Creating better footprints.

NLB Group Pillar III Disclosures Q3 2023

Contents

1.	**Key highlights**	**3**
2.	**Introduction**	**5**
3.	**Scope of application**	**6**
4.	**Capital and capital requirements**	**7**
4.1.	Capital adequacy	7
4.2.	Risk weighted exposure amounts	10
4.3.	Risk factors	11
4.4.	CRR ‘Quick Fix’	13
5.	**Liquidity**	**14**
6.	**Appendices**	**18**
6.1.	Appendix 1	18
6.2.	Appendix 2	18

1. Key highlights

(Article 447 of CRR)

Table 1 – EU KM Key metrics template of NLB Group

		30.09.2023	30.06.2023	31.03.2023	31.12.2022	30.09.2022
		a	b	c	d	e
	Available own funds (amounts)					
1	Common Equity Tier 1 (CET1) capital	2,192,893	2,181,381	2,166,912	2,208,219	2,076,606
2	Tier 1 capital	2,280,566	2,269,153	2,254,574	2,295,700	2,082,130
3	Total capital	2,791,407	2,780,111	2,765,244	2,806,375	2,369,623
	Risk-weighted exposure amounts					
4	Total risk exposure amount (TREA)	14,919,023	14,838,352	14,622,299	14,653,059	14,283,739
	Capital ratios (as a percentage of risk-weighted exposure amount)					
5	Common Equity Tier 1 ratio	14.70%	14.70%	14.82%	15.07%	14.54%
6	Tier 1 ratio	15.29%	15.29%	15.42%	15.67%	14.58%
7	Total capital ratio	18.71%	18.74%	18.91%	19.15%	16.59%
	Additional own funds requirements to address risks other than the risk of excessive leverage (as a percentage of risk-weighted exposure amount)					
EU 7a	Additional own funds requirements to address risks other than the risk of excessive leverage	2.40%	2.40%	2.40%	2.60%	2.60%
EU 7b	of which: to be made up of CET1 capital	1.35%	1.35%	1.35%	1.46%	1.46%
EU 7c	of which: to be made up of Tier 1 capital	1.80%	1.80%	1.80%	1.95%	1.95%
EU 7d	Total SREP own funds requirements	10.40%	10.40%	10.40%	10.60%	10.60%
	Combined buffer and overall capital requirement (as a percentage of risk-weighted exposure amount)					
8	Capital conservation buffer	2.50%	2.50%	2.50%	2.50%	2.50%
9	Institution specific countercyclical capital buffer	0.01%	0.01%	0.00%	0.00%	0.00%
EU 9a	Systemic risk buffer	0.10%	0.10%	0.10%	0.00%	0.00%
EU 10a	Other Systemically Important Institution buffer	1.25%	1.25%	1.25%	1.00%	1.00%
11	Combined buffer requirement	3.86%	3.86%	3.85%	3.50%	3.50%
EU 11a	Overall capital requirements	14.26%	14.26%	14.25%	14.10%	14.10%
12	CET1 available after meeting the total SREP own funds requirements	797,964	793,995	799,727	822,040	725,364
	Leverage ratio					
13	Total exposure measure	26,320,818	25,778,410	25,105,562	25,240,506	24,509,522
14	Leverage ratio	8.66%	8.80%	8.98%	9.10%	8.50%
	Additional own funds requirements to address the risk of excessive leverage (as a percentage of total exposure measure)					
EU 14c	Total SREP leverage ratio requirements (%)	3.00%	3.00%	3.00%	3.00%	3.00%
	Leverage ratio buffer and overall leverage ratio requirement (as a percentage of total exposure measure)					
EU 14d	Leverage ratio buffer requirement	3.00%	3.00%	3.00%	3.00%	3.00%
EU 14e	Overall leverage ratio requirement	3.00%	3.00%	3.00%	3.00%	3.00%
	Liquidity Coverage Ratio					
15	Total high-quality liquid assets (HQLA)	6,174,159	5,916,414	5,774,965	5,647,162	5,526,560
EU 16a	Cash outflows - Total weighted value	3,162,936	3,128,451	3,099,033	3,008,960	2,871,465
EU 16b	Cash inflows - Total weighted value	503,623	505,154	500,673	512,851	521,447
16	Total net cash outflows	2,659,314	2,623,297	2,598,360	2,496,109	2,350,018
17	Liquidity coverage ratio	232.11%	225.52%	222.21%	227.15%	236.85%
	Net Stable Funding Ratio					
18	Total available stable funding	21,156,302	20,870,086	20,217,758	20,409,092	19,628,877
19	Total required stable funding	11,499,159	11,368,668	11,109,114	11,154,678	11,010,637
20	NSFR ratio	183.98%	183.58%	181.99%	182.96%	178.27%

Key ratios and figures are reflected throughout the Pillar 3 disclosures, while the summary is presented in Table 1.

Figure 1: Total capital (in EUR millions)

