shortcomings of the internal control system for operational risk have been identified, and its improvement is needed. - The bank has defined internal restrictions on exposure limits, which enable the reduction or limitation of exposure to operational risk and are mostly in line with the strategy, policy and risk appetite. - The internal audit function is staffed to assess operational risk management, but the quality of audit reports needs to be improved, and although the bank is undertaking steps to implement internal audit recommendations, there are still a number of unexecuted recommendations.
4	The level and control of operational risk pose a high risk to the bank's sustainability.	<u>Risk level</u> - The level of loss suffered by the bank over the past few years is high or there has been a significant increase. - Inadequate level and quality of outsourced activities. - Losses based on operational risk refer to all categories of operational risk. - High level of ICT risk. - High amount of customer complaints. - High level of risk arising from money laundering activities. - Medium-high level of non-compliance with regulations. - Significant corporate events, with poor previous results or no previous experience in such activities. <u>Risk control</u> - The organizational structure for operational risk is inadequate in terms of its transparency, efficiency and stability, defined levels of competence and responsibility at operational, organizational, managerial and governing levels, and significant shortcomings in compliance with the rules for preventing conflicts of interest have been identified. A clear operational and organizational separation of the transaction contracting function from the

		support and risk management function, including management and governing levels is not ensured. - The strategy and policy of the bank's operational risk, as well as the defined risk appetite are not in line with its business strategy. - The bank has not established an operational risk management system, which includes procedures for determining, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure, or the established system of the bank is not adequate. - The system of internal controls for operational risk is unreliable. - Internal restrictions on exposure limits are not in line with strategy, policy and risk appetite. - The internal audit function is not staffed to provide an assessment of operational risk management, the quality of audit reports is not adequate, internal audit has not covered all risk areas and/or its recommendations are not implemented by the bank continuously.

Interest rate risk in the banking book
Article 11

(1) The assessment of interest rate risk in the banking book includes:

1) analysis of changes in economic value, i.e. the impact of changes in interest rates on the present value of the bank's expected net cash flows, and

2) analysis of the change in earnings, i.e. the impact of changes in interest rates on the bank's short-term earnings.

(2) The Agency shall assess the type and level of interest rate risk in the banking book to which the bank is exposed or could be exposed, which includes an assessment of the nature and structure of the bank's interest rate risk profile and the results of scenario analysis and stress testing.

(3) When assessing interest rate risk in the banking book, at least the following subcategories of that risk shall be included if they are significant for the bank: risk of maturity mismatch of interest rate resetting, yield curve risk, base risk and option risk.

(4) The main indicator used in assessing the level of interest rate risk in the banking book is: the ratio of changes in economic value in parallel shift of the yield curve by +/- 200 basis points and regulatory capital, but additional indicators of the impact on net interest income are also taken into account, also including internal indicators used by the bank to monitor interest rate risk in the banking book. During the assessment, indicators of the interest rate risk in the banking book of peer banks are also considered, as well as indicators at the level of the banking sector of Republika Srpska.

(5) When assessing the management system of the interest rate risk in the banking book, i.e. control of that risk, the following shall be assessed:

1) management, i.e. the manner of organization of the management function of the interest rate risk in the banking book,

2) risk appetite for the interest rate risk in the banking book, including an assessment of the compliance of the bank's strategies and policies and other internal acts defining risk tolerance with the bank's business objectives and long-term interests,

3) management of the interest rate risk in the banking book and internal control systems,

4) internal audit function, i.e. staff qualifications of the internal audit function for assessing the management of the interest rate risk in the banking book, the quality of audit reports and the bank's compliance with internal audit recommendations.

