Creating better footprints.

NLB Group Pillar III Disclosures Q1 2023

Contents

1. Key highlights

(Article 447 of CRR)

Table 1 – EU KM Key metrics template of NLB Group

		31.03.2023	31.12.2022	30.09.2022	30.06.2022	31.03.2022
		a	b	c	d	e
	Available own funds (amounts)					
1	Common Equity Tier 1 (CET1) capital	2,166,912	2,208,219	2,076,606	2,043,477	1,901,470
2	Tier 1 capital	2,254,574	2,295,700	2,082,130	2,048,928	1,906,565
3	Total capital	2,765,244	2,806,375	2,369,623	2,336,205	2,193,990
	Risk-weighted exposure amounts					
4	Total risk exposure amount (TREA)	14,622,299	14,653,059	14,283,739	14,172,549	13,843,373
	Capital ratios (as a percentage of risk-weighted exposure amount)					
5	Common Equity Tier 1 ratio	14.82%	15.07%	14.54%	14.42%	13.74%
6	Tier 1 ratio	15.42%	15.67%	14.58%	14.46%	13.77%
7	Total capital ratio	18.91%	19.15%	16.59%	16.48%	15.85%
	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%	2.60%	2.60%	2.60%	2.60%
EU 7b	of which: to be made up of CET1 capital	1.35%	1.46%	1.46%	1.46%	1.46%
EU 7c	of which: to be made up of Tier 1 capital	1.80%	1.95%	1.95%	1.95%	1.95%
EU 7d	Total SREP own funds requirements	10.40%	10.60%	10.60%	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%
EU 9a	Systemic risk buffer	0.10%	0.00%	0.00%	0.00%	0.00%
EU 10a	Other Systemically Important Institution buffer	1.25%	1.00%	1.00%	1.00%	1.00%
11	Combined buffer requirement	3.85%	3.50%	3.50%	3.50%	3.50%
EU 11a	Overall capital requirements	14.25%	14.10%	14.10%	14.10%	14.10%
12	CET1 available after meeting the total SREP own funds requirements	799,727	822,040	725,364	702,754	591,887
	Leverage ratio					
13	Total exposure measure	25,105,562	25,240,506	24,509,522	23,711,555	20,854,558
14	Leverage ratio	8.98%	9.10%	8.50%	8.64%	7.58%
	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%	3.14%
	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%	3.14%
EU 14e	Overall leverage ratio requirement	3.00%	3.00%	3.00%	3.00%	3.14%
	Liquidity Coverage Ratio					
15	Total high-quality liquid assets (HQLA)	5,774,965	5,647,162	5,526,560	5,445,021	5,336,395
EU 16a	Cash outflows - Total weighted value	3,099,033	3,008,960	2,871,465	2,737,213	2,623,971
EU 16b	Cash inflows - Total weighted value	500,673	512,851	521,447	545,620	577,103
16	Total net cash outflows	2,598,360	2,496,109	2,350,018	2,191,593	2,046,825
17	Liquidity coverage ratio	222.21%	227.15%	236.85%	250.65%	261.43%
	Net Stable Funding Ratio					
18	Total available stable funding	20,217,758	20,409,092	19,628,877	19,031,012	19,268,104
19	Total required stable funding	11,109,114	11,154,678	11,010,637	10,835,911	11,072,422
20	NSFR ratio	181.99%	182.96%	178.27%	175.63%	174.02%