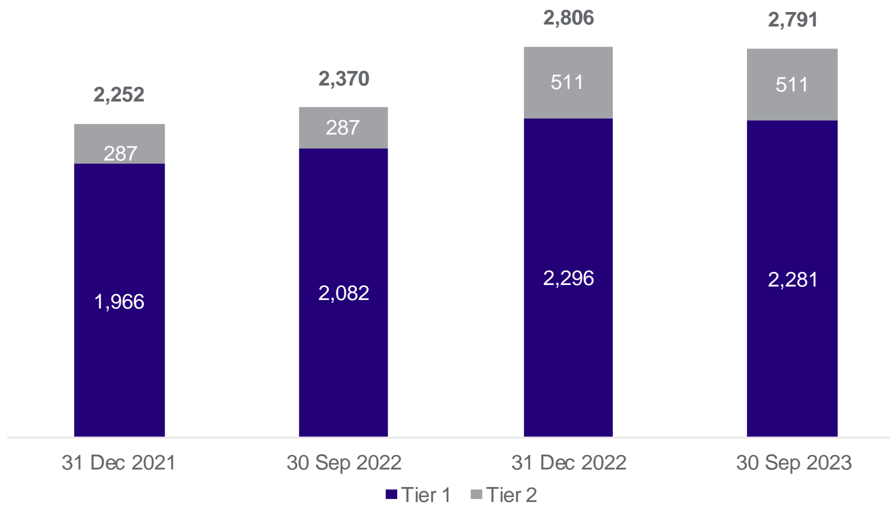


Figure 2: Total capital and capital ratio evolution YtD

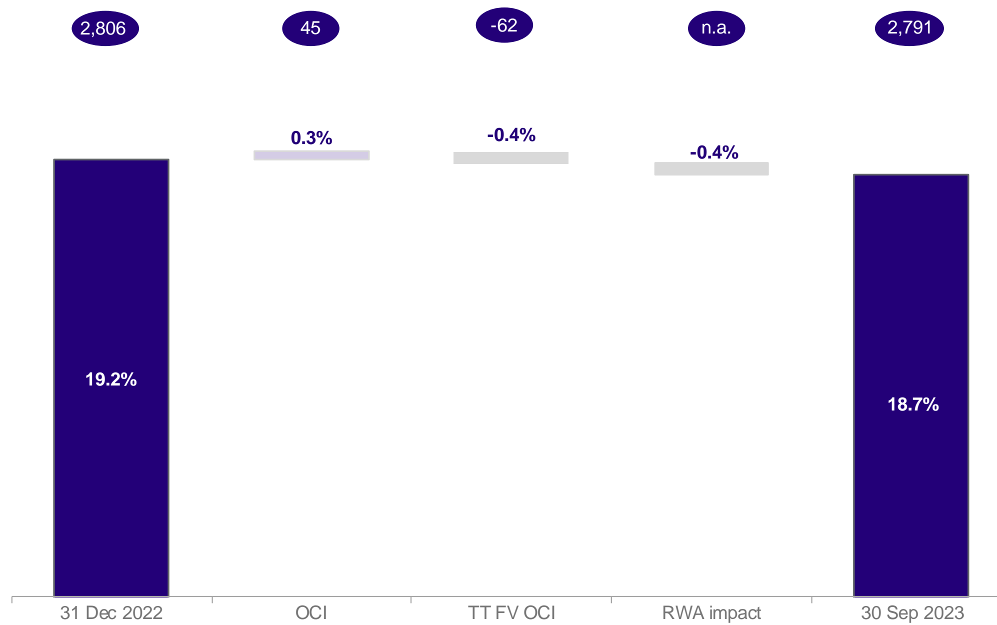
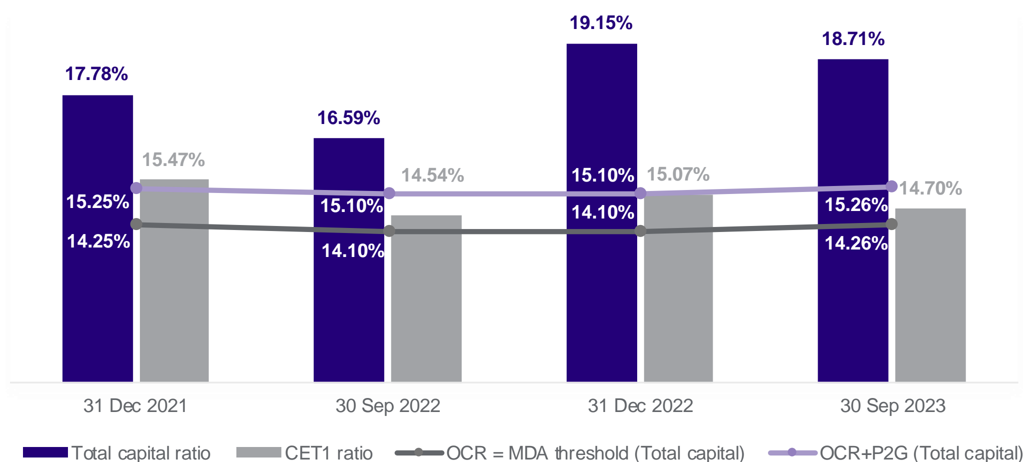


Figure 3: Capital ratios and regulatory thresholds (in %)



2. Introduction

In the context of this document, the ‘EU banking legislation’ describes the package of the CRR, CRD, and regulatory/implementing technical standards. It commonly refers as containing the following three Pillars:

- Pillar 1 contains mechanisms and requirements for the calculation by financial institutions of their minimum capital requirements for credit risk, market risk, and operational risk,
- Pillar 2 is intended to ensure that each financial institution has sound internal processes in place to assess the adequacy of its capital, based on a thorough evaluation of its risks. Supervisors are tasked with valuating how well financial institutions are assessing their capital adequacy needs relative to their risks. Risks not considered under Pillar 1 are considered under this Pillar,
- Pillar 3 is intended to complement Pillar 1 and Pillar 2. It requires that financial institutions disclose information on the scope of the application of the EU banking legislation requirements, particularly covering own funds requirements/risk weighted exposure amounts (RWEA) and resources, risk exposures, and risk assessment processes.

For ease of reference, the requirements described under the last indent above are referred to as ‘Pillar 3’ in this Report. Pillar 3 contains both qualitative and quantitative disclosure requirements.

All disclosures are prepared on a consolidated basis (Prudential consolidation) and in EUR thousands unless otherwise stated. Any discrepancies between data disclosed in this document are due to the effect of rounding.

CRD V and EBA guidelines require the NLB Group (hereinafter: ‘the Group’) to disclose information at least on an annual basis. To ensure the effective communication of the Group’s business and risk profile, the Group also pays particular attention to the possible need to provide information more frequently than annually. A separate Pillar 3 document is also published quarterly on the NLB’s website Financial Reports (nlb.si), following our Annual or Interim Reports for the Group disclosure.

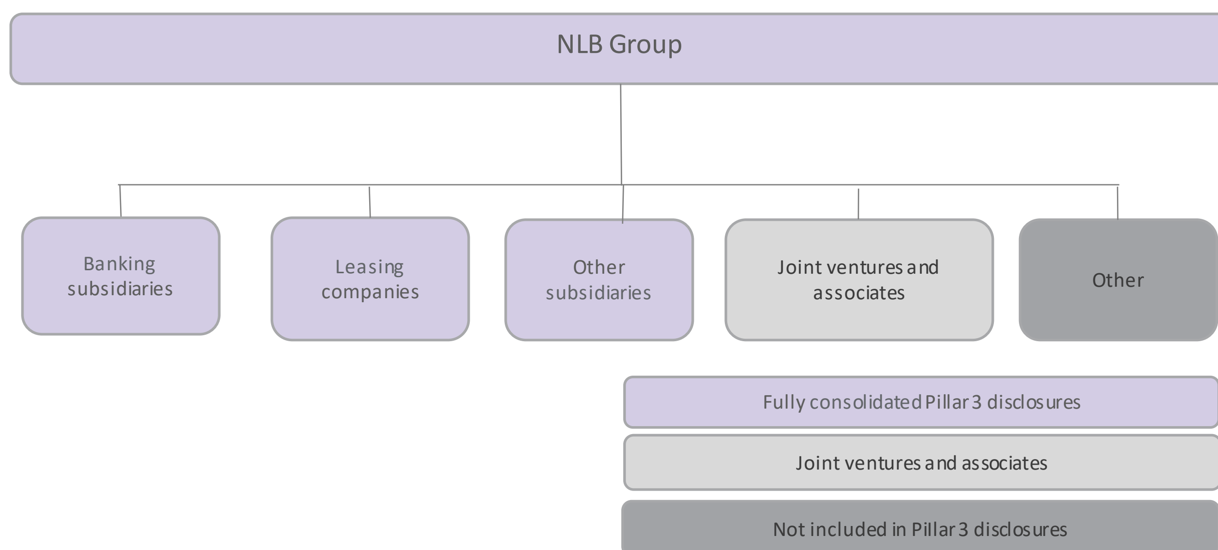
It should be noted that while some quantitative information in this document is based on financial data contained in the NLB Group Interim Report Q3 2023, other quantitative data is sourced from the regulatory reporting (Finrep and Corep) and is calculated according to regulatory requirements. Pillar 3 quantitative data is thus not always directly comparable with the quantitative data contained in the NLB Group Interim Report Q3 2023.

