

Internal Audit Report for 2024

1. THE PURPOSE OF PREPARING THE REPORT

According to Article 281a. of the Companies Act, Article 164 of the Banking Act, and Article 10 of the Internal Audit Charter of NLB d.d., the Internal Audit is required to prepare the Internal Audit Annual Report and submit it to the Management Board, the Audit Committee, the Supervisory Board and the auditor of the financial statements. The Management Board of NLB d.d. must then inform the General Meeting of Shareholders about the report and the Supervisory Board's opinion thereon.

The Annual Report provides the Management Board, the Supervisory Board, the Audit Committee, the General Meeting of Shareholders, and the auditor of the financial statements with information on:

- the statement of objectivity and independence.
- the implementation of the Annual Action Plan.
- the major findings of the audits of operations carried out.
- the assessment of compliance of remuneration practices with the remuneration policy.
- the implementation of the Quality Improvement and Assurance Programme.

The report contains all the information specified in Article 164 of the Banking Act.

2. STATEMENT OF OBJECTIVITY AND INDEPENDENCE

In terms of ensuring independence and objectivity, avoiding conflicts of interest, and reporting on the occurrence of any circumstances that could compromise their independence and objectivity, the duties of the Chief Audit Executive of the Internal Audit and internal auditors in NLB d.d. are defined in the Internal Audit Charter of NLB d.d.

The independence of the Internal Audit department has been clearly established. As a management support service within the organizational structure, it operates functionally separate from other parts of the Bank and reports directly to the Management Board, the Supervisory Board, and the Audit Committee.

In setting objectives, defining the areas and scope of internal auditing, and carrying out performance and reporting, the Internal Audit is independent. Those carrying out internal auditing tasks do not engage in any other responsibilities within the Bank that could lead to conflicts of interest and compromise their objectivity.

The Chief Audit Executive and internal auditors perform their work objectively and without bias. Potential threats to independence and objectivity are managed at the level of individual auditor, engagement, and functional and organizational responsibility. If independence and objectivity are compromised, the Chief Audit Executive of the Internal Audit must promptly disclose such information to the Management Board, the Supervisory Board, and the Audit Committee.

In accordance with the Global Internal Audit Standards, the Code of Ethics of the Institute of Internal Auditors of Slovenia and the Internal Audit Charter of NLB d.d., the Chief Audit Executive of the Internal Audit states that both the Chief Audit Executive of the Internal Audit and the internal auditors of NLB operated independently in 2024, and that no circumstances arose in the course of their activities that could compromise their objectivity. To this end, the Chief Audit Executive and all internal auditors have signed a statement confirming their independence and objectivity for 2024.

3. IMPLEMENTATION OF THE ANNUAL ACTION PLAN

The Internal Audit performs its tasks and responsibilities at its discretion and in compliance with the Annual Internal Audit Plan approved by the Management Board and the Supervisory Board. Based on its internal methodology and comprehensive risk assessment for 2024, the Internal Audit planned 95 audits. By 31 December 2024, 84 audits had been completed, covering various areas of operations within the Bank and the Group. These included 27 branch inspections, 8 Group Audits, 1 Joint Audit conducted with a local auditor, 3 quality reviews of Internal Audit functions in banking subsidiaries, and 2 newly initiated audits.

In addition, the Internal Audit participated in several strategic projects as an advisor and observed the integration process. Five planned audits were postponed for valid reasons, and one audit was removed from the plan as it was addressed by another audit. Most recommendations issued in 2024 were implemented within the agreed-upon deadlines.

4. MAJOR AUDIT FINDINGS – 2024

All findings and recommendations issued by the Internal Audit have been addressed, with the responsible areas preparing action plans to mitigate the associated risks.

Risk management

Risk management is faced with extensive regulatory reporting requirements, frequent changes of the regulatory framework, and consequently, challenges related to data availability and quality.

In climate and environmental risk management, improvements have been made with upgraded policies and methodologies. Ongoing activities related to Net-Zero Banking Alliance (NZBA) portfolio decarbonization targets are progressing in cooperation with an external provider. Additionally, a Group Chief Environment and Social Management System (ESMS) Officer Coordinator has been appointed, playing a key role in the green loan origination process. The green loan portfolio is monitored through regular reports to the Sustainability Committee. To assure comprehensive green portfolio data reporting, a working group has been established, and data issues are promptly identified.

Significant efforts have been made to implement the Basel III requirements for Risk-Weighted Asset (RWA) calculation. This includes ensuring additional data collection at the Group level and implementing a calculation engine.

Interest rate risk management has undergone several changes following the recommendations from the inspection conducted by the Joint Supervisory Team of the European Central Bank (JST of ECB). NLB is committed to implementing the proposed changes within the set deadlines. Improvements in monitoring and reporting activities within the risk management framework will also be accomplished through the deployment of a new IT application, which is scheduled for implementation in 2025.

