CEE LEGAL MATTERS COMPARATIVE LEGAL GUIDE: BANKING/FINANCE 2023

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FOREWORD

By Igor Odobescu, Managing Partner, ACI Partners

In an era marked by rapid globalization, increasing cross-border transactions, ever-evolving regulatory frameworks, and unprecedented technological advancements, understanding the intricacies of banking and finance law is crucial to navigating the complex challenges and opportunities across specific jurisdictions and the CEE region.

The banking and finance sector, in the past years, has witnessed remarkable growth, driven by robust economic development, foreign investment, innovative business models, and the emergence of new technologies. As technology reshapes the industry and financial services become increasingly digitalized, it is crucial to stay abreast of the legal challenges and opportunities that accompany these transformative changes. This guide serves as a compass, providing in-depth analysis and insights into the regulatory frameworks governing the banking and finance sector in specific jurisdictions, with a particular focus on the dynamic interplay between local regulations, regional harmonization efforts, and global best practices.

One of the distinctive features of this guide is its comparative approach, offering readers the opportunity to explore the similarities, differences, and best practices across jurisdictions. By examining the legal frameworks and regulatory environments side by side, it equips legal professionals with a wide-ranging understanding of the legal complexities, facilitating cross-border transactions and fostering effective legal advice for clients operating in multiple jurisdictions.

Moreover, this guide recognizes that the growth and digitalization of the banking sector extend beyond the boundaries of traditional banking institutions. The rise of fintech startups, digital banking, alternative lending platforms, blockchain, and cryptocurrency and decentralized finance have disrupted the status quo, presenting both opportunities and challenges for legal practitioners. By shedding light on these emerging sectors and their unique legal considerations, it enables readers to stay ahead of the curve, embracing the potential of technological innovation while ensuring compliance with evolving regulatory frameworks.

As we delve into the depths of banking and finance law, it is crucial to acknowledge that the future of the industry lies in embracing digital transformation. This guide serves as a compass, guiding legal professionals toward a comprehensive understanding of the legal implications of this transformation. It explores the legal challenges posed by artificial intelligence, data analytics, cryptocurrencies, regulatory sandboxes, and other cutting-edge technologies that have become integral to the banking and finance landscape.

Together with CEE Legal Matters, we extend our warmest wishes to all readers as we embark on this enlightening journey through the world of banking and finance law in the age of digital transformation.

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If you like what you read in these pages (or even if you don't) we really do want to hear from you. Please send any comments, criticisms, questions, or ideas to us at:
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I. LEGAL FRAMEWORK

1.1. Which main legislative and regulatory provisions govern the banking sector in your jurisdiction?

The banking sector in Albania is governed by a comprehensive legislative package that includes both laws and regulations issued by the Bank of Albania (Regulatory Authority), the most important of which are listed below:

■ Law no. 8269, dated 23.12.1997 "On Bank of Albania", as amended;

■ Law no. 9662, dated 18.12.2006 "On banks in the Republic of Albania", as amended;

■ Law no. 133/2016 "On the recovery and resolution of banks in the Republic of Albania;

■ Law no. 133/2013 "On the payments system";

■ Law no. 55/2020 "On the payments services";

■ Regulation no. 14/2009 "On the licensing and performance of the activity by banks and branches of foreign banks in the Republic of Albania", as amended;

■ Regulation 59/2008 "On the transparency of the financial and banking services", as amended;

■ Regulation 67/2015 "On the internal audit system", as amended;

■ Regulation 69/2014 "On the regulatory capital of the banks", as amended;

1.2. Which bodies are responsible for enforcing the applicable laws and regulations? What are their main competencies? Please refer to the resolution authority as well.

The Bank of Albania is the regulatory body and as such is enforcing the applicable laws and regulations. Its main competencies are the following:

■ It issues licenses for banks, branches of foreign banks, and non-bank financial institutions exercising their activity in Albania.

■ It prepares and enacts the regulatory framework applicable to banks, branches of foreign banks, and non-bank financial institutions.

■ It approves and implements the monetary policy of the Republic of Albania.

■ It supervises and audits banks, branches of foreign banks, and non-bank financial institutions.

■ It acts as the resolution authority for banks licensed in Albania.

1.3. What are the current priorities of regulators and how does the regulator engage with the banking sector?

In the last year, the Bank of Albania has been focused on implementing the Payments Services Law (implementing PSD 2 in Albania) by issuing various Regulations.