(6) Based on the assessment referred to in Paragraphs 1–5 of this Article, the Agency shall form an opinion and determine the final score of the adequacy of the level and control of interest rate risk in the banking

book as follows:

Score	Opinion	Criteria
1	The level and control of interest rate risk in the banking book pose a low risk to the bank's sustainability.	<u>Risk level</u> - The sensitivity of the economic value of the banking book to changes in interest rates is not significant. - The sensitivity of earnings (net interest income) to changes in interest rates is not significant. - The sensitivity of the economic value of the banking book and earnings to changes in basic assumptions (e.g. products with a built-in option) is not significant. - Internal indicators used by the bank to monitor risk are adequate and reliable. - Internal capital requirements for interest rate risk in the banking book are calculated conservatively and the bank has provided available capital for their coverage. - The results of stress testing indicate a high level of confidence that the bank has the capacity to withstand risk. <u>Risk control</u> - The organizational structure for interest rate risk in the banking book is transparent, efficient and stable, with clearly defined levels of competence and responsibility at all operational, organizational, managerial and governing levels and in compliance with the rules for preventing conflicts of interest. A clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governing levels, is ensured. - The strategy and policy of interest rate risk in the banking book, and the defined risk appetite are in line with the bank’s business strategy. - The bank has established an efficient and reliable management system of the interest rate risk in the banking book, which includes efficient and reliable processes and procedures for determining, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure. - The system of internal controls for interest rate risk in the banking book is adequate and reliable. - The bank has defined internal restrictions on exposure limits, which enable the reduction or limitation of exposure to interest rate risk in the banking book and are in line with the strategy, policy and risk appetite. - The internal audit function is staffed to assess the management of the interest rate risk in the banking book, the quality of audit reports is at a high level, and the bank continuously undertakes measures to implement the recommendations of internal audit.
2	The level and control of interest rate risk in the banking book pose a medium-low risk to the bank's sustainability.	<u>Risk level</u> - The sensitivity of the economic value of the banking book to changes in interest rates is medium-low. - The sensitivity of earnings (net interest income) to changes in interest rates is medium-low. - The sensitivity of the economic value of the banking book and earnings to changes in basic assumptions (e.g. products with a built-in option) is medium-low. - Particular indicators used by the bank to monitor interest rate risk in the banking book are not adequate and/or reliable leading to a lesser underestimation of risk levels, but the bank has undertaken activities to address the shortcomings.

		- Internal capital requirements for interest rate risk in the banking book are calculated conservatively and the bank has provided available capital for their coverage. - The results of stress testing indicate are still acceptable, but it is necessary to monitor the bank's capacity to absorb risks. <u>Risk control</u> - The organizational structure for interest rate risk in the banking book is mostly transparent, efficient and stable, with clearly defined levels of competence and responsibility at all operational, organizational, managerial and governing levels and in compliance with the rules for preventing conflicts of interest. A clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governing levels, is ensured. - The strategy and policy of interest rate risk in the banking book, and the defined risk appetite are in line with the bank's business strategy, - The bank has established an efficient and reliable management system of the interest rate risk in the banking book, which includes efficient and reliable processes and procedures for determining, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure, but there is a need for their improvement. - The system of internal controls for interest rate risk in the banking book is to a greater extent adequate and reliable. - The bank has defined internal restrictions on exposure limits, which enable the reduction or limitation of exposure to interest rate risk in the banking book and are in line with the strategy, policy and risk appetite. - The internal audit function is staffed to assess the management of the interest rate risk in the banking book, the quality of audit reports is at an adequate level, and the bank continuously undertakes measures to implement the recommendations of internal audit.
3	The level and control of interest rate risk in the banking book pose a medium-high risk to the bank's sustainability.	<u>Risk level</u> - The sensitivity of the economic value of the banking book to changes in interest rates is medium-high. - The sensitivity of earnings (net interest income) to changes in interest rates is medium-high. - The sensitivity of the economic value of the banking book and earnings to changes in basic assumptions (e.g. products with a built-in option) is medium-high. - Deficiencies in particular main indicators the bank uses for risk monitoring have been identified. - It is necessary to improve the way of determining internal capital requirements for interest rate risk in the banking book and providing available capital for their coverage. - The results of stress testing are poor and require undertaking of special measures by the bank and their monitoring by the Agency. <u>Risk control</u> - Deficiencies in the organizational structure for interest rate risk in the banking book in terms of its transparency, efficiency and stability, and defined levels of competence and responsibility at some operational, organizational, managerial and governing levels have been identified, as well as certain shortcomings in compliance with the rules for preventing conflicts of interest. A clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governing levels, is not ensured in all cases.