The Internal Capital Adequacy Assessment Process (ICAAP) is adequately established and managed, with ongoing upgrades. ICAAP stress testing should be further improved to align with supervisory expectations.

The Bank regularly monitors its current and forward-looking capital positions, which are reviewed by various corporate bodies.

The process of setting up and monitoring the Risk Appetite Framework (RAF) is well established. The Risk Appetite Statement should be supplemented to separately include additional risks faced by the Bank, such as FX lending, cloud computing, outsourcing, and IT risks.

Lending process

The lending process has been continuously upgraded and optimized. Key controls in the process and segregation of duties are established and functioning well. Nevertheless, several applications are being used in the corporate lending process, and manual data processing remains extensive. Furthermore, various instructions and required credit documents add complexity to the process.

The cross-border lending portfolio is steadily growing within the Risk Appetite limit. The portfolio, along with all relevant risk parameters and limits, is regularly monitored. Generally, credit risk plays a professional and independent role in the underwriting process. Any identified shortcomings in process and documentation completeness have been resolved.

In the area of “Green Financing”, the process of green portfolio management is complex. The documentary framework has been established, and loans have been properly classified. Prior to the public announcement, Sustainalytics validated the collected green portfolio data, and no anomalies were detected. The Environmental, Social and Governance (ESG) tool for collecting comprehensive data is expected to be further refined. Additionally, the green loan origination process is expected to be further improved with the integration of additional controls on classification, impact calculation, and green portfolio reporting.

Contact Centre 24/7 is increasingly important for retail loan origination, with rising sales and a positive customer experience. Credit Risk Retail has established monitoring on approval documentation quality, and workshop and training sessions were held to enhance knowledge and expertise. Improvements are expected in completeness of audio and video recordings for transaction approvals. In the retail segment, processes are subject to continuous improvement, with NLB placing an emphasis on streamlining the processes through automation in line with the digital transformation strategy. As a result, an upgraded credit card facility approval process was introduced in 2024.

Non-Performing Loan (NPL) management

Effective early collection is a key factor in preventing the increase of NPL volumes. NLB has invested in robotic process automation, resulting in improvements in the process due to upgraded application support for telephone collection. Further improvements are currently being implemented to improve the archiving process related to early collection and efficiency measurement.

In terms of corporate restructuring, comprehensive management monitoring of forbearance measures at both individual and portfolio level is performed, with covenants monitoring and independent verification in place. Additionally, further methodology enhancements and improvement of viability calculation are underway.

IT risk management & cybersecurity

A new IT risk management governance framework compliant with the Digital Operational Resilience Act (DORA) had been introduced. It should be adopted group-wide and has yet to prove effectiveness and efficiency. Special attention should be devoted to automating Identity and Access Management, IT development, and change management processes, as well as strengthening cloud solution control. Digital resilience should be upgraded through regular testing of the complete restoration of critical systems

Third-party risk management

A sound outsourcing process was established during the past years. However, the new DORA requires additional elements to be implemented in the internal control system and advanced third-risk management. The register of third-party providers needs to be extended with additional outsourcing and ICT service providers and all necessary data need to be collected to be able to manage third-party risk efficiently and in line with DORA requirements.

Cash management in branches, safe deposit boxes, and the central vault

As part of the Internal Audit plan for 2024, 27 branches were visited to assess their compliance with cash-handling instructions. The Internal Audit noted a need to increase awareness among colleagues regarding the adherence to internal procedures. The distribution network management has already initiated several remedial actions, including the frequency of managerial controls, providing more focused and tailored education to branch employees, and implementing cash-handling-specific Key Performance Indicators (KPIs) within the branch network.

The management and key controls related to safe deposit boxes provided by NLB to clients are sound, with no security shortcomings identified.

Central vaults operate according to the highest industrial standards. Cash-handling procedures and security measures are at a satisfactory level, and cash transportation is secure and well organized.

The Internal Audit also reviewed the operations of the Mobile Branch, which delivers services in different locations across Slovenia. The processes and functioning of the mobile branch are adequate, reliable, and in accordance with the predefined schedule. Additionally, security standards are well managed.

Commercial banking

Private banking has been continuously strengthening the internal control environment in recent years., including the segregation of duties, roles, responsibilities, and preparation of client reports Remedial actions were taken to further improve client-related procedures.

The number of Loro and Nostro accounts has been rationalized in recent years. The process is generally adequately managed.

The customer data management process requires further enhancements by implementing system-enforced application controls to reduce the manual workload. Subsequent controls over inputted data are conducted by the back office, with timely correction of data by account managers.