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) of NLB Group

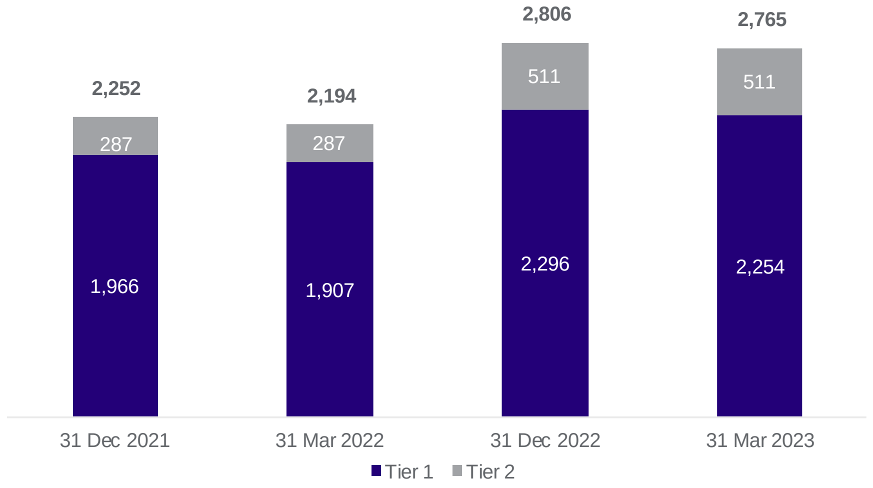


Figure 2: Total capital and capital ratio evolution YtD of NLB Group

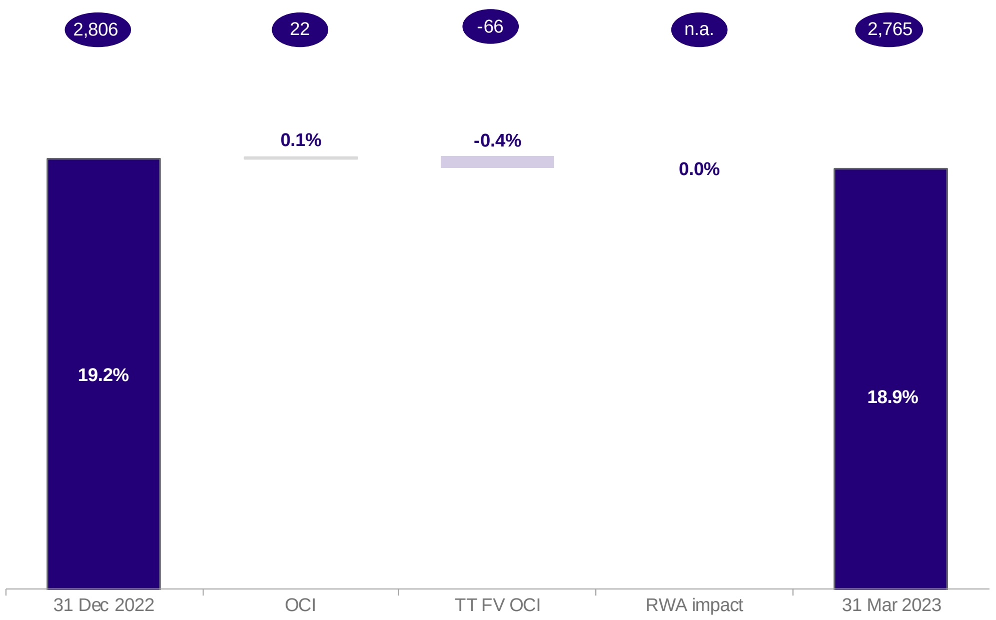
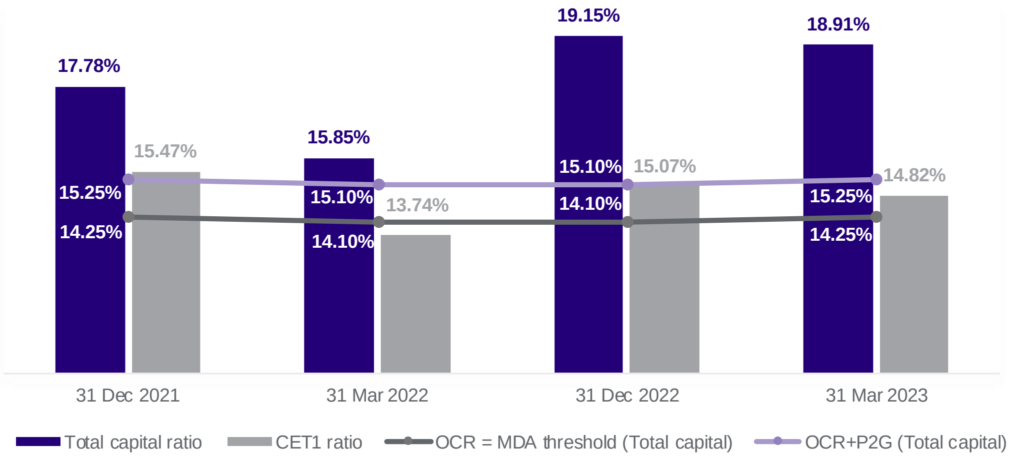


Figure 3: Capital ratios and regulatory thresholds (in %) of NLB Group



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 the data disclosed in this document are due to the effect of rounding.

Frequency of disclosures and media

CRD V and EBA guidelines require NLB Group to disclose information at least on an annual basis. To ensure the effective communication of NLB Group's business and risk profile, NLB 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 Annual or Interim Reports for NLB Group disclosure.