3. Scope of application

(Articles 436 a, b, c, and d of CRR)

In accordance with the capital legislation, NLB d.d. (LEI Code 5493001BABFV7P27OW30) has the position of an 'EU parent bank,' and so is a parent company of the Group. NLB d.d. (hereinafter: 'the Bank') is therefore obliged to disclose information on a consolidated basis. Consolidated financial statements for the purpose of Pillar 3 disclosures are based on CRR requirements (regulatory scopes of consolidation). A summarised Group's presentation in accordance with the regulatory scope of consolidation is presented below.

Picture 4: NLB Group scheme



The consolidation for *accounting purposes* comprises all:

- subsidiaries (banking, leasing, and other subsidiaries) controlled by the Bank or the Group,
- associated companies in which the Group directly or indirectly holds between 20% and 50% of the voting rights, and over which the Group exercises significant influence, but does not have control and
- jointly controlled companies (i.e., jointly controlled by the Group based on a contractual agreement).

In contrast to the accounting consolidation, the *regulatory consolidation* includes only (in accordance with the definitions under Article 4 of CRR) credit institutions, financial institutions, ancillary service undertakings, and asset management companies.

The difference between accounting consolidation and regulatory consolidation as at 30 September 2023 represents:

- the company operating in the area of other activities NLB Zavod za upravljanje kulturne dediščine (ZUKD – the NLB Cultural Heritage Management Institute), and
- the IT services company NLB DigIT, Beograd,

which are not included in regulatory consolidation, in accordance with Article 4 of CRR. Companies from the Prvi faktor Group are excluded from the regulatory consolidation (that would otherwise require the proportional consolidation method, in accordance with CRD) due to immateriality in accordance with CRR. In the accounting consolidation, the net assets of the Prvi faktor Group using the equity method amount to zero.

4. Capital and capital requirements

4.1. Capital adequacy

European banking capital legislation – CRD V, defines three capital ratios reflecting a different quality of capital:

- Common Equity Tier 1 ratio (ratio between common or CET1 capital and risk-weighted exposure amount or RWA), which must be at least 4.5%;
- Tier 1 capital ratio (Tier 1 capital to RWA), which must be at least 6%;
- Total capital ratio (Total capital to RWA), which must be at least 8%.

In addition to the aforementioned ratios, which constitute the Pillar 1 Requirement, the Bank must meet other requirements and recommendations that are imposed by the supervisory institutions or by the legislation:

- Pillar 2 Requirement (SREP requirement): bank-specific, obligatory requirement set by the supervisory institution through the SREP process (together with the Pillar 1 Requirement it represents the minimum total SREP capital requirement – TSCR);
- The applicable combined buffer requirement (CBR): system of capital buffers to be added on top of TSCR – breaching of the CBR is not a breach of capital requirement, but triggers limitations in payment of dividends and other distributions from capital. Some of the buffers are prescribed by law for all banks and some of them are bank-specific, set by the supervisory institution (CBR and TSCR together form the overall capital requirement – OCR);
- Pillar 2 Capital Guidance: capital recommendation set by the supervisory institution through the SREP process. It is bank-specific and a recommendation not obligatory. Any non-compliance does not affect dividends or other distributions from capital; however, it might lead to intensified supervision and the imposition of measures to re-establish a prudent level of capital (including preparation of a capital restoration plan).

Table 2 – Capital requirements and buffers

		30.09.2023	2022	2021
Pillar 1 (P1R)	CET1	4.50%	4.50%	4.50%
	AT1	1.50%	1.50%	1.50%
	T2	2.00%	2.00%	2.00%
Pillar 2 (SREP req. - P2R)	CET1	1.35%	1.46%	1.55%
	Tier 1	1.80%	1.95%	2.06%
	Total Capital	2.40%	2.60%	2.75%
Total SREP Capital requirement (TSCR)	CET1	5.85%	5.96%	6.05%
	Tier 1	7.80%	7.95%	8.06%
	Total Capital	10.40%	10.60%	10.75%
Conservation buffer	CET1	2.50%	2.50%	2.50%
O-SII buffer	CET1	1.25%	1.00%	1.00%
Systemic risk buffer	CET1	0.10%	0.00%	0.00%
Countercyclical buffer	CET1	0.01%	0.00%	0.00%
Combined buffer requirement (CBR)	CET1	3.86%	3.50%	3.50%
Overall capital requirement (OCR) = MDA threshold	CET1	9.71%	9.46%	9.55%
	Tier 1	11.66%	11.45%	11.56%
	Total Capital	14.26%	14.10%	14.25%
Pillar 2 Guidance (P2G)	CET1	1.00%	1.00%	1.00%
OCR + P2G	CET1	10.71%	10.46%	10.55%
	Tier 1	12.66%	12.45%	12.56%
	Total Capital	15.26%	15.10%	15.25%

The Overall Capital Requirement (OCR) for the Group was 14.26%, consisting of:

- 10.40% total SREP capital requirement (TSCR) (8.00% Pillar 1 Requirement (P1R) and 2.40% Pillar 2 Requirement P2R)); and
- 3.86% Combined Buffer Requirement (CBR) (2.50% Capital Conservation Buffer, 1.25% O-SII Buffer, 0.10% Systemic Risk Buffer and 0.01% Countercyclical Buffer).

Pillar 2 Guidance remains at 1.00% and should be comprised entirely of CET1 capital.

Changes that came into effect on 1 January 2023:

- The Pillar 2 Requirement for 2023 decreased by 0.2 p.p. to 2.40%, as a result of a better overall Supervisory Review and Evaluation Process (SREP) assessment.
- The Capital Buffer for Other Systemically Important Institutions (O-SII) increased by 0.25 p.p. to 1.25%.
- A new BoS regulation, introduced the systemic risk buffer rates for the sectoral exposures in the Republic of Slovenia: 1.0% for all retail exposures to natural persons, secured by residential real estate and 0.5% for all other exposures to natural persons, resulted in 0.10% Systemic Risk Buffer in Q3 2023.

In December 2022, the BoS announced that due to growing uncertainties in the economic environment and systemic risks, the countercyclical buffer for credit exposures in the Republic of Slovenia is increased from 0% to the level of 0.5% of the total risk exposure amount. Banks have to meet the requirement by 31 December 2023. The Countercyclical Buffer calculated at the Group level on 30 September 2023 was 0.01%.

In September 2023, the Bank of Slovenia verified compliance with the criteria for Other Systemically Important Institutions (O-SII) and set the new values of the indicator of systemic importance and the respective buffer rates for each O-SII. It is worth noting that the adjustment will not impact the O-SII buffer for the Bank. The Bank of Slovenia has confirmed that the existing buffer of 1.25% of the total risk exposure will remain unchanged.

The Group’s capital covers all the current and announced regulatory capital requirements, including capital buffers and other currently known requirements, as well as the Pillar 2 Guidance.