The Bank of Albania's most used instrument is the decisions of its Supervisory Board approving Regulations that are mandatory for all banks and non-banks financial institutions. In addition to the Regulations, the Bank of Albania may also issue Instructions and Advance Rulings (individual ruling).

II. AUTHORISATION

2.1. What licenses are required to provide banking services in your jurisdiction? What activities do they cover?

Pursuant to the Law on Banks, banking services may be conducted only upon receipt of a license as a bank, which is issued by the Bank of Albania as the regulatory body. Only banks may conduct banking activity which is defined as "the receipt of monetary deposits or other repayable funds from the public, and their use to grant credits or placement for its own account." In addition to the above Banks in the Republic of Albania may provide the following financial services:

a. lending of all types including, inter alia, consumers credit, and mortgage;

b. factoring and financing of commercial transactions;

c. leasing;

d. all payments and money transferring services;

e. guarantees and commitments;

f. trading for own account or for the account of clients, whether on foreign exchange, in an over-the-counter market, or otherwise the following

(i) money market instruments (cheques, bills, certificates of deposits, etc.);

(ii) foreign exchange;

(iii) derivative products, including, but not limited to futures and options;

(iv) exchange rates and interest rate instruments including products such as swaps and forward agreements;

(v) transferable securities;

(vi) other negotiable instruments and financial assets including

bullion;

(vii) participation in issues of all kinds of securities including, underwriting and placement as an agent (whether publicly or privately) and provision of services related to such issues;

g. money broking:

(i) asset management such as cash or portfolio management, fund management, custodial, depository, and trust services;

(ii) settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments;

(iii) provision and transfer of financial information, financial data processing, and related software by providers of other financial services;

h. advisory, intermediation, and other auxiliary financial services of all activities listed in letters *(a)-(f)* above, including credit reference and analyses, investment and portfolio research and advice, advice on acquisitions, and on corporate restructuring and strategy.

i. issue and management of payment instruments, (such as credit, debit, and charge cards, travelers' cheques, banker's draft, and mobile phone payments), including the issue of electronic money.

2.2. What is the procedure for obtaining a banking license? How long does this typically take?

The procedure for obtaining a banking license is a two-stage procedure. In the first stage, the Bank of Albania issues its prior approval based on the documents submitted by the applicant such as documents on the identity of the shareholder(s), a detailed business plan, financial capabilities, etc. After receipt of the prior approval, the applicant should proceed with the incorporation of the entity, payment of the initial capital, recruitment of the staff, opening of the branches, etc. Once the above conditions are fulfilled, the Bank of Albania performs an inspection and only after it issues the final banking license.

2.3. Can a foreign bank operate in your jurisdiction on the basis of its domestic license?

No, passporting of the banking license is not allowed pursuant to the Albanian banking legislation.

2.4. What are the restrictions on ownership, including foreign ownership of banks?

There are no express restrictions on ownership of a bank, however, based on the documents to be submitted during the licensing process, it may be concluded that persons who have a criminal record, have caused the bankruptcy of another entity, or do not comply with the AML legislation cannot be a direct, or indirect shareholder of a bank in Albania.

2.5. What are the requirements for a proposed acquisition and acquirer of a qualified holding in a bank? Would the same requirements apply in the case of an increase of a qualifying holding?

In principle, the acquisition of a qualified holding in the bank (i.e., higher than 10%) is subject to the Bank of Albania's prior approval. The set of documents is very similar to the one submitted during the initial licensing process and the procedure may last up to six months.

The same requirements do apply in case of an increase of a qualifying holding above 20%, 33%, and 50%.

III. REGULATORY CAPITAL AND LIQUIDITY

3.1. How are banks typically funded in your jurisdiction?

Banks are generally funded through clients' deposits which means that financing from money markets is not broadly used. During the last few years, banks have started to raise capital also through the issuance of medium and long-term bonds which are privately offered to the investors (up to 100 investors) for the purposes of complying with the provisions of Bank of Albania Regulation no. 78/2020 "On the minimum requirements for regulatory capital instruments and eligible liabilities" (MREL) which was drafted in accordance with Directive 2019/879 (BRRD II) amending Directive 2014/59/EU and Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019. Further to this Regulation, the Bank of Albania has drafted yearly methodological documents, to determine the way of calculation of the MREL, based on the EU SRB (Single Resolution Board), with the target level for MREL, to be reached within the transitional period, as defined in the relevant regulatory framework. Following the methodology for setting MREL and the final target level to be met up until 2027, for each individual bank, Bank of Albania sets the target and intermediate MREL levels for each individual bank.