		- The strategy and policy of interest rate risk in the banking book, and the defined risk appetite are mostly in line with the bank's business strategy, but there is a need to improve them. - The bank has established the management system of the interest rate risk in the banking book, which includes procedures for determining, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure, but it needs to be improved in order to ensure greater efficiency and reliability. - The shortcomings of the system of internal controls for interest rate risk in the banking book have been identified, and its improvement is needed. - The bank has defined internal restrictions on exposure limits, which enable the reduction or limitation of exposure to interest rate risk in the banking book and are mostly in line with the strategy, policy and risk appetite. - The internal audit function is staffed to assess the management of interest rate risk in the banking book, but it is necessary to improve the quality of audit reports, and although the bank undertakes measures to implement internal audit recommendations, there are still a number of unexecuted recommendations.
4	The level and control of interest rate risk in the banking book pose a high risk to the bank's sustainability.	<u>Risk level</u> - The sensitivity of the economic value of the banking book to changes in interest rates is high. - The sensitivity of earnings (net interest income) to changes in interest rates is high. - The sensitivity of the economic value of the banking book and earnings to changes in basic assumptions (e.g. products with a built-in option) is high. - The main indicators used by the bank to monitor risk are not adjusted or have major shortcomings. - It is necessary to significantly improve the method of determining internal capital requirements for interest rate risk in the banking book and providing available capital for their coverage. - The results of stress testing are critical and require immediate action by the bank and careful monitoring of the implementation of these measures by the Agency. <u>Risk control</u> - The organizational structure for interest rate risk in the banking book is inadequate in terms of its transparency, efficiency and stability, defined levels of competence and responsibility at operational, organizational, managerial and governing levels, and significant shortcomings in compliance with rules to prevent conflicts of interest have been identified. A clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governing levels is not ensured. - The strategy and policy of interest rate risk in the banking book, and the defined risk appetite are not in line with the bank's business strategy. - The bank has not established the management system of the interest rate risk in the banking book, which includes procedures for determining, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure, or the established system of the bank is inadequate. - The system of internal controls for interest rate risk in the banking book is unreliable. - Internal restrictions on exposure limits are not in line with strategy, policy and risk appetite. - The internal audit function is not staffed to assess the management of interest rate risk in the banking book, the quality of audit reports is not adequate,

		internal audit has not covered all risk areas and/or its recommendations are not implemented by the bank continuously.

Capital adequacy

Article 12

(1) The Agency shall assess capital adequacy to determine whether the bank's regulatory capital is sufficient to cover the risks associated with the capital to which the bank is exposed or could be exposed, if such risks are assessed as significant for the bank, conducted by level analysis (quantity) and the structure (quality) of the bank's regulatory capital. The assessment compares the determined level and quality of the bank's capital with the assessment of capital needs, considering the analysis of capital needs and availability of capital for at least three years in normal and stress conditions, including capital planning.
(2) The main indicators that are the subject of analysis when assessing the bank's capital adequacy are: regulatory capital ratio, Tier 1 capital ratio and leverage ratio, but additional indicators are also considered, such as CET1 capital ratio, regulatory capital structure and similar.
(3) When assessing the bank's capital adequacy, the Agency shall also assess the reliability of the ICAAP, which may be assessed as: robust (score 1), adequate (score 2), poor (score 3) and inadequate (score 4).
(4) Based on the assessment referred to in Paragraphs 1–3 of this Article, the Agency shall form an opinion and determine the final score of the bank's capital adequacy as follows:

Score	Opinion	Criteria
1	The amount and structure of the bank's regulatory capital pose a low risk to the bank's sustainability.	- The level of the bank's regulatory capital is significantly above the stipulated minimum, as well as sufficiently above the minimum capital ratios set by the Agency for the bank, increased by the capital buffer, and it is expected to remain so in the future. - Capital indicators are at a satisfactory level in absolute and relative terms. - Stress testing has not revealed any significant risk related to the impact of a severe but possible economic recession on regulatory capital. - The bank has a realistic and credible capital plan, which can be effectively implemented if necessary, i.e. there are no obstacles to recapitalize the bank in case of need. - The bank's leverage ratio is sufficiently above the stipulated minimum and the risk of excessive leverage has not been identified.
2	The amount and structure of the bank's regulatory capital pose a medium-low risk to the bank's sustainability.	- The level of the bank's regulatory capital is above the stipulated minimum, as well as the minimum capital ratios set by the Agency for the bank, increased by the capital buffer. - Capital indicators are at a satisfactory level in absolute and relative terms. - Stress testing has revealed a low risk related to the impact of a severe but possible economic recession on regulatory capital, however the activities of the bank's governing bodies to address this risk seem reliable. - The bank has a realistic and credible capital plan, which, although it carries risk, can be effectively implemented if necessary. - The bank's leverage ratio is above the stipulated minimum and the risk of excessive leverage has been identified as low.
3	The amount and structure of the bank's regulatory capital pose a medium-high	- The level of the bank's regulatory capital is not significantly above the stipulated minimum, i.e. the minimum capital ratios set by the Agency for the bank. However, there is a possibility that the bank does not maintain or will soon not be able to maintain the capital buffer.