Table 3 – Capital adequacy:

	30.09.2023	31.12.2022
Paid up capital instruments	200,000	200,000
Share premium	871,378	871,378
Retained earnings	1,237,367	908,965
Current result	-	334,297
Accumulated other comprehensive income	(114,893)	(98,470)
Other reserves	13,522	13,522
Minority interest	27,402	26,806
Prudential filters: Additional Valuation Adjustments (AVA)	(2,301)	(2,981)
(-) Goodwill	(3,529)	(3,529)
(-) Other intangible assets	(35,495)	(41,351)
(-) Insufficient coverage for non-performing exposures	(558)	(418)
COMMON EQUITY TIER 1 CAPITAL (CET1)	**2,192,893**	**2,208,219**
Capital instruments eligible as AT1 Capital	82,000	82,000
Minority interest	5,673	5,481
Additional Tier 1 capital	**87,673**	**87,481**
TIER 1 CAPITAL	**2,280,566**	**2,295,700**
Capital instruments and subordinated loans eligible as T2 capital	507,516	507,516
Minority interest	3,325	3,159
Tier 2 capital	**510,841**	**510,675**
TOTAL CAPITAL	**2,791,407**	**2,806,375**
Risk exposure amount for credit risk	12,026,990	11,797,851
Risk exposure amount for market risks	1,387,088	1,359,476
Risk exposure amount for CVA	94,813	85,600
Risk exposure amount for operational risk	1,410,132	1,410,132
TOTAL RISK EXPOSURE AMOUNT (RWA)	**14,919,023**	**14,653,059**
Common Equity Tier 1 Ratio	14.7%	15.1%
Tier 1 Ratio	15.3%	15.7%
Total Capital Ratio	**18.7%**	**19.2%**

As at 30 September 2023, the total capital ratio (TCR) for the Group stood at 18.7%, and the CET1 ratio for the Group stood at 14.7%, both decreasing by 0.4 p.p. YtD due to lower total capital and higher RWA. Although the overall revaluation adjustments in 2023, till the end of September, were positive in the amount of EUR 45.2 million, the total capital decreased by EUR 15.0 million YtD since the temporary treatment of fair value through other comprehensive income (FVOCI) valuations for sovereign securities with the positive effect of EUR 61.7 million as at 31 December 2022 ceased to apply in January 2023.

The total capital does not include a part of the 2022 result in the amount of EUR 55 million, which is still envisaged to be paid as a dividend in 2023 (EUR 55 million was already paid as a dividend in June). Therefore, there will be no effect on the capital once dividends are paid.

The drivers behind the differences between the RWAs in the year 2023 are explained in Chapter 4.2 Risk weighted exposure amounts in Table 4 – EU OV1 – Overview of risk weighted exposure amounts.

4.2. Risk weighted exposure amounts

(Article 438 d of CRR)

The Group uses the following approaches to calculate Pillar 1 capital requirements on a consolidated basis:

- Credit risk – standardised approach,
- Market risk – standardised approach, and
- Operational risk – basis indicator approach.

In the calculation of capital ratios, risk is expressed as a risk exposure amount or a capital requirement. The capital requirement for an individual risk amounts to 8% of the total exposure to the individual risk.

Table 4 shows the detailed composition of the risk weighted exposure amounts of the Group at the end of September 2023, at the end of June 2023 and at the end of 2022; as well as the composition of own fund (capital) requirements at the end of September 2023.

Table 4 – EU OV1 – Overview of risk weighted exposure amounts

		Total risk exposure amounts (TREA)			Total own funds requirement
		30.09.2023	30.06.2023	31.12.2022	30.09.2023
		a	b	b-2	c
1	**Credit risk (excluding CCR)**	**11,804,233**	**11,759,978**	**11,570,861**	**944,339**
2	of which the standardised approach	11,804,233	11,759,978	11,570,861	944,339
6	**Counterparty credit risk - CCR**	**161,882**	**144,881**	**144,580**	**12,951**
7	of which the standardised approach	67,069	55,256	58,980	5,366
EU 8b	of which credit valuation adjustment - CVA	94,813	89,625	85,600	7,585
20	**Position, foreign exchange and commodities risks (Market risk)**	**1,387,088**	**1,367,001**	**1,359,476**	**110,967**
21	of which the standardised approach	1,387,088	1,367,001	1,359,476	110,967
23	**Operational risk**	**1,410,132**	**1,410,132**	**1,410,132**	**112,811**
EU 23a	of which basic indicator approach	1,410,132	1,410,132	1,410,132	112,811
24	**Amounts below the thresholds for deduction (subject to 250% risk weight)**	**155,688**	**156,360**	**168,010**	**12,455**
29	**Total**	**14,919,023**	**14,838,352**	**14,653,059**	**1,193,522**

Risk Weighted Assets (RWA) in the Group increased by EUR 266.0 million compared to the end of 2022.

In first nine months of 2023, the RWA for Credit risk increased by EUR 229.1 million (lines 2, 7, and 24 in Table 4), mainly due to ramping up lending activity in all the Group banks. On the other hand, RWA decreased due to lower liquidity assets, mainly in NLB Komercijalna Banka Beograd. Additionally, repayments resulted in the RWA reduction for non-performing exposures. The Bank and Multilateral Investment Guarantee Agency (MIGA) as of year 2020 concluded several contracts guaranteeing central bank reserves of the Group banking subsidiaries amounted to EUR 481.1 million (30 September 2023), thus also leading to lowering RWA at the Group level.

The increase in RWAs for market risks and Credit Value Adjustments (CVA) (lines EU 8b and 20 in Table 4) in the amount of EUR 36.8 million compared to the end of 2022 is the result of a new position RWA for Equity risk in the amount of EUR 19.5 million, higher RWA for FX risk in the amount of EUR 9.3 million, higher RWA for CVA risk in the amount of EUR 9.2 million (due to new deals), and lower RWA for Traded debt instruments risk in the amount of EUR 1.2 million.

4.3. Risk factors

Risk factors affecting the business outlook are (among others):
- The economy's sensitivity to a potential slowdown in the euro area or globally
- Potential liquidity outflows
- Widening credit spreads
- Worsened interest rate outlook / Persistence of high inflation
- Energy and commodity price volatility
- Increasing Unemployment
- Geopolitical uncertainties
- Potential cyber-attacks
- Litigation risks
- Regulatory, other legislative, and tax measures impacting the banks

The sharp rebound from the COVID recession has turned in the prospective stagflation in 2023. As a result of rising inflation, high-interest rates, weaker external demand and increased macroeconomic uncertainty, subdued economic growth or its gradual slowdown is expected. The Group's region is still expected to grow moderately, though relatively high inflationary pressures and other uncertainties might suggest a further slowdown, namely in private consumption and investment growth.

Credit risk usually considerably increases in times of economic slowdown. The Group has thoroughly analysed and adjusted the potential impact on the credit portfolio in the light of anticipated inflationary pressures and expected decreases in economic growth. Lending growth in the corporate and retail segments is expected to remain relatively moderate, especially in such circumstances. Regarding the credit portfolio quality, the Group carefully monitors the potentially most affected segments to detect any significant increase in credit risk at a very early stage. In August 2023, certain areas in Slovenia were damaged by the floods. Their impact on the quality of the Bank's credit portfolio in the corporate and retail segments are estimated as negligible, and only minor client credit quality deteriorations or received collaterals are expected. The aforementioned adverse developments could affect the cost of risk and NPLs. Notwithstanding the established procedures in the Group's credit risk management, there can be no certainty that they will be sufficient to ensure the Group's credit portfolio quality or the corresponding impairments remain at an adequate level.

