

Statement of Management of Risk

NLB d.d.'s Management Board and Supervisory Board provide herewith a concise statement of the risk management according to Article 17 of the Regulation on Internal Governance Arrangements, the Management body and the Internal Capital Adequacy Assessment Process for Banks and Savings banks (Official Gazette of the RS, no. 73/2015, 49/2016 68/17, 33/18 and 81/18) and Regulation (EU) 575/2013 (date of publication 21 December 2015), article 435 (Risk management objectives and policies), point (e) and (f), as well as EBA Guidelines in on Disclosure requirements (EBA GL/2016/11).

Risk management in NLB Group is implemented in accordance with the established internal policies and procedures which take into account the European banking regulations, the regulations adopted by the Bank of Slovenia, the current EBA guidelines and the relevant good banking practices. EU regulations are followed by all Group members, where the Group subsidiaries operating outside Slovenia are also compliant with the rules set by the local regulators. NLB Group gives high importance to the risk culture and awareness of all relevant risks within the entire Group. Business and operating environment, relevant for the Group's operations, is changing with trends such as changing customer behaviour, emerging new technologies and competitors, increasing new regulatory requirements. Consequently risk management is continuously adapting with aim to detect and manage new potential emerging risks.

Risk management function, acting as second line of defence, represents an important part of overall management and governance system in the Group. NLB Group Risk Management framework is defined and organized with regard to the Group's business and risk profile, based on forward looking perspective to meet internal objectives and all external requirements. Proactive Risk

management and control system is based on Risk appetite and Risk strategy, which are consistent with the Group's Business strategy, and focused on early risk identification and efficient risk management. Set governance and different risk management tools enable adequate oversight of the Group's risk profile, proactively support its business operations and its management by incorporating escalation procedures and using different mitigation measures when necessary. Nevertheless, the Group is constantly enhancing and complementing the existing methods and processes in all risk management segments.

NLB Group plans prudent risk profile, optimal capital usage and profitable operations on the long run, considering the risks assumed. The Business strategy, the Risk appetite, the Risk strategy and the key internal risk policies of NLB Group, approved by the Management Board and the Supervisory Board of NLB d.d., specify the strategic objectives and guidelines concerning risk assumption, the approaches and methodologies of monitoring, measuring, mitigating and managing all types of risk at different relevant levels. Moreover, main strategic risk guidelines are integrated into annual business plan review and budgeting process. NLB Group is regularly monitoring its target Risk appetite profile, representing the key component of risk mitigation process. Risk profile enables detailed monitoring and proactive management. Risk limits usage and potential deviations from limits or target values are regularly reported to the respective committees and/or the Management Board of the Bank, the Risk Committee of the Supervisory Board, and the Supervisory Board of the Bank.

Additionally NLB Group established comprehensive stress testing framework and other early warning systems in different risk areas, with the intention to contribute to setting and pursuing Group's business strategy, support decision making on on-going basis,

strengthen the existing internal controls and timely responding when necessary. Stress testing framework includes all material types of risk and different relevant stress scenarios or sensitivity analysis, according to the vulnerability of the Group's business model. Stress testing has an important role when assessing the Group's resilience to stressed circumstances, namely from profitability, capital adequacy and liquidity forward looking perspective. As such it is embedded into Group's Risk management system, namely Risk appetite, ICAAP, ILAAP and Recovery plan, as an important component of sound risk management. Beside internal stress testing NLB Group as a systemically important bank also participates in the regulatory stress test exercises carried out by ECB.

NLB Group is the largest Slovenian banking and financial group with important presence in the SEE region. In accordance with its strategic orientations intends to be a sustainably profitable, predominantly working with clients on its core markets, providing innovative but simple customer-oriented solutions. NLB Group has a well-diversified business model. Based on the Group's business strategy credit risk is the dominant risk category, followed by operational risk, interest rate risk in banking book, liquidity risk, market risk and other non-financial risks. Regular risk identification and their assessment is performed within ICAAP process with aim to assure their overall control and effective risk management. Moreover, in 2018 ICAAP process was substantially upgraded in accordance with newly published ECB Guidelines, including its stronger integration into overall risk management system in order to assure proactive support for informed decision making.

Managing risks and capital efficiently at all levels is crucial for NLB Group sustained long-term profitable operations. Management of credit risk, representing the Group's most important risk, focuses on the taking of

moderate risks – diversified credit portfolio, adequate credit portfolio quality, sustainable cost of risk and ensuring an optimal return considering the risks assumed. The liquidity risk tolerance is low. The NLB Group must maintain an appropriate level of liquidity at all times to meet its short-term liabilities, even if a specific stress scenario is realised. Further, with the aim of minimising this risk, the Group pursues an appropriate structure of sources of financing. When assuming operational risk, the NLB Group pursues the orientation that such risk must not significantly impact its operations. Risk appetite for operational risks is low to moderate, with focus on mitigation actions for important risks and key risk indicators servicing as an early warning system. The NLB Group’s basic orientation in the management of interest rate risk is to limit unexpected negative effects on revenues and capital that would arise from changed market interest rates and, therefore, a moderate tolerance for this risk is stated. The conclusion of transactions in derivative financial instruments at NLB d.d. is primarily limited to servicing customers and hedging Bank’s own positions. In the area of currency risk, the NLB Group thus pursues the goals of low to moderate exposure. The tolerance for all other risk types, including non-financial risks, is low with a focus on minimising their possible impacts on the Group’s operations.

The main NLB Group Risk Appetite objectives are following:

- preservation of a prudent level of capital adequacy, considering also regulatory requirements and relevant capital buffers, and maintaining of low financial leverage
- maintaining a solid level and structure of liquidity where stable customers’ deposits are representing the main funding base
- adequate quality and diversification of the credit portfolio, sufficient coverage of non-performing loans and sustainable cost of risk across the economic cycle
- diversification of risk in exposures to banks and sovereigns
- sustainable tolerance to net losses from operational risk
- limited exposure to interest rate risk in banking book and to foreign exchange risk
- sustainable profitability in terms of risk-return
- sustainable size of subsidiary banks.

Values of the most important risk appetite indicators of NLB Group as at the end of 2018, reflecting interconnection between strategic business orientations, risk strategy and targeted risk appetite profile, were following:

- CAR 16.7%

- Cost of risk -43 bps
- The share of non-performing exposure by EBA (NPE) 4.7 %
- LTD 68.3 %
- LCR 361 %
- Net stable funding ratio (NSFR) 158.7 %
- Net losses from operational risk 5.7% of capital requirement for operational risk
- BPV sensitivity (of 200 bps) 7.0 % of capital

Consequently NLB Group concluded the year 2018 as self-funded, with strong liquidity and capital position, demonstrating the Group’s financial resilience.

During 2018 no transactions of sufficiently material nature to impact on NLB Group’s risk profile or distribution of risks on the NLB Group were carried out.

Condensed Statement of the management of risk is also published on the NLB intranet with the aim of strict adherence of the banks’ employees at daily operations of the Bank, as regards the definition and importance of a consistent tendency of the adopted risks, and ways to take into account when adopting its daily business decisions.

Ljubljana, 12 April 2019

The Supervisory Board



Primož Karpe
Chairman of the Supervisory Board

The Management Board



László Pelle
Member of the Management Board



Archibald Kremser
Member of the Management Board



Andreas Burkhardt
Member of the Management Board



Blaž Brodnjak
President & CEO