	risk to the bank's sustainability.	- Capital indicators are not at satisfactory levels in absolute and relative terms in relation to the group of peer banks. However, there is currently no threat that capital quality will fall below regulatory requirements. - Stress testing revealed a medium-high risk related to the impact of a serious but possible economic recession on regulatory capital. There is a possibility that the bank's governing bodies will not be able to adequately address this. - The bank has a capital plan that is unlikely to be implemented effectively. - The leverage ratio of the bank is above the stipulated minimum, but in comparison with the group of peer banks, certain weaknesses have been identified. There is a moderate risk of excessive leverage.
4	The amount and structure of the bank's regulatory capital pose a high risk to the bank's sustainability.	- The bank has certain violations of compliance with regulatory capital requirements or there is a possibility that such violations will occur. - Capital indicators are at the worst levels in absolute and relative terms in relation to the group of peer banks. - Stress testing revealed that there will be a violation of the minimum stipulated capital ratios for the bank or the legal minimum in the initial phase of a serious but possible economic recession. The bank's governing bodies are unlikely to be able to adequately address this. - The bank does not have a capital plan or has a plan that is inadequate or infeasible. - The bank's leverage ratio is not greatly above the stipulated minimum. There is a high risk of excessive leverage.

Risks related to liquidity and funding sources

Article 13

(1) When assessing liquidity risk, the Agency shall determine whether the available liquidity reserves of the bank provide adequate coverage of short-term liquidity risk in normal and stress conditions, as well as whether the bank has provided adequate long-term funding sources for its business activities in the medium to long term in a sustainable manner. In doing so, the Agency shall consider whether it is necessary to impose certain additional liquidity requirements to cover the short-term liquidity risk and the risk of sustainability of funding sources to which the bank is exposed or could be exposed.

(2) When assessing liquidity risk, at least the assessment of short-term liquidity risk is taken into account, which includes at least the risk of short-term funding sources by financial institutions, intraday liquidity risk and foreign exchange risk of short-term liquidity, and the risk of sustainability of funding sources, which includes the least risks of structural mismatch of funding sources, the strength of funding from retail deposits and foreign exchange risk, which arises from funding sources.

(3) The main indicators used in assessing short-term liquidity risk are: liquidity coverage ratio (LCR), ratio of unsecured short-term funding sources from financial institutions and total liabilities and ratio of 10 largest funding sources and total liabilities, and funding source sustainability risk: ratio net stable funding ratio (NSFR), the ratio of loans and stable funding sources, the ratio of loans and deposits and similar. During the assessment, indicators of peer banks are also considered, as well as indicators at the level of the banking sector of Republika Srpska.

(4) When assessing the management system of short-term liquidity and funding sources, i.e. liquidity risk control, the following shall be assessed:

1) management, i.e. the manner of organization of the liquidity risk management function,

2) liquidity risk appetite, including assessment of compliance of the bank's strategies and policies and other internal acts defining risk tolerance with the bank's business objectives and long-term interests,

3) liquidity risk management and internal control systems,

4) internal audit function, i.e. staff qualifications of the internal audit function for assessing liquidity risk management, quality of audit reports and the bank's compliance with internal audit recommendations.

(5) When assessing the bank's liquidity adequacy, the Agency shall also assess the reliability of ILAAP, which can be assessed as: robust (score 1), adequate (score 2), poor (score 3) and inadequate (score 4).