The investment strategy of the Group, referring to the Group's bond portfolio kept for liquidity purposes, adapts to the expected market trends in accordance with the set risk appetite. Geopolitical uncertainties have increased volatility in the financial markets, particularly shifts in credit spreads, rising interest rates and foreign exchange rate fluctuations. The Group is closely monitoring its prominent bond portfolio positions, mostly sovereigns, and carefully manages them by incorporating adequate early warning systems to limit the potential sensitivity of regulatory capital.

So far, no material movements regarding the Group's significant FX positions have been observed. Current developments, market observations, and potential mitigations are closely monitored and discussed. While the Group monitors its liquidity, interest rate, credit spread, FX position and corresponding trends, their impacts on the Group positions, any significant and unanticipated movements on the markets or a variety of factors, such as competitive pressures, consumer confidence, or other certain factors outside the Group's control, could adversely affect the Group's operations, capital, and financial condition.

Special attention is paid to the continuous provision of services to clients, their monitoring, health protection measures, and the prevention of cyber-attacks and potential fraud events. The Group has established internal controls and other measures to facilitate adequate management. However, these measures may only sometimes fully prevent potential adverse effects.

With regards to litigation risk, in recent years, and even more so in recent periods, we have seen a shift in case law that is generally more favourable to consumers, including when it comes to CHF litigations. We have noticed a slight increase in the number of proceedings against the Bank, which was expected. The current litigations against the Bank related to CHF are not material, but we are closely monitoring developments.

The Group is subject to various regulations and laws relating to banking, insurance, and financial services. Respectively, it faces the risk of significant interventions by several regulatory and enforcement authorities in each jurisdiction in which it operates.

The SEE region is the Group's most significant geographic area of operations outside the RoS, and the economic conditions in this region are, therefore, crucial to the Group's operations and financial condition results. The Group's financial condition could be adversely affected by any instability or economic deterioration in this region.

In this regard, the Group closely follows the macroeconomic indicators relevant to its operations:

- GDP trends and forecasts,
- Economic sentiment,
- Unemployment rate,
- Consumer confidence,
- Construction sentiment,
- Deposit stability and growth of loans in the banking sector,
- Credit spreads and related future forecasts,
- Interest rate development and related future forecasts,
- FX rates,
- Energy and commodity prices,
- Other relevant market indicators.

During 2023, the Group reviewed the IFRS 9 provisioning by testing the relevant macroeconomic scenarios to accurately reflect the current circumstances and their future impacts. The Group established multiple scenarios (i.e., baseline, optimistic and severe) for the Expected Credit Losses (ECL) calculation, aiming to create a unified projection of macroeconomic and financial variables for the Group, aligned with the Bank's consolidated view of the future of economic development in the SEE. The Group formed three probable scenarios with an associated probability of occurrence for forward-looking assessment of risk provisioning in the context of the IFRS 9. These IFRS 9 macroeconomic scenarios incorporate the forward-looking and probability-weighted aspects of the ECL impairment calculation. Both features may change when material changes in the future development of the economy are recognised and not embedded in previous forecasts.

The baseline scenario presents an expected forecast macroeconomic view for all the countries of the Group. This scenario is based on recent official and professional forecasts, with specific adjustments for individual countries of the Group. Key characteristics include no additional supply shocks, decreasing inflation due to increased ECB key rate and quantitative tightening, a slightly less tight labour market, GDP growth supported by declining interest rates and positive expectations, regional containment of political tensions, and limited spill over effects of financial system issues on the real economy.

The alternative scenarios are based on plausible drivers of economic development for the next three years. The optimistic scenario is supply- and demand-driven, with a mild winter and sufficient energy supplies easing price pressures in the euro area. China's decision to abandon strict COVID restrictions supports the euro area exports, stimulating demand. Lower inflation leads to an optimistic financial market outlook, and the first year shows positive growth expectations, followed by additional ECB support and moderated growth potential in the following two years.

The severe, supply- and demand-driven scenario depicts sluggish economic growth due to lower consumer purchasing power, geopolitical disruption, and elevated inflation. The Group home countries experience near-zero real economic growth, leading to substantial upward shocks in financial markets. Political tensions persist, causing supply disruptions, and inflation remains higher than expected, resulting in increased long-term inflation expectations. GDP growth remains low as the ECB implements a restrictive monetary policy. Despite a slow increase in the unemployment rate, many industries still face a tight labour market. The financial system stabilises, allowing the ECB to focus on taming inflation. The Bank considers these scenarios in calculating expected credit losses in the context of the IFRS 9.

On this basis, the Group revised scenario weights in H1 2023, and assigned weights of 20%-60%-20% (alternative scenarios receiving 20% each, and the baseline scenario 60%), with minor changes in some entities to reflect the likelihood of relevant future economic conditions in their environment.

The Group established a comprehensive internal stress-testing framework and early warning systems in various risk areas with built-in risk factors relevant to the Group's business model. The stress-testing framework is integrated into Risk Appetite, Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP), and the Recovery Plan to determine how severe and unexpected changes in the business and macro environment might affect the Group's capital adequacy or liquidity position. The stress-testing framework and recovery

plan indicators support proactive management of the Group's overall risk profile in these circumstances, including capital and liquidity positions from a forward-looking perspective.

Risk Management actions that the Group might use are determined by various internal policies and applied when necessary. Moreover, the selection and application of mitigation measures follow a three-layer approach, considering the feasibility analysis of the measure, its impact on the Group's business model, and the strength of the available measure.

4.4. CRR 'Quick Fix'

The European Commission published on 26 June 2020 an amendment of two regulations to address the impact of COVID-19 pandemic on the economy in order to maximise the capacity of credit institutions to lend and absorb losses related to the pandemic.

The Amendment of CRR (EU) No. 575/2013:

- Modification of the calculation of the leverage ratio to exclude central bank reserves;
- Extension of the provisions of ECL accounting under the IFRS 9 from 2018–2022 to 2020–2024;
- Temporary treatment of public debt issued in the currency of another Member State;
- Temporary treatment of unrealised gains and losses measured at fair value through other comprehensive income in view of the COVID-19 pandemic;
- Extension of the preferential treatment regarding provisioning requirements to exposures guaranteed by the public sector for seven years. The preferential treatment is usually available only for NPLs, guaranteed by official export credit agencies.

The Amendment of CRR II (EU) No. 2019/876:

- Bringing forward the implementation of:
  - Provisions on the treatment of certain loans, granted by credit institutions to pensioners or employees;
  - Adjustments of risk-weighted non-defaulted SME exposures (SME supporting factor);
- The preferential treatment of exposures to entities that operate or finance physical structures or facilities systems and networks that provide or support essential public services (Infrastructure supporting factor);
- Exempt prudently valued software assets from CET1 calculations.

The amending application was directly applied the day after publication in the *Official Journal*, starting on 27 June 2020.