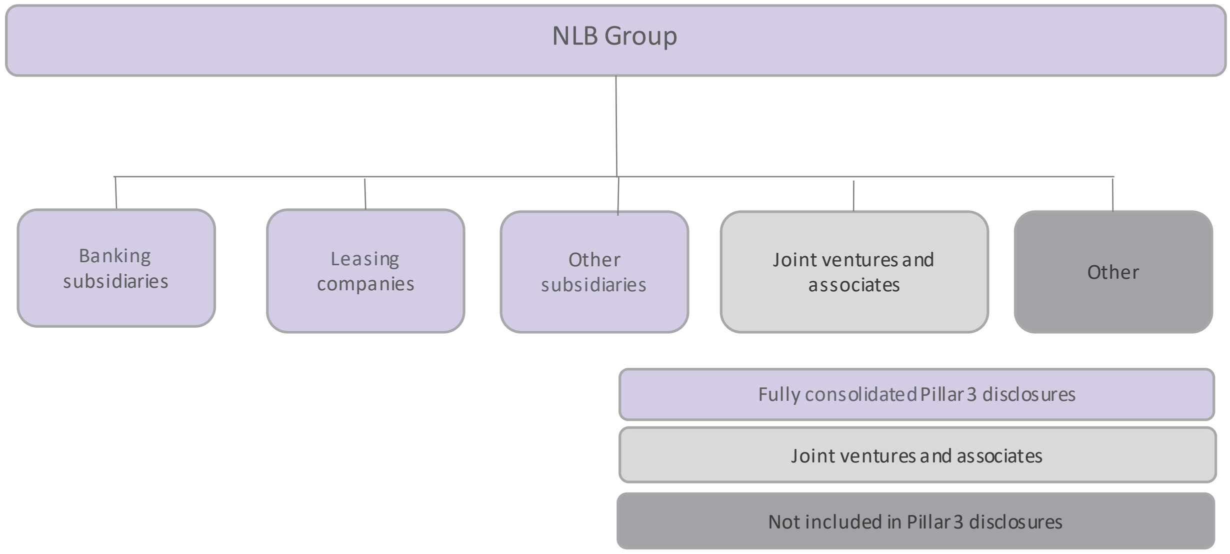
It should be noted that while some quantitative information in this document is based on financial data contained in the NLB Group Interim Report Q1 2023, other quantitative data is sourced from the regulatory reporting (Finrep and Corep) and is calculated according to regulatory requirements. Pillar 3 quantitative data is thus not always directly comparable with the quantitative data contained in the NLB Group Interim Report Q1 2023.

3. Scope of application

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

In accordance with the capital legislation, NLB (LEI Code 5493001BABFV7P27OW30) has the position of an 'EU parent bank,' and so is a parent company of NLB Group. NLB 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 NLB 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 31 March 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 as 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 of NLB Group

		2023	2022	2021
Pillar 1 (P1R)	CET1	4.5%	4.5%	4.5%
	AT1	1.5%	1.5%	1.5%
	T2	2.0%	2.0%	2.0%
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%	2.5%	2.5%
O-SII buffer	CET1	1.25%	1.0%	1.0%
Systemic risk buffer	CET1	0.10%	0.0%	0.0%
Countercyclical buffer	CET1	0.00%	0.0%	0.0%
Combined buffer requirement (CBR)	CET1	3.85%	3.5%	3.5%
Overall capital requirement (OCR) = MDA threshold	CET1	9.70%	9.46%	9.55%
	Tier 1	11.65%	11.45%	11.56%
	Total Capital	14.25%	14.10%	14.25%
Pillar 2 Guidance (P2G)	CET1	1.0%	1.0%	1.0%
OCR + P2G	CET1	10.70%	10.46%	10.55%
	Tier 1	12.65%	12.45%	12.56%
	Total Capital	15.25%	15.10%	15.25%

The Overall Capital Requirement (OCR) for the Group was 14.25%, consisting of:

- 10.40% total SREP capital requirement (TSCR) (8.00% Pillar 1 Requirement (P1R) and 2.40% Pillar 2 Requirement P2R)); and
- 3.85% Combined Buffer Requirement (CBR) (2.50% Capital Conservation Buffer, 1.25% O-SII Buffer, 0.10% Systemic Risk Buffer and 0.00% 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 1Q.

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.

Table 3 – Capital adequacy of NLB Group:

	31.03.2023	**31.12.2022**
Paid up capital instruments	200,000	200,000
Share premium	871,378	871,378
Retained earnings	1,241,305	908,965
Current result	-	334,297
Accumulated other comprehensive income	(138,278)	(98,470)
Other reserves	13,522	13,522
Minority interest	27,398	26,806
Prudential filters: Additional Valuation Adjustments (AVA)	(2,609)	(2,981)
(-) Goodwill	(3,529)	(3,529)
(-) Other intangible assets	(41,790)	(41,351)
(-) Insufficient coverage for non-performing exposures	(485)	(418)
COMMON EQUITY TIER 1 CAPITAL (CET1)	**2,166,912**	**2,208,219**
Capital instruments eligible as AT1 Capital	82,000	**82,000**
Minority interest	5,662	5,481
Additional Tier 1 capital	**87,662**	**87,481**
TIER 1 CAPITAL	**2,254,574**	**2,295,700**
Capital instruments and subordinated loans eligible as T2 capital	507,516	507,516
Minority interest	3,154	3,159
Tier 2 capital	**510,670**	**510,675**
TOTAL CAPITAL	**2,765,244**	**2,806,375**
Risk exposure amount for credit risk	11,758,017	11,797,851
Risk exposure amount for market risks	1,363,625	1,359,476
Risk exposure amount for CVA	90,525	85,600
Risk exposure amount for operational risk	1,410,132	1,410,132
TOTAL RISK EXPOSURE AMOUNT (RWA)	**14,622,299**	**14,653,059**
Common Equity Tier 1 Ratio	14.8%	15.1%
Tier 1 Ratio	15.4%	15.7%
Total Capital Ratio	**18.9%**	**19.2%**

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.

As at 31 March 2023, the total capital ratio (TCR) for the Group stood at 18.9% and the CET1 ratio for the Group stood at 14.8%, both decreased by 0.3 p.p. YtD due to lower total capital. Although the overall revaluation adjustments in 1Q 2023 were positive in the amount EUR 21.9 million, the total capital decreased by EUR 41.1 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 110 million, which is envisaged to be paid as a dividend in 2023. Therefore, there will be no effect on the capital once the dividends are paid.

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

4.2. Capital requirements

(Article 438 d of CRR)

NLB 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 NLB Group at the end of March 2023, and at the end of 2022; as well as the composition of own fund (capital) requirements at the end of March 2023.

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

		Total risk exposure amounts (TREA)		Total own funds requirement
		31.03.2023	31.12.2022	31.03.2023
		a	b	c
1	**Credit risk (excluding CCR)**	**11,533,670**	**11,570,861**	**922,694**
2	of which the standardised approach	11,533,670	11,570,861	922,694
6	**Counterparty credit risk - CCR**	**153,017**	**144,580**	**12,241**
7	of which the standardised approach	62,492	58,980	4,999
EU 8b	of which credit valuation adjustment - CVA	90,525	85,600	7,242
20	**Position, foreign exchange and commodities risks (Market risk)**	**1,363,625**	**1,359,476**	**109,090**
21	of which the standardised approach	1,363,625	1,359,476	109,090
23	**Operational risk**	**1,410,132**	**1,410,132**	**112,811**
EU 23a	of which basic indicator approach	1,410,132	1,410,132	112,811
24	**Amounts below the thresholds for deduction (subject to 250% risk weight)**	**161,855**	**168,010**	**12,948**
29	**Total**	**14,622,299**	**14,653,059**	**1,169,784**

In Q1 2023, the RWA for Credit risk decreased by EUR 39.8 million (lines 2, 7, and 24 in Table 4). RWA decrease was observed for liquidity assets mainly in NLB Komercijalna Banka, Beograd due to maturity of some Serbian bonds and lower assets at central bank in foreign currency (EUR). RWA reduction was partially offset by higher RWA for exposures, associated with particularly high risk due to drawing of project finance exposure. Higher was also RWA for retail exposures as the consequence of ramping up lending activity. Despite new production at corporates, RWA on this segment remained at a similar level as at the end of the year 2022 because of regular repayments and early repayment of cross border loan in NLB.

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 9.1 million compared to the end of 2022 is the result of higher RWA for FX risk in the amount of EUR 12.1 million, higher RWA for CVA risk in the amount of EUR 4.9 million, and lower RWA for TDI risk in the amount of EUR 8.0 million (a consequence of termination of some deals).

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
- Widening credit spreads
- Potential liquidity outflows
- Worsened interest rate outlook / Persistence of high inflation
- Energy and commodity price volatility
- Increasing Unemployment
- Potential cyber-attacks
- Regulatory, other legislative, and tax measures impacting the banks
- Geopolitical uncertainties

The sharp rebound from the COVID recession has turned in the prospective stagflation in the 2023. As a result of rising inflation, high interest rates, weaker external demand and greater uncertainty, a gradual slowdown in economic growth 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 the area of private consumption and investment growth.

Credit risk usually considerably increases in times of economic slowdown. In light of inflationary pressures, and a forecast of a decrease in economic growth, the Group has thoroughly analysed potential impact on the credit portfolio. Lending growth in the corporate and retail segments is expected to remain relatively moderate, especially in the current circumstances. With regards to credit portfolio quality, the Group carefully monitors the most affected segments with the intention to detect any significant increase in credit risk at a very early stage. The aforementioned adverse developments could affect the evolution of 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 quality of credit portfolio, or the corresponding impairments will remain at the adequate level in the future.