3.2. What capital and own funds requirements apply to banks in your jurisdiction?

Each bank must monitor the adequacy of its capital using, among other measures, the rules and ratios established by the Bank of Albania, which ultimately determines the statutory capital required to underpin its business. The regulations "On the capital adequacy ratio", the last amendment of which was made in December 2022, and "On the regulatory capital" are the main pieces of the regulatory framework that serves the purposes of calculating the capital.

The Capital Adequacy Ratio is the proportion of the regula-

tory capital to risk-weighted exposures, calculated as the sum of the risk-weighted exposure amounts, on- and off-balance sheet for credit risk and for credit counterparty risk, the capital requirement for market and operational risk. The extended capital requirement framework in Albania is generally based on international standards. This makes the risk assessment and the qualitative requirements for capital coverage for banks in the country, similar to banks operating outside Albania. Meanwhile, it may be seen that quantitative regulatory capital requirements in Albania are significantly higher than those defined by international standards. Just to mention, the minimum capital requirement in Albania is 12% versus the 8% ratio, defined by international standards; the leverage ratio in Albania is 5.75% from a 3% ratio by international standards.

The minimum Tier 1 Capital Ratio is 6% and the minimum Common Equity Tier 1 Ratio is 4. 5%.

3.3. Has your jurisdiction implemented the Basel III framework? Are there any major deviations?

In Albania, the capital adequacy framework is built upon the Basel Framework and the regulatory package of Directive 2013/36/EU of the European Parliament and of the Council (CRD IV). This framework serves as a standard set of rules for central banks, or supervisory authorities, in the process of building the internal regulatory framework. Adoption of the international standards on capital and liquidity of Basel III and their implementing acts (regulation and directive on capital requirements) are being adopted on a consistent basis and are expected to be finalized within 2024. Such regulatory interventions aim at strengthening the banking sector's resilience, to be in a rather good position for absorbing shocks. It also aims at urging banks to continue to finance economic activity and growth. In its capacity as the Resolution Authority, the Bank of Albania focuses continuously on strengthening the banking sector's capacity to implement the resolution, as well as regularly updating the methodology for defining the minimum requirement

Capital indicators of Albanian second-tier banks as compared to capital adequacy requirements set by Basel III indicate that the capital adequacy ratios of banking institutions in Albania are in compliance with Basel III requirements and even significantly above minimum requirements.

IV. REPORTING, ORGANISATIONAL REQUIREMENTS, INTERNAL GOVERNANCE, AND RISK MANAGEMENT

4.1. What key reporting and disclosure requirements apply to banks in your jurisdiction?

As a general principle, the Albanian authorities uphold the *International Financial Reporting Standards* (IFRS). The Albanian accounting Law requires public interest entities (PIEs) and their regulators operating in the field of credit and insurance to prepare their financial statements following IFRS. Nevertheless, the Bank of Albania has deferred the implementation of IFRS by banks for regulatory purposes and still requires prudential reporting from the banking sector. Banking legislation requires banks to prepare their financial statements in accordance with the Financial Reporting Manual (FRM), which was based on the 1998 IFRS. Banks that are subsidiaries of international banks prepare an additional set of financial statements based on IFRS for their shareholders and public use.

Banks in Albania report pursuant to *Regulation 45/2009 "On the reports at the Bank of Albania accordingly to the Unified Reporting System"*, which sets out the rules, conditions, and terms of reporting from banks and foreign banks branches, non-bank financial entities, the savings and credit associations and their unions, and the rules for the management of these reports at the Bank of Albania. In accordance with this Regulation, the reports from banks and branches of foreign banks are made on a monthly, quarterly, semi-annually, and yearly basis.

For commercial banks, the reporting forms consist of:

(i) Second Tier Bank Reporting Forms – SRU which contain all applicable financial and accounting reporting standards;

(ii) the Consolidated Supervision Forms that include the consolidated balance sheets, profit and loss accounts, regulatory capital, currency positions, capital ratio, liquidity ratio, exposures, securities, etc.; and

(iii) Interest Rate Forms

4.2. What are the organizational requirements for banks, including with respect to corporate governance?

The legal framework for bank governance in Albania consists of *Banking Law 9662/2006*, *Company Law 9901/2008*, and *Regulation 63/2012 "On the core management principles of banks and branches of foreign banks and the criteria on the approval of their administrators"*.

The bodies of the bank are:

a) shareholders' assembly;

b) the board of directors;

c) the Executive directorate;

d) the control committee.