The Group implemented:

- Changes in the SME-supporting factor;
- Temporary treatment of public debt issued in the currency of another Member State;
- Exempt prudently valued software assets from CET1 calculations;
- Temporary treatment of unrealised gains and losses measured at fair value through other comprehensive income in view of the COVID-19 pandemic (the measure ceased to apply in January 2023);
- Modification of the calculation of the leverage ratio to exclude central bank reserves.

Changes in the SME-supporting factor were introduced in 2019 CRR II in article 501 containing reductions to the capital requirements for credit risk on exposures to SMEs. The threshold to qualify for the SME-supporting factor increased from EUR 1.5 million to EUR 2.5 million, with an additional factor of 0.85 (add-on to the previous 0.7619).

The temporary treatment of public debt issued in the currency of another Member State is set out in new article 500a to the CRR and applies with respect to the credit risk framework until 31 December 2024. For exposures to the central governments and central banks of the Member States, where those exposures are denominated and funded in the domestic currency of another Member State, the risk weight applied shall be:

- 0% until 31 December 2022;
- 20% in 2023;
- 50% in 2024.

In accordance with CRR article 36 (b), and Regulation (EU) 2020/2176 software assets are from December 2020 onwards partially a deduction item from capital and partially included in RWA calculation.

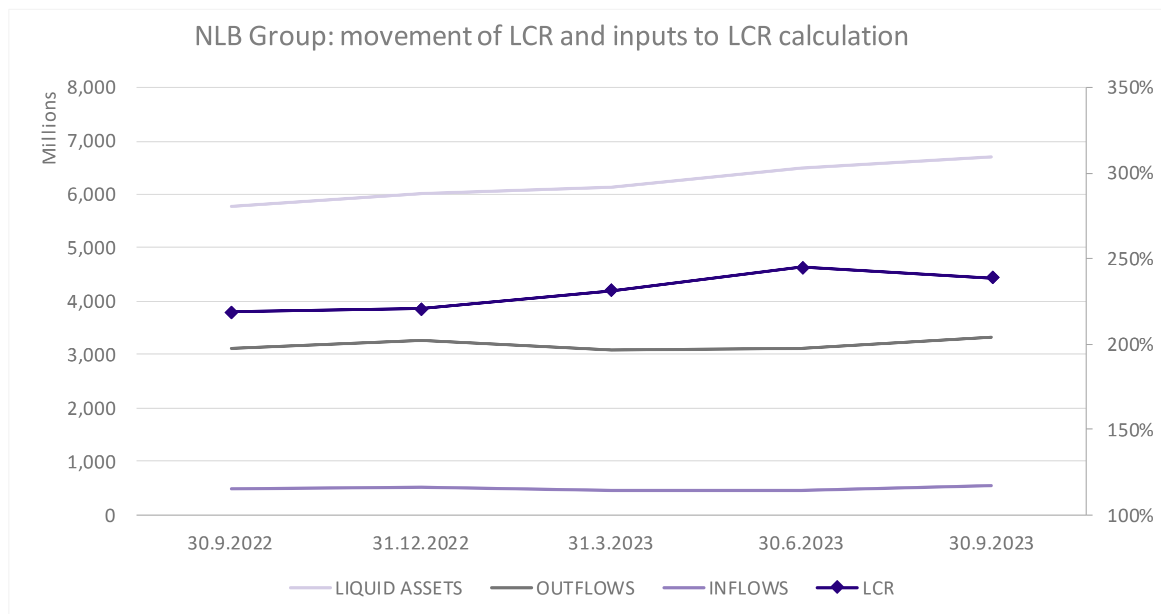
5. Liquidity

(Article 451a (2) of CRR)

Liquidity coverage ratio

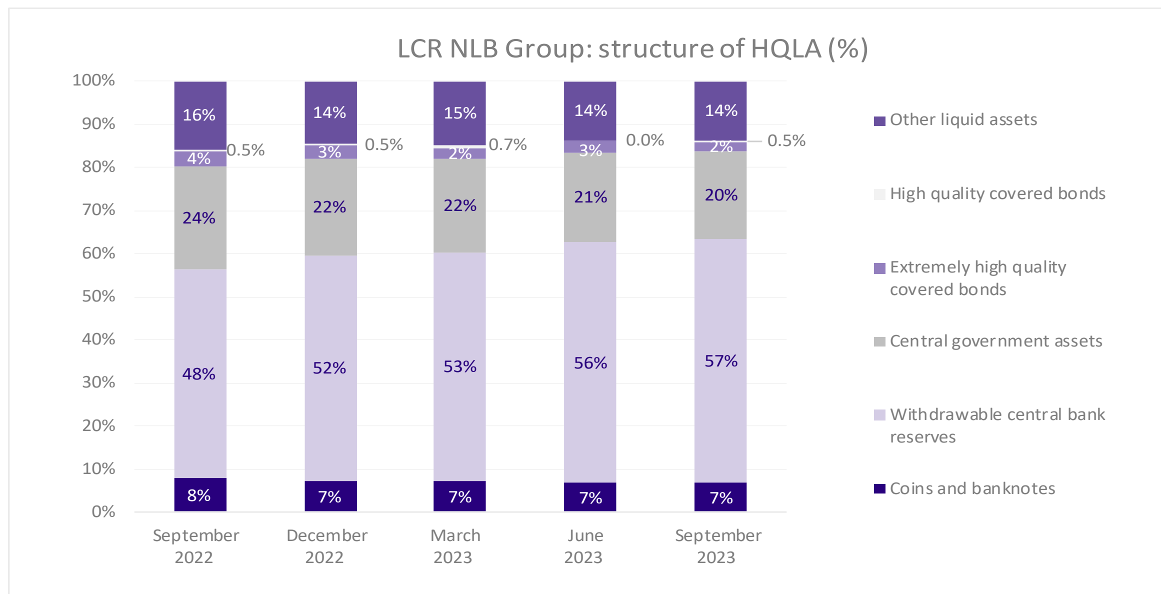
The Group holds a very strong liquidity position at the Group (and individual subsidiary bank) level, which is well above the risk appetite. In the last twelve months (30 September 2022 – 30 September 2023), the LCR of the Group ranged between 213% and 252% (238.9% as at 30 September 2023). A slightly downward trend is seen in the Q3 2023. LCR of the Group decreased in Q3 2023 due to higher amount of net liquidity outflows in the next 30 days. Nevertheless, LCR remained very solid, standing at 238.9% as at 30 September 2023.