(6) Based on the assessment referred to in Paragraphs 1–5 of this Article, the Agency shall form an opinion and determine the final adequacy of the level and control of the bank's liquidity risk, i.e. the adequacy of the bank's liquidity as follows:

Score	Opinion	Criteria
1	The bank's liquidity position and funding profile pose a low risk to the bank's sustainability.	Risk level - The level and structure of the liquidity buffer, i.e. internal liquidity reserves are adequate and significantly higher than the stipulated minimum and there is no doubt that they will not be sufficient to cover liquidity needs in normal and stress conditions. - No risk has been identified arising from the mismatch (e.g. maturity of liabilities and assets, currency in which liabilities and assets are denominated, etc.). - Other factors that have an impact on liquidity risk are not significant (e.g. reputational risk, inability to implement contracted liquidity lines, etc.). - No risk has been identified arising from the profile of the bank's funding sources and there is no doubt about its stability and sustainability. - The structure and stability of long-term funding (> 1 year) do not represent a significant risk in relation to the activities and business model of the bank. - The bank has a realistic and credible plan for contingency cases of liquidity disruption, which can be effectively implemented if necessary, i.e. there are no obstacles to providing the necessary liquid funds of the bank in case of need. Risk control - The organizational structure for liquidity risk is transparent, efficient and stable, with clearly defined levels of competence and responsibility at all operational, organizational, managerial and governing levels and with respect for the rules for preventing conflicts of interest. A clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governing levels, is ensured. - The liquidity risk strategy and policy, and the defined risk appetite are in line with the bank's business strategy. - The bank has established an efficient and reliable liquidity risk management system, which includes efficient and reliable processes and procedures for determining, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure. - The system of internal controls for liquidity risk is adequate and reliable. - The bank has defined internal restrictions on exposure limits, which enable the reduction or limitation of exposure to liquidity risk and are in line with the strategy, policy and risk appetite. - The internal audit function is staffed to provide an assessment of liquidity risk management, the quality of audit reports is at a high level, and the bank continuously undertakes measures to implement the recommendations of internal audit.

2	The bank's liquidity position and funding profile pose a medium-low risk to the bank's sustainability.	<u>Risk level</u> - The level and structure of the liquidity buffer, i.e. internal liquidity reserves are adequate and significantly higher than the stipulated minimum and there is no doubt that they will not be sufficient to cover liquidity needs in normal and stress conditions. - No significant risk has been identified arising from the mismatch (e.g. maturity of liabilities and assets, currency in which liabilities and assets are denominated, etc.). - Other factors that have an impact on liquidity risk are low (e.g. reputational risk, inability to implement contracted liquidity lines, etc.). - No significant risk has been identified arising from the profile of the bank's funding sources and there are no significant doubts about its stability and sustainability. - The structure and stability of long-term funding (> 1 year) represent a low risk in relation to the activities and business model of the bank. - The bank has a realistic and credible plan for contingency cases of liquidity disruption, which carries certain risks, but can be effectively implemented if necessary, and there are no significant obstacles to providing the necessary liquid funds of the bank. <u>Risk control</u> - The organizational structure for liquidity risk is mostly transparent, efficient and stable, with clearly defined levels of competence and responsibility at all operational, organizational, managerial and governing levels and with respect for the rules for preventing conflicts of interest. A clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governing levels, is ensured. - The liquidity risk strategy and policy, and the defined risk appetite are in line with the bank's business strategy, but there is a need for their improvement. - The bank has established an efficient and reliable liquidity risk management system, which includes efficient and reliable processes and procedures for determining, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure, but there is a need for their improvement. - The system of internal controls for liquidity risk is to a greater extent adequate and reliable. - The bank has defined internal restrictions on exposure limits, which enable the reduction or limitation of exposure to liquidity risk and are in line with the strategy, policy and risk appetite. - The internal audit function is staffed to provide an assessment of liquidity risk management, the quality of audit reports is at an adequate level, and the bank continuously undertakes measures to implement the recommendations of internal audit.
3	The bank's liquidity position and funding profile pose a medium-high risk to the bank's sustainability.	<u>Risk level</u> - The level and structure of the liquidity buffer have deteriorated (but the bank still meets the requirement to maintain liquidity coverage ratio) and/or internal liquidity reserves are below the additional liquidity requirements set for the bank by the Agency, and there are concerns that the bank will not re-establish compliance with the Agency's request in a timely manner. - The medium risk arising from the mismatch (e.g. maturities of liabilities and assets, the currency in which the liabilities and assets are denominated) has been identified.