KC 24/7, NLB's call centre, provides banking services to clients 24 hours a day, every day of the year. The foundations for delivering appropriate services via remote channel have been established, and internal control points are in place. However, in accordance with the digital transformation strategy and with the goal of providing an enhanced level of remote service to customers, further improvements are needed. These include making the internal archiving process more efficient and enhancing the internal control environment of customer relationship-related transactional processes performed by KC 24/7.

NLB is dedicated to the ongoing improvement of its mobile banking applications both for retail and corporate clients. Significant efforts have been invested in implementing automated controls in the onboarding procedures in KlikPro, providing sufficient information about security measures to clients upon activation of mobile banking.

The review of the NLB Pay application confirmed that adequate procedures are in place. NLB has also conducted several activities to increase clients' internet security literacy and awareness level. The development of the application, in terms of usability and security, is progressing quickly.

The processes related to business account management are robust, with only minor deficiencies identified that aim at further improving some application controls and internal documentary processes.

NLB Group ensures compliance with Anti-Money Laundering (AML) requirements and international restrictive measures. This continuous effort led to the implementation of additional controls, Group-wide standardization, and automation of client reviews, restrictive measures, transaction monitoring, managing unresponsive clients, and reporting the status of client reviews.

NLB d.d. has already recognized the importance of preventive fraud management and the necessity for a coordinated approach and information-sharing across the Group in various areas such as payments, cards, and information security. Consequently, a reorganization and team expansions were undertaken in 2024. NLB is taking steps towards standardizing card handling processes within the NLB Group.

Cross-border payments in the Bank are well-organized and managed efficiently, with execution being highly automated, resulting in high levels of straight-through processing. Automatic control procedures in payment applications are established, and if a payment is stopped for specific reasons, appropriate manual controls are in place.

Single Resolution Board (SRB)

The Bank adheres to SRB guidelines when preparing documents required for resolution. However, there is a need to enhance internal controls in the area of data quality during the preparation of relevant reports.

Corporate Governance

Based on the adopted strategy for the period 2025–2030, NLB has defined new strategic projects. To ensure effective management of these projects and initiatives, a new methodology has been adopted, and the selection of a new IT solution to manage the projects is currently in progress. Regular quarterly monitoring of project progress and reporting to Corporate Bodies have been established.

The Group Governance Policy and instructions for coordinating the operation of individual business areas at the NLB Group level had been revised. A target organizational structure for the banks within the NLB Group was also adopted in 2024. The Bank has defined the architecture of business processes with designated owners and adopted a methodological approach. The renewal of business processes is underway.

NLB is well recognized for its ESG efforts among financial institutions and regional companies. ESG aspects have been embedded in several processes; notably, sustainability is also a criterion in the area of donations and sponsorships.

Additionally, NLB has established an organizational unit dedicated to coordinating mergers and acquisitions (M&A). A structured approach is applied, taking strategic objectives into consideration. The Management Board, Supervisory Board, and investors are regularly updated on the latest developments in all ongoing M&A projects.

Fraud Management

NLB Group's commitment to zero tolerance for harmful conduct is outlined in the Code of Conduct and the Compliance and Integrity Policy. Currently, fraud management spans across multiple organizational units within NLB d.d., but a centralized and coordinated approach will soon be implemented to manage and prevent fraud. Different fraud taxonomies are reflected in the quality of reporting data in accordance with the European Sustainability Reporting Standards (ESRS).

Human Resource (HR) management

In 2024, NLB focused on identifying successors and talents to ensure effective leadership continuity and key employee retention from internal sources. HR developed a new HR Strategy for NLB Group, outlining strategic goals for managing employees at the Group level. Despite HR efforts in recruitment and continuous update of the recruitment process, filling specific positions remains challenging due to the labour market conditions.

The Bank has a well-established process to provide training and education to employees. A wide range of high-quality and diverse training and educational programmes are available, enabling employees to easily achieve the goal of 5.5 training days per year.

Internal communication

The Bank has established an effective internal communication system that ensures timely, high-quality information, fostering trust and efficiency among employees.

Financial services

Several improvements and novelties were noted in the securities portfolio within the banking book during the internal audit. The established Asset and Liability Committee (ALCO) sub-committee enhanced governance processes and risk management practices. There was an upgrade to the Early Warning Signal (EWS) system, which now includes daily monitoring and mitigation of credit (spread) risk exposures from the bond portfolio. Additionally, Power BI reports were created for monitoring related EWS limits. Furthermore, new characteristics associated with ESG investing were defined and pursued in the portfolio.

The update of the Model Inventory with the internal model, which currently determines Funds Transfer Pricing (FTP) values, is being conducted in accordance with the applicable NLB Model Governance Policy.