The branch of the foreign bank is managed by the directorate. Its other governing bodies are the same as those of the foreign bank.

First and foremost, it is to be mentioned that Banks in Albania

are established and organized as Joint Stock companies (JSC). Hence, they are subject to most *Company Law* provisions on corporate governance, even though their organization and governance are specifically regulated by Chapter III of the Banking Law. These pieces of legislation usually complement each other, even though in some cases they overlap. While corporate governance provisions in the Banking Law are motivated by financial stability concerns and the systemic importance of the banks for financial stability, *Company Law* provisions apply to banks merely as JSC. Therefore, in our view *Company Law* provisions should apply to banks only on issues for which *Banking Law* and relevant by-laws are silent or ambiguous. Therefore, the *Banking Law* should prevail in case of legal conflict for two main reasons: First, the *Banking Law* regulates a specific type of JSC, unlike the Company Law, thus the postulate *lex specialis derogat legi generali* should apply. Second, based on the systemic importance of banks, the *Banking Law* should prevail, based on the arguments of financial stability concerns and public interest.

Under Article 134 of the Company law, a Joint Stock Company established in Albania needs to have: a General Meeting of Shareholders and either a Supervisory Board, a Management Board (two-tier system), or an Administrative Board (one-tier system), depending on their company statutes.

Unlike general JSCs, banks are directed by a board of Directors and a directorate (senior management). They have no Supervisory Board. Article 35(1) of the *Banking Law* only provides for a one-tier structure for banks. Accordingly, the Board of Directors is both the decision-making (direction and management) and the supervisory (control) body. It delegates day-to-day management to one or more executive

Under Article 35(2) of the *Banking Law*, the Board of Directors should be composed of an odd number of individuals, between five and nine members. The *Banking Law* emphasizes the need for a board that is sufficiently separated from management in order to exercise objective decision-making, to ensure accountability, and provide strategic guidance to the management. Before the most recent amendment, Article 35(4) required at least one-third of board members to be outsiders (independent), i.e., persons not related through private interests to the bank itself, its shareholders, or its executive directors.

Article 37(2), e) of the *Banking Law* empowers the board with oversight of the audit function, which is key to shareholder and depositor confidence and the integrity of markets. Under Article 42, board members, as well as senior management, and the director of the audit unit shall be approved by the Bank of Albania. The requirements on the approval, revocation, dismissal, and removal of management are set forth under *Regulation 63/2012* in addition to quality, experience, and independence of the board's membership ability to perform its duties. Therefore, board members should possess the necessary qualifications, reputation, and expertise to enable effective governance and oversight. The qualifying criteria include a university or post-graduate degree as a general rule in law or economics, or, if not, at least five years of experience in the banking sector, a good reputation, and at least three years of experience in the financial sector, risk management in the financial markets, financial management, banking/financial supervision, business, auditing, legal or academic experience related to financial market economics or jurisprudence.

4.3. What are the local rules for loans to the management body and their related parties?

In accordance with Banking Law a related party is a party that has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions.

The Banking Law stipulates that the bank's exposure to related parties cannot exceed 10% of its regulatory capital. When the related party or group of related parties is a parent bank, a subsidiary of the bank, or one or more subsidiaries of the parent company, the exposure cannot exceed 25% of the regulatory capital. The Bank must comply at all times with this restriction regarding its exposures. In case the exposures exceed the limits of the above, the bank immediately reports to the Bank of Albania, which then determines the measures necessary and the time to restore the exposures within the limitations of the above. In any case, the Board of Directors must grant a preliminary approval by a qualified majority of 2/3 of the votes of Board members, with respect to all actions of the bank related to transactions with related parties.

More generally speaking, the *Company Law* provides a further restriction by which a person who is both an administrator and a single member or shareholder of a company may not enter into a loan or guarantee contract with the company.

4.4. What are the main legal provisions governing risk management in the banking sector in your jurisdiction?

According to Albanian *Banking Law* and regulatory framework, the major risks for banks include credit, operational, market, systemic, liquidity risks, etc. Each of these risks are duly regulated with separate and dedicated Regulations by the Bank of Albania. Therefore, regulatory criteria have been set out, especially on capital requirements, the quality of the bank shareholders, the quality of the administrators, minimum regulatory capital requirement for credit, market and operational risk, credit risk assessment, consumer credit, on anti-money laundering, bank resolution, etc.