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. The war in Ukraine has led to quite considerable volatility in the financial markets, in particular shifts in credit spreads, rising of interest rates and foreign exchange rates fluctuations. The Group is closely monitoring its major bond portfolio positions, mostly sovereigns, and carefully manages them also by incorporating adequate early warning systems in order to limit the potential sensitivity of regulatory capital.

No material movements were observed so far regarding the Group's major FX positions. Current developments, market observations, and potential mitigations are very closely monitored and discussed. While the Group monitors its liquidity, interest rate, credit spread, FX position and corresponding trends, their impacts on Group positions, any significant and unanticipated movements on the markets or 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 their adequate management. However, these measures may not always fully prevent potential adverse effects.

The Group is subject to a wide variety of regulations and laws relating to banking, insurance, and financial services. Respectively, it faces the risk of significant interventions by a number of regulatory and enforcement authorities in each of the jurisdictions in which it operates.
The SEE region is the Group's most significant geographic area of operations outside of the RoS and the economic conditions in this region are therefore important to the Group's results of operations and financial condition. The Group's financial condition could be adversely affected as a result of 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 2022, the Group reviewed IFRS 9 provisioning by testing a set of relevant macroeconomic scenarios to adequately reflect the current circumstances and the related impacts in the future. The Group established and developed multiple scenarios (i.e., baseline, mild, and severe) on the level of an Expected Credit Losses (ECL) calculation. The baseline scenario presents a common forecast macroeconomic view for all countries of the Group. This scenario is constructed with the purpose to culminate various outlooks into a unified projection of macroeconomic and financial variables for the Group. This is in line with the concept that the Bank has a consolidated view on the future of economic development in SEE. The IFRS 9 baseline scenario is based on the most recent official and professional forecaster outputs, with additional specific adjustments for individual countries of the Group.

The macroeconomic rationale behind the alternative scenarios is related to a range of plausible drivers of economic development in the next three years (for the upcoming two years). The narrative for the alternative scenarios combines statistical techniques with expert knowledge as a means of the concept and validation of outputs. The Group developed both alternative scenarios through the lens of possible expected impact on the regional economic activity. In general, the mild scenario is a demand-driven optimistic scenario, where limited supply disruption factors and an active role from the central banks help to brighten the economic conditions and economic subjects' confidence. This scenario narrates stronger economic growth, while the severe scenario envisions zero real economic growth for all Group home countries. Namely, the severe one is a supply-driven pessimistic scenario, where both upside inflation risk and downside growth risk materialize. The Bank includes these scenarios in calculating expected credit losses in the context of IFRS 9.

The Group formed three probable scenarios with an associated probability of occurrence for forward-looking assessment of risk provisioning in the context of IFRS 9. These IFRS 9 macroeconomic scenarios incorporate the forward-looking and probability-weighted aspects of 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. A comprehensive review and updating of the scenario perspective should be undertaken and completed prior to the conclusion of the forthcoming quarter.

The monitoring process of the macroeconomic environment revealed that uncertainties remain high in the global economy due to the energy crisis, inflation, and the war in Ukraine. The current economic situation led to sluggish growth projections, persistent inflationary pressures, and interest rate hikes. Increased uncertainty and changes in expectations of macroeconomic development affected forecasts for some economies in the Group. Material decreases in growth projections for Slovenia and Serbia for 2023 were noticed. Hence, an executive decision was taken to adjust risk expectations using the scenario's weight. The scenario probability weighting was changed to 0%-10%-90% where severe and baseline scenarios reflect the likelihood of relevant future economic conditions for them. The likelihood of occurrence for the pessimistic scenario was derived to 90%, whereby the baseline scenario received a weight of 10%. Minor changes were also applied in other countries based on the latest available forecast. A comprehensive review and updating of the scenario perspective should be undertaken and completed prior to the conclusion of the forthcoming quarter.

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. Both 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 might be used by the Group are determined by various internal policies and applied when necessary. Moreover, the selection and application of mitigation measures follows 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.

NLB 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 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