Alternative investment funds have gained importance in recent years due to their diverse range of assets, necessitating specialized controls for the depositary. Internal controls are generally well-established and are being performed regularly. The framework for the custodian bank is appropriately established through various internal acts.

The audit of the securities issuance process for NLB d.d. revealed that the specifics of each issuance are continuously tested in the main application, with parallel manual calculations performed to verify the accuracy of the system's calculations. Despite the process involving numerous manual activities, risk management and the operation of related internal controls are deemed appropriate.

The European Market Infrastructure Regulation (EMIR) Refit (Regulatory Fitness and Performance Programme) updates the existing EMIR by introducing new requirements and standards for reporting, registration, and access to data on derivatives. The recent changes have increased the number of reportable fields and modified the format and content of existing fields. NLB d.d. has met the deadlines required for implementing these changes in reporting. Internal controls are generally in place. Further efforts towards automation of the reporting are still in progress.

Procurement process

The Bank selected a new procurement tool with the aim of harmonizing procurement procedures across NLB Group. In recent years, procurement has strengthened the internal control environment and improved the internal documentation of the procurement process.

5. ASSESSMENT OF COMPLIANCE OF REMUNERATION PRACTICES WITH THE REMUNERATION POLICY

The regulator continuously makes additional inquiries and monitors the Bank's compliance with the EBA directive and guidelines. The Bank has received an SREP letter concerning remuneration, with recommendations to be implemented by the end of 2025. The Internal Audit ensures that remuneration for 2023 is disbursed in accordance with the Remuneration Policy.

6. IMPLEMENTATION OF THE QUALITY ASSURANCE AND IMPROVEMENT PROGRAMME

The Internal Audit has implemented the Quality Assurance and Improvement Programme to ensure compliance with the Global Internal Audit Standards and ethical rules of internal auditing, while continually improving the operational efficiency and effectiveness. This programme was implemented through various methods, as described below, starting in 2024.

a. Internal quality review

- Permanent supervision by the Chief Audit Executive over the work of internal auditors
- Continuous professional supervision and direction of the work of internal auditors by expert managers

- Weekly monitoring of the progress of individual engagements to improve work efficiency;
- Regular monitoring of the time spent by internal auditors on different activities (assignments, trainings, administration, etc)
- Semi-annual and annual assessment of the objectives attained by the internal auditors and Internal Audit as a whole
- Measuring the satisfaction of the management of the audited units with the work of the Internal Audit
- Performed internal quality review of the internal audit files.

b. Education and training

Thirteen out of 39 internal auditors hold various professional licences awarded by Slovenian (SIR) and international internal audit institutions (CIA). This includes seven auditors with an international licence in the field of Information Systems Auditor (CISA) and/or Information Security Auditor licence, and one with the ESG Certificate of the IIA.

Internal auditors spent a significant amount of time on professional training and upskilling through various training courses organized by the Slovenian Institute of Auditors (SIR), the International Institute of Auditors (IIA), International Institute of Auditors of Hungary, the ISACA (Information Systems Audit and Control Association), the Bank Association of Slovenia (BAS), and other relevant institutions. They improved their knowledge in areas such as: information systems and information security management, information and personal data protection, updates in banking regulations with an emphasis on risk management, ESG, international accounting standards, fraud prevention, abuse and money laundering, corporate governance, new Global Internal Audit Standards including specific requirements, and more. Additionally, they were familiarized with international auditing trends and improved their communication and presentation skills.

c. Implementation of recommendations from the external quality review

The latest external assessment of the quality of work of NLB's Internal Audit was conducted in 2022. The external provider confirmed overall compliance with all International Standards of Professional Practice of Internal Auditing.

d. Supervision over the work of the internal audit departments of the NLB Group members

In 2024, the following activities were conducted:

- Three internal quality reviews of internal audit functions in subsidiaries.
- Monthly competence line meetings with Heads of Internal Audit departments in subsidiaries.
- A competence line meeting was held in Bosnia and Herzegovina with the Heads of Internal Audits in subsidiaries.
- Training sessions provided for internal auditors of the Group, including examples of practical audits, the process of Group audits, and implementation of the Internal Audit IT tool (Audimex).
- Regular professional assistance to internal auditors of subsidiaries in performing audits.
- Group and joint audits according to the Group Internal Audit Plan.
- Monitoring of reports prepared by the internal auditors in subsidiaries for their management and supervisory bodies, including annual action plans, quarterly and annual reports on activities, and the implementation of audit recommendations.
- Coordination of IT internal audit activities.
- Monthly meeting for IT auditors.
- Alignment of the Internal Audit Manual and the Internal Audit Charter of NLB d.d. with the Global Internal Audit Standards, which came into force on 9 January 2025, and their implementation throughout the NLB Group.

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