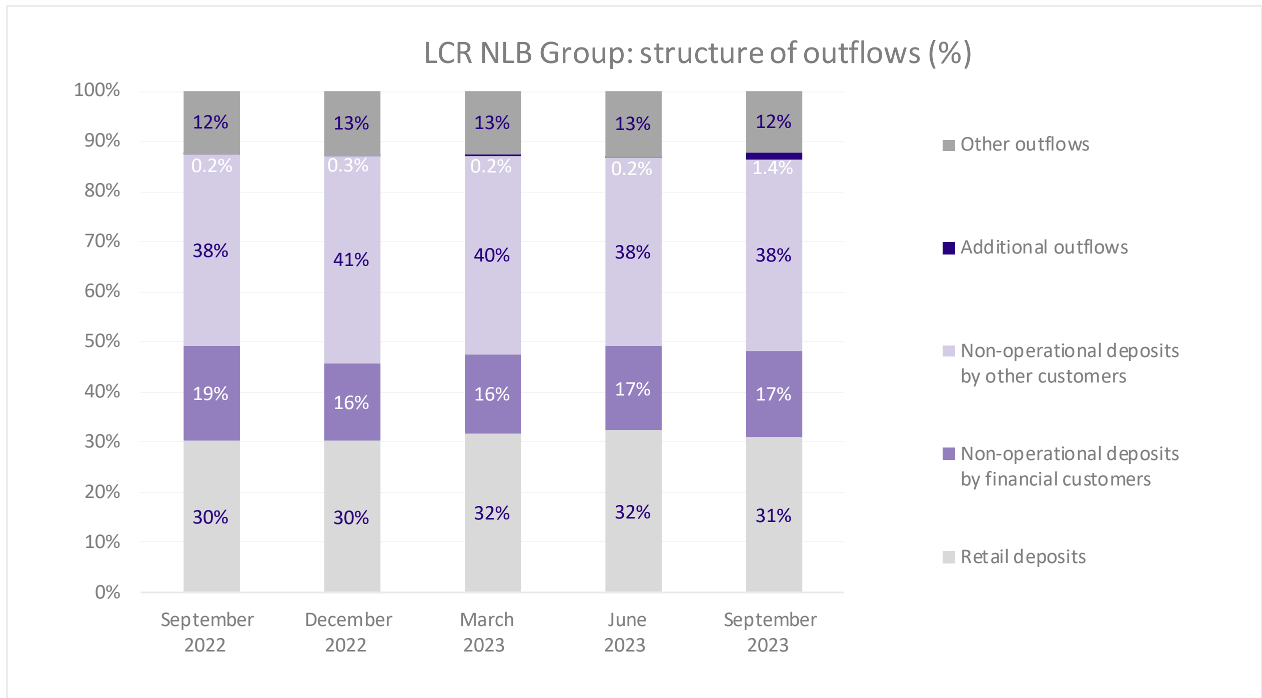
One of the specific rules for calculating consolidated LCR on the Group level is that, from each subsidiary (banking member) only HQLA in the amount of its net liquidity outflows in specific currency is included in the calculation of consolidated LCR.

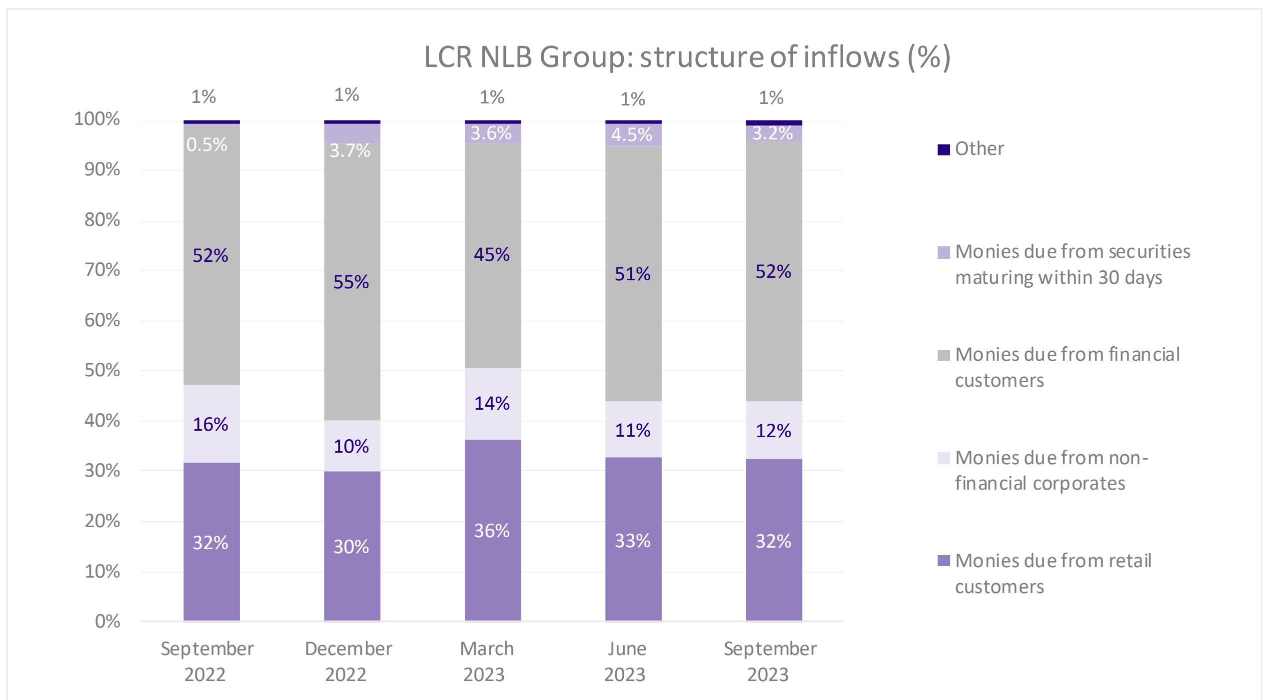


The surplus of HQLA is at a very high level in NLB Group, ranging between EUR 5.51 billion and EUR 6.77 billion in the last twelve months (EUR 6.69 billion as at 30 September 2023), mainly in the form of placements at the ECB and prime debt securities.

The structures of HQLA, outflows and inflows over one-year period are shown in figures below.







Concentration of funding and liquidity sources

In accordance with the Risk Appetite Statement of the Group, tolerance for liquidity risk is low. Therefore, the goal of the funding strategy is to ensure a sufficient, stable, and well-diversified funding base in the long term and compliance with relevant regulatory frameworks.

The funding strategy in the Bank is established in a way that enables diversification, minimises concentration risk, and limits the reliance on a short-term wholesale funding or other unstable sources. With the objective to effective management of liquidity and funding risk, the Group regularly performs stress tests and makes liquidity projections under different scenarios. With this approach, the Group is able to detect any potential liquidity and funding needs early.

In accordance with the business model, the primary source of funding of the Group represent customer (non-banking sector) deposits. The Group's deposit base is highly stable and diversified. Due to the high importance of customer

deposits in the Group's funding, it is very important to limit a high concentration. The desired diversification is achieved using different instruments, including the application of limits by type of counterparty. Dependence on wholesale funding is low. The Group takes into consideration the concentration of funding to have well diversified sources of funding and to prevent unwanted effects of concentration. For customer deposits as the main funding sources of the Group, a limit is set to prevent a too high concentration of depositors.

Limits are also set for other Group members and defined in the Group Risk Management Standards. All banking members of the Group must adopt limits in their policies and comply with the limits. Any deviations from the limit must be reported and justified to the parent bank. The funding structure is presented to ALCO on a monthly basis.

On the Group level, at the end of September 2023, the top 30 counterparties provided 3.6% of the total liabilities, mostly in retail, while the top 30 counterparties in the Bank provided 4.3% of the total liabilities.