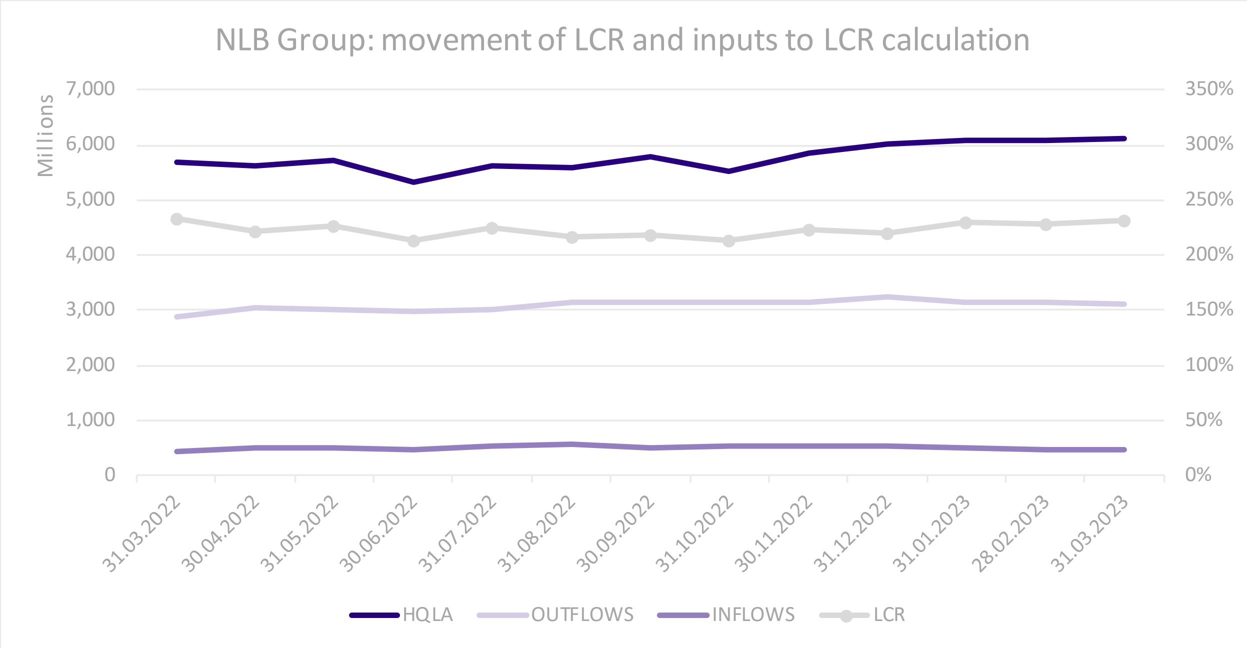
(Article 451a (2) of CRR)

Liquidity coverage ratio

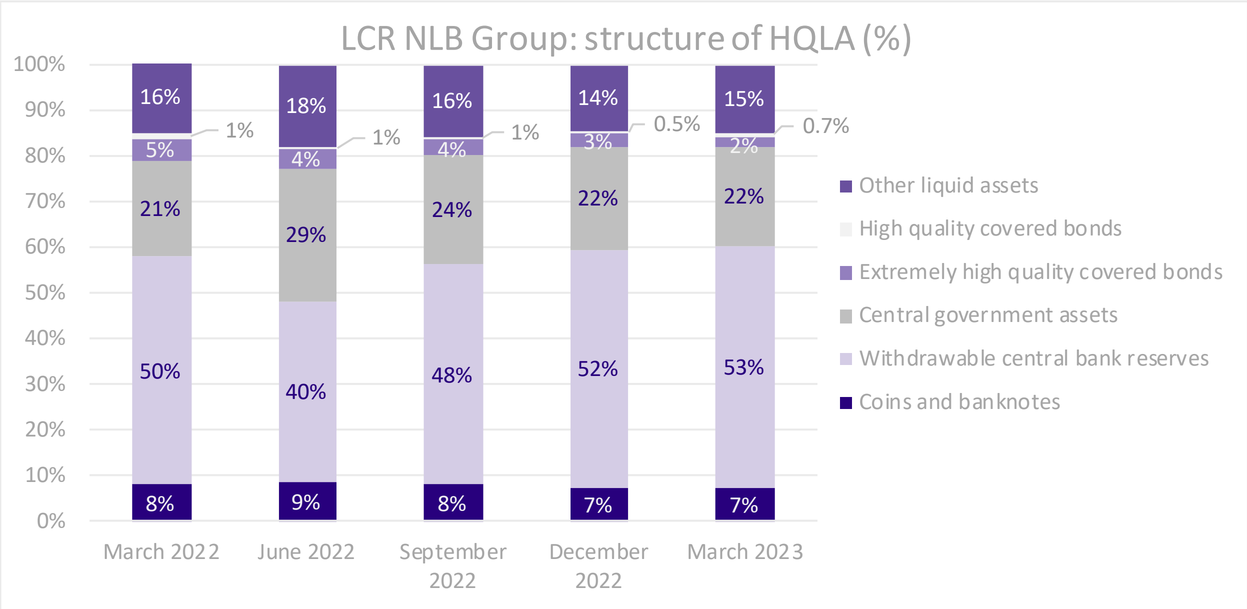
NLB Group holds a very strong liquidity position at the Group (and individual subsidiary bank) level, which is well above the risk appetite. In the last twelve months (31 March 2022 – 31 March 2023), the LCR of NLB Group ranged between 213% and 233% (231.3% as at 31 March 2023). The surplus of HQLA is at a very high level in NLB Group, ranging between EUR 2.83 billion and EUR 3.48 billion in the last twelve months (EUR 3.48 billion as at 31 March 2023).