		- Other factors have a medium impact on liquidity risk (e.g. reputational risk, inability to implement contracted liquidity lines). - The medium risk arising from the profile of the bank's funding sources has been identified and there are doubts about its stability and sustainability. - The structure and stability of long-term funding (> 1 year) represent a medium risk in relation to the activities and business model of the bank. - The bank has a contingency plan for liquidity disruptions, which is suspected of not being implemented effectively if necessary, and there are certain obstacles to providing the necessary liquidity to the bank. Risk control - Deficiencies in the organizational structure for liquidity risk in terms of its transparency, efficiency and stability, and defined levels of competence and responsibility at some operational, organizational, managerial and governing levels have been identified, as well as certain shortcomings in compliance with rules to prevent conflicts of interest. A clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governing levels, is not ensured in all cases. - The liquidity risk strategy and policy, and the defined risk appetite are to a greater extent in line with the bank's business strategy, but there is a need to improve them. - The bank has established a liquidity risk management system, which includes procedures for determining, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on the bank's risk exposure, but it needs to be improved in order to ensure greater efficiency and reliability. - The shortcomings of the internal control system for liquidity risk have been identified, and its improvement is needed. - The bank has defined internal restrictions on exposure limits, which enable the reduction or limitation of exposure to liquidity risk and are to a greater extent in line with the strategy, policy and risk appetite. - The internal audit function is staffed to assess liquidity risk management, but the quality of audit reports needs to be improved, and although the bank is undertaking steps to implement internal audit recommendations, there are still a number of unexecuted recommendations.
4	The bank's liquidity position and funding profile pose a high risk to the bank's sustainability.	Risk level - The level and structure of the liquidity buffer, i.e. internal liquidity reserves, have significantly deteriorated and/or are below the stipulated minimum and additional requirements of the Agency, and there are serious concerns that the bank will not re-establish compliance with the stipulated requirements in a timely manner. - High risk arising from mismatch (e.g. maturities of liabilities and assets, currency in which liabilities and assets are denominated) has been identified. - Other factors have a high impact on liquidity risk (e.g. reputational risk, inability to implement contracted liquidity lines, etc.). - High risk has been identified that arises from the profile of the bank's funding sources and there are doubts about its stability and sustainability. - The structure and stability of long-term funding (> 1 year) represent a high risk in relation to the activities and business model of the bank. - The bank does not have a contingency plan in terms of liquidity, or it is inadequate. Risk control - The organizational structure for liquidity risk is inadequate in terms of its transparency, efficiency and stability, defined levels of competence and

		responsibility at operational, organizational, managerial and governing levels, and significant shortcomings in compliance with the rules for preventing conflicts of interest have been identified. There is no clear operational and organizational separation of the transaction contracting function from the support and risk management function, including management and governing levels. - The liquidity risk strategy and policy, as well as the defined risk appetite are not in line with the bank's business strategy. - The bank has not established a liquidity risk management system, which includes procedures for determining, assessing, i.e. measuring, limiting and mitigating, monitoring and reporting on risk exposure, or the established system of the bank is not adequate. - The system of internal controls for liquidity risk is unreliable. - Internal restrictions on exposure limits are not in line with strategy, policy and risk appetite. - The internal audit function is not staffed to provide an assessment of liquidity risk management, the quality of audit reports is not adequate, internal audit has not covered all risk areas and or its recommendations are not implemented by the bank continuously.

Overall SREP assessment

Article 14

(1) Assessment of four SREP elements in accordance with Articles 2–13 of this Decision results in an overall SREP score, i.e. a comprehensive score of the bank's risk profile and sustainability.

(2) When determining the overall SREP score referred to in Paragraph 1 of this Article, all individual SREP elements referred to in Article 2 of this Decision shall be given the same significance, i.e. the overall SREP score represents the arithmetic mean of all scores determined for four SREP elements.

(3) The overall SREP score of the bank determined in accordance with the provisions of this Decision shall be a business secret in accordance with Article 29 of the Law on the Banking Agency of Republika Srpska.