High-level description of the composition of the institution`s liquidity buffer
The liquidity buffer represents the most liquid assets which are available immediately and can be used in a stressed situation within a short-term survival period (for the Bank and the Group members: 1 month). It is composed of cash, a central bank balance (excluding obligatory reserve), and internally defined unencumbered high-quality liquid assets (debt securities) which can be liquidated via repo or sale without significant value loss. There are no legal, regulatory, or operational impediments to using these assets to obtain funding.

Derivative exposures and potential collateral calls
The Group enters into the derivatives to support corporate customers and financial institutions in their management of financial exposures (sales business), and in order to manage the NLB Group risks such as interest rate risk and FX risk.

To mitigate CCR risk arising from derivatives, the Group uses netting agreements such as the ISDA Master Agreement, the Global Master Repurchase Agreement (GMRA), and the Slovenian framework agreement. Furthermore, collateral agreements (e.g., ISDA Credit Support Annex) are in place to substantially reduce credit risk arising out of derivatives transactions. Additionally, clearing transactions via a clearing house is in place for relevant derivatives transactions. Daily margin call calculations are in place for each relevant counterparty. Portfolio reconciliation is agreed as per European Market Infrastructure Regulation (EMIR). The Bank calculates the net positive market value for individual counterparty exposure on a daily basis, and as a result, collateral is adjusted accordingly. Regarding the LCR, the CCR exposure from the derivatives is low and there are no significant outflows to be recorded.

Currency mismatch in the LCR
The Bank actively manages liquidity risk exposures and funding needs within and across legal entities, business lines, and currencies, considering legal, regulatory, and operational limitations to the transferability of liquidity. Specific characteristics and liquidity risks of foreign exchange positions are considered, particularly when preparing the plan of cash flows by currency.

In the Group, there are no currency mismatches in the LCR. The LCR indicator is fulfilled in all currencies because the Group has enough liquidity reserves in all currencies where the outflows might happen. The most significant currency of the Group is euro currency. Additionally, the Group reports LCR in a second significant currency, which is in Serbian dinar (RSD). As at 30 September 2023, the aggregate liabilities in RSD represented 6.27% of the total liabilities of the Group, therefore, RSD is qualified as a significant currency.

Other items in the LCR calculation that are not captured in the LCR disclosure table
The Group is focused on its retail banking activities; therefore, the structure of the balance sheet does not include any complex products. There are no other items in the LCR calculation that are not captured in the LCR disclosure table.

The liquidity of the Bank is strong, and the volume of unencumbered liquidity reserves is at a high level. The Global Risk view is that the liquidity position is strong, and it will continue to maintain at high levels, as is also reflected in liquidity planning and cash flow forecasting.

The table below illustrates the values and data for each of the four calendar quarters (October–December, January–March, April–June and July–September). They are calculated as a simple average of observations on the last calendar day of each month for a period of 12 months before the end of each quarter.

Table 5 – LIQ1 – Quantitative information of LCR, data in EUR millions

		Total unweighted value (average)				Total weighted value (average)			
EU 1a	**Quarter ending on**	**30.09.2023**	**30.06.2023**	**31.03.2023**	**31.12.2022**	**30.09.2023**	**30.06.2023**	**31.03.2023**	**31.12.2022**
		a	b	c	d	e	f	g	h
EU 1b	Number of data points used in the calculation of averages	12	12	12	12	12	12	12	12
High-quality liquid assets									
1	Total high-quality liquid assets (HQLA)					6,174	5,916	5,775	5,647
Cash-outflows									
2	Retail deposits and deposits from small business customers, of which:	15,982	15,806	15,619	15,360	992	973	954	931
3	*Stable deposits*	11,857	11,762	11,640	11,464	593	588	582	573
4	*Less stable deposits*	3,378	3,275	3,182	3,062	400	385	372	357
5	Unsecured wholesale funding	3,645	3,599	3,557	3,393	1,756	1,745	1,718	1,645
7	*Non-operational deposits (all counterparties)*	3,643	3,597	3,556	3,392	1,754	1,743	1,717	1,644
8	*Unsecured debt*	2	2	1	1	2	2	1	1
10	Additional requirements	2,342	2,322	2,259	2,175	201	198	206	215
11	*Outflows related to derivative exposures and other collateral requirements*	10	7	19	37	10	7	19	37
13	*Credit and liquidity facilities*	2,332	2,315	2,240	2,138	191	191	186	178
14	Other contractual funding obligations	223	231	244	248	125	125	135	135
15	Other contingent funding obligations	1,553	1,527	1,499	1,451	89	87	86	84
16	**TOTAL CASH OUTFLOWS**					**3,163**	**3,128**	**3,099**	**3,009**
Cash-inflows									
18	Inflows from fully performing exposures	733	740	737	745	483	488	486	500
19	Other cash inflows	21	17	15	12	21	17	15	12
20	**TOTAL CASH INFLOWS**	**754**	**757**	**752**	**757**	**504**	**505**	**501**	**513**
EU-20c	***Inflows subject to 75% cap***	**754**	**757**	**752**	**757**	**504**	**505**	**501**	**513**
TOTAL ADJUSTED VALUE									
21	**LIQUIDITY BUFFER**					**6,174**	**5,916**	**5,775**	**5,647**
22	**TOTAL NET CASH OUTFLOWS**					**2,659**	**2,623**	**2,598**	**2,496**
23	**LIQUIDITY COVERAGE RATIO**					**232.11%**	**225.52%**	**222.21%**	**227.15%**

6. Appendices

6.1. Appendix 1

List of all disclosures required under Part 8 of CRR

Article	Chapter	Page
438 d)	4.2	10
h)	/	/
447	1	3
451a (2)	5	14

6.2. Appendix 2

Abbreviations

ALCO	Asset and Liability Committee
AT1	Additional Tier 1 capital
AVA	Additional Valuation Adjustments
BoS	Bank of Slovenia
CBR	Combined buffer requirement
CCR	Counterparty credit risk
CET1	Common equity tier 1 capital
COVID-19	Coronavirus Disease 2019
CRD	Capital Requirements Directive
CRD V	Capital Requirements Directive and Regulation
CRR	Capital Requirements Regulation
CVA	Credit valuation adjustment
ECB	European Central Bank
ECL	Expected Credit Losses
EMIR	European Market Infrastructure Regulation
FVOCI	Fair Value Through Other Comprehensive Income
FX	Foreign Exchange
GDP	Gross Domestic Product
GMRA	Global Master Repurchase Agreement
HQLA	High-quality liquid assets
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process
ISDA	International Swaps and Derivatives Association
LCR	Liquidity coverage ratio
MDA	Maximum Distributable Amount
MIGA	Multilateral Investment Guarantee Agency
NPL	Non Performing Loans
OCI	Other comprehensive income
OCR	Overall capital requirement
O-SII	Other systemically important institutions
P2G	Pillar 2 Guidance
P1R	Pillar 2 Requirement
P2R	Pillar 2 Requirement
RWA	Risk-weighted assets
RWEA	Risk weighted exposure amount
SEE	Southeast Europe
SME	Small Medium Enterprise
SREP	Supervisory Review and Evaluation Process
T2	Tier 2 (capital)
TCR	Total Capital ratio
TREA	Total risk exposure amount
TSCR	Total SREP capital requirement
TT	Temporary treatment