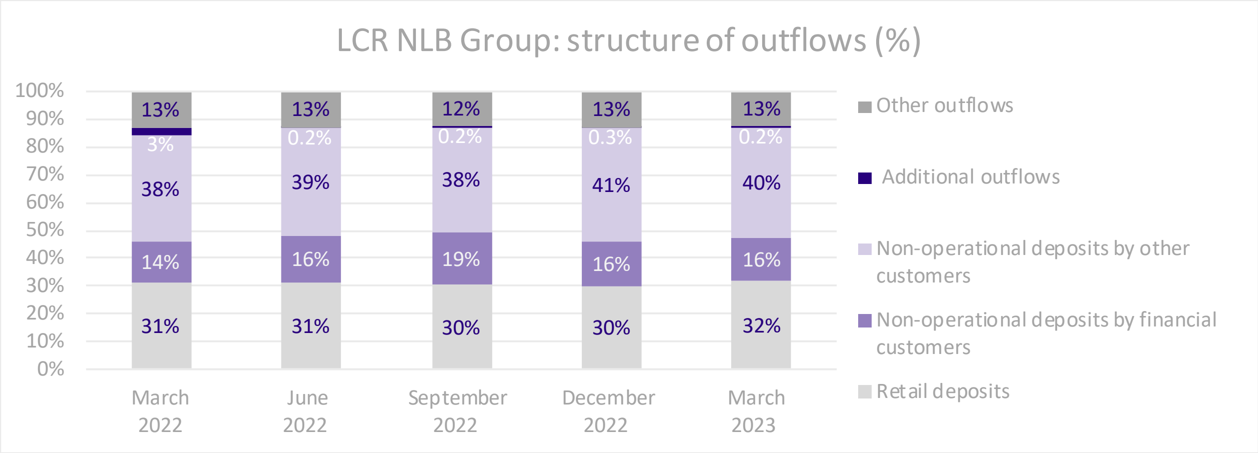
Slightly up warded trend is seen in the Q1 2023. LCR of NLB Group increased in Q1 2023 due to higher amount of HQLA (mostly central bank reserves) and generally due to lower amount of net liquidity outflow. Net outflows were lower due to decrease of corporate deposits.

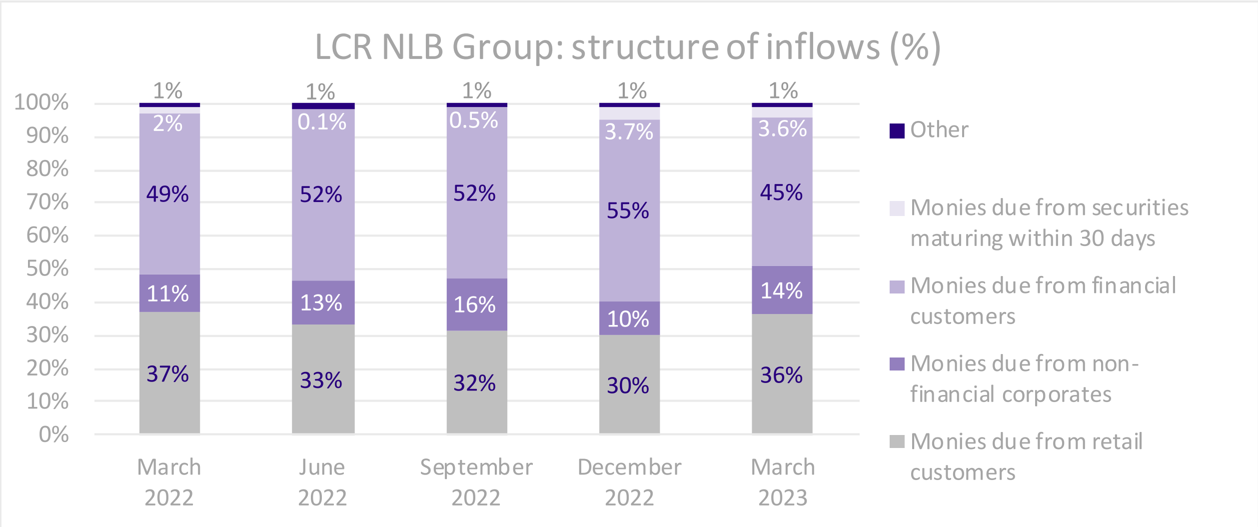
One of the specific rules for calculating consolidated LCR on NLB Group level is that, from each subsidiary (banking member) only HQLA in the amount of its net liquidity outflows in specific currency is included in the calculation of consolidated LCR.