(4) In the case of a newly established bank, in which the conditions for the application of all assessment criteria have not been met, the overall SREP score shall cover only the applicable criteria, with a special note that it is a newly established bank.

(5) The Agency shall monitor key financial and non-financial indicators of the bank's operations on a quarterly basis in order to monitor changes in its business model and risk profile. In the event that the monitoring identifies a significant change in the bank's business model and risk profile or identifies irregularities in the bank's operations, the Agency will analyze the causes and, if necessary, review the adequacy of the assessment determined for the relevant SREP element, and the overall SREP assessment accordingly.

(6) In the event that, by monitoring referred to in Paragraph 5 of this Article, significant irregularities in the bank's operations and/or non-compliance with regulations are identified, the Agency shall undertake supervisory measures necessary to eliminate irregularities or non-compliances, and then update the SREP assessment.

Supervisory measures

Article 15

(1) Based on the assessment of individual SREP elements and the overall SREP assessment, the Agency shall undertake the following supervisory measures:

1) measures related to additional capital requirements in relation to the minimum stipulated by the Banking Law and/or the Decision on calculating capital in banks,

2) measures related to additional liquidity requirements in relation to the minimum stipulated by the Decision on liquidity risk management,

3) other quantitative or qualitative supervisory measures.

(2) For the purposes of making a decision on the additional capital requirement referred to in Paragraph 1, Item 1 of this Article, the Agency, based on the overall SREP assessment, shall make a decision on determining the minimum capital ratios as follows:

Score	Increase of minimum capital ratios
1	0%–0.5%
2	0.6%–1%
3	1.1%–2.5%
4	2.6%–3.5%

(3) The bank shall provide coverage of additional capital requirements referred to in Paragraph 2 of this Article from the CET1 capital items.

(4) Notwithstanding Paragraph 2 of this Article, if the bank within ICAAP determines a higher capital requirement than the capital requirement determined in accordance with Paragraph 2 of this Article, the Agency may determine minimum capital ratios in accordance with ICAAP results.

(5) In the event that based on the assessment in accordance with Article 13 of this Decision, the Agency assesses that the liquidity position and funding profile of the bank represent a medium-high or high risk for the bank's sustainability, the Agency may determine additional liquidity requirements regarding the level and structure of liquidity buffer, LCR level, assets and funding sources mismatch and similar.

Frequency of SREP assessment implementation

Article 16

(1) In determining the frequency and required level of supervisory engagement of the Agency within the SREP assessment, the Agency shall be guided by the size and importance of the bank for the banking system in Republika Srpska, unless otherwise determined based on the bank's risk profile and/or significant changes in business model.

(2) The Agency shall classify banks into the following categories according to their size:

1) category of large banks or

2) category of medium and small banks.

(3) On an annual basis, the Agency shall assign banks into the categories referred to in Paragraph 2 of this Article, using data from regulatory reports, whereby the decision may be reviewed in case of significant

business events such as mergers and acquisitions of banks, sale of part of the bank's operations and similar.

(4) The category referred to in Paragraph 2 of this Article is a criterion for determining the minimum frequency and scope of supervisory engagement referred to in Paragraph 5 of this Article, whereby it may be more frequent and extensive for banks with a higher risk profile.

(5) The minimum frequency and scope of supervisory engagement within the SREP assessment are defined in the table below:

Bank category	**Monitoring key business indicators**	**Assessment of all SREP elements (as a minimum)**	**Scope of supervisory engagement**
Large banks	Quarterly	Annually	Continuous engagement with the bank's management; engagement with the bank for the assessment of each element
Medium and small banks	Quarterly	Every two years, except in case of significant changes	Engagement with the bank based on risk assessment; engagement with the bank in case of significant changes

Transitional and final provisions

Article 17

(1) This Decision shall enter into force on the eighth day from the day of its publication in the "Official Gazette of Republika Srpska".

(2) The application of the net stable funding ratio (NSFR) referred to in Article 13, Paragraph 3 of this Decision as the main indicator shall start from the financial date 31/12/2021.

Number: UO-261/21

Date: 1 November, 2021

PRESIDENT OF THE
MANAGEMENT BOARD
Bratoljub Radulović