The 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 NLB 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, NLB Group regularly performs stress tests and makes liquidity projections under different scenarios. With this approach, NLB Group is able to detect any potential liquidity and funding needs early.

In accordance with the business model, the primary source of funding of NLB Group represent customer (non-banking sector) deposits. NLB 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. NLB Group takes into consideration concentration of funding to have well diversified sources of funding and to prevent unwanted effects of concentration. For customer deposits as main funding sources of NLB 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 NLB 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 NLB Group level, at the end of March 2023, the top 30 counterparties provided 3.6% of the total liabilities, mostly in retail, while the top 30 counterparties in NLB provided 3.9% 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 (NLB, NLB 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
NLB 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, NLB 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). NLB is calculating 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
NLB actively manages liquidity risk exposures and funding needs within and across legal entities, business lines, and currencies, considering legal, regulatory, and operational limitation 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 NLB Group, there are no currency mismatches in the LCR. The LCR indicator is fulfilled in all currencies because NLB Group has enough liquidity reserves in all currencies where the outflows might happen. The most significant currency of NLB Group is euro currency. Additionally, the Group reports LCR in a second significant currency, which is in Serbian dinar (RSD). As at 31 March 2023, the aggregate liabilities in RSD represented 5.77% of 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
NLB 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.

Liquidity of the Bank is strong, and the volume of unencumbered liquidity reserves is at a high level. The Global Risk view is that 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 (April–June, July–September, October–December and January–March). 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**	**31.03.2023**	**31.12.2022**	**30.09.2022**	**30.06.2022**	**31.03.2023**	**31.12.2022**	**30.09.2022**	**30.06.2022**
		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)					5,775	5,647	5,527	5,445
Cash-outflows									
2	Retail deposits and deposits from small business customers, of which:	15,619	15,360	15,066	14,773	954	931	906	882
3	*Stable deposits*	11,640	11,464	11,241	11,006	582	573	562	550
4	*Less stable deposits*	3,182	3,062	2,945	2,837	372	357	344	332
5	Unsecured wholesale funding	3,557	3,393	3,162	2,943	1,718	1,645	1,539	1,422
7	*Non-operational deposits (all counterparties)*	3,556	3,392	3,161	2,942	1,717	1,644	1,538	1,421
8	*Unsecured debt*	1	1	1	1	1	1	1	1
10	Additional requirements	2,259	2,175	2,088	2,055	206	215	227	249
11	*Outflows related to derivative exposures and other collateral requirements*	19	37	58	86	19	37	58	86
13	*Credit and liquidity facilities*	2,240	2,138	2,030	1,970	186	178	169	163
14	Other contractual funding obligations	244	248	235	223	135	135	119	108
15	Other contingent funding obligations	1,499	1,451	1,381	1,301	86	84	80	76
16	**TOTAL CASH OUTFLOWS**					**3,099**	**3,009**	**2,871**	**2,737**
Cash-inflows									
18	Inflows from fully performing exposures	737	745	744	754	486	500	510	533
19	Other cash inflows	15	12	12	13	15	12	12	13
20	**TOTAL CASH INFLOWS**	**752**	**757**	**755**	**767**	**501**	**513**	**521**	**546**
EU-20c	***Inflows subject to 75% cap***	**752**	**757**	**755**	**767**	**501**	**513**	**521**	**546**
						TOTAL ADJUSTED VALUE			
21	**LIQUIDITY BUFFER**					**5,775**	**5,647**	**5,527**	**5,445**
22	**TOTAL NET CASH OUTFLOWS**					**2,598**	**2,496**	**2,350**	**2,192**
23	**LIQUIDITY COVERAGE RATIO**					**222.21%**	**227.15%**	**236.85%**	**250.65%**

6. Appendices

6.1. Appendix 1

List of all disclosures required under Part 8 of CRR

Article	Chapter	Page
438 d)	4.2	9
h)	/	/
447	1	3
451a (2)	5	13

6.2. Appendix 2

Abbreviations

ALCO	Asset and Liability Committee
AT1	Additional Tier 1 capital
AVA	Additional Valuation Adjustments
BoS	Bank of Slovenia
CBR	Central bank
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
EBA	European Banking Authority
ECL	Expected Credit Losses
EMIR	European Market Infrastructure Regulation
EU	European Union
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
LEI	Legal Entity Identifier
MDA	Maximum Distributable Amount
NPL	Non Performing Loans
NSFR	Net Stable Funding Ratio
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
TDI	Traded Debt Instruments
TREA	Total risk exposure amount
TSCR	Total SREP capital requirement
TT	Temporary treatment