The main regulations adopted by the Bank of Albania in relation to risk management of the bank are listed below:

■ Regulation 27/2019 "On the liquidity coverage ratio"

The scope of this regulation is to determine the criteria and rules for calculating the liquidity coverage ratio and the minimum level of this ratio. Banks calculate the liquidity coverage ratio (RML) as the ratio of the bank's liquidity reserve to net liquidity outflows over a 30-calendar-day stress period, expressed as a percentage, on an individual and consolidated basis.

■ Regulation 4/2017 "On consolidated supervision"

The scope of this regulation is to determine the conditions, rules, and regulatory requirements for the implementation of consolidated supervision, for the purposes of risk management arising from the banking group and the financial group.

■ Regulation 10/2014 "On risk management from large exposures of banks"

The scope of this regulation is to determine the rules and criteria for the calculation, supervision, and reporting of the bank's large exposures to a person/client or group of persons/clients related to each other or to the bank, for the purpose of managing the risk arising from the exposure focused on them.

■ Regulation 48/2013 "On capital adequacy report"

The scope of this regulation is the establishment of the criteria and rules for calculating the capital adequacy ratio; and the determination of the minimum level of the capital adequacy ratio.

■ Regulation 67/2015 "On the internal control system"

The scope of this regulation is the determination of the rules for the organization, operation, and responsible structures of the internal control system of the bank and the branch of the foreign bank. The main responsible structures for the internal control system are a) the Board of Directors; b) the control committee; c) the executive directorate and every organizational unit in the bank that belongs to the first and second line of control; d) the internal control unit; e) special committees etc.

■ Regulation 69/2014 "On regulatory capital of the bank"

The scope of this regulation is to determine the structure, constituent elements, and method of calculating the bank's regulatory capital and determining its minimum level.

■ Regulation 62/2011 "On credit risk management by banks and branches of foreign banks"

The scope of this regulation is: a) determining the rules for credit risk management in the activity of banks and branches of foreign banks; and b) determining the criteria for risk assessment and classification of loans and other assets, as well as the calculation of reserve funds to cover losses from their devaluation.

■ Regulation 3/2011 "On operational risk management"

The scope of this regulation is the determination of requirements and rules for operational risk management in banking and/or financial activity by the banks.

■ Regulation 48/2010 "On risk management from open currency positions"

The scope of this regulation is to determine the rules and criteria for the calculation, reporting, and supervision of the open currency positions of banks, in order to manage the exchange rate risk.

■ Regulation 71/2009 "On liquidity risk management"

The scope of this regulation is the determination of the minimum requirements and standards for the effective management of liquidity risk, by the banks and branches of foreign banks, which carry out banking and financial activities in the Republic of Albania.

■ Regulation 44/2009 "On the prevention of money laundering and financing of terrorism"

The scope of this regulation is the determination of the procedures and documentation for customer identification, the rules for registration, storage of data, and their reporting to the responsible authority by the banks. It aims to prevent the use of banks for money laundering and/or terrorist financing.

■ Regulation 72/2017 "On bank recovery plans"

The scope of this regulation is the establishment of supervisory requirements for the recovery plans of banks and banking groups, content of recovery plans and simplified recovery plans, the manner and deadline for their reporting and updating; the minimum framework of qualitative and quantitative indicators, which are included in the recovery plans; as well as the minimum criteria on which the assessment of the recovery plans is carried out by the Bank of Albania.

■ Regulation 57/2007 "On risk management in the activity of foreign bank branches",

The scope of this regulation is the definition of the instruments that ensure the safe and stable exercise of the activity of the foreign branches of banks, the establishment of maximum exposure limits to some of the risks in the conduction of

their activity, as well as determination of requirements and obligations on reports and verification documentation for the implementation of this regulation.

■ Regulation 70/2020 "On the net stable financing ratio of banks", integrated version

The scope of this regulation is the determination of the criteria and rules for calculating the net stable financing ratio of banks and the minimum level of this ratio.

4.5. What are the legal requirements applicable to banks in combating money laundering and terrorist financing area?

Banks or financial institutions in the Republic of Albania are subject to *Law no. 9917 dated 19.05.2008 "On the prevention of money laundering and terrorism financing"* (AML Law) which provides general rules to be observed by specific natural or legal persons. Additionally, banks comply also with the AML *Regulation of the Bank of Albania no. 44/2009 "On the prevention of money laundering and terrorist financing" as amended* and *Instruction no. 28, dated 31.12.2012, of the Albanian Financial Intelligence Unit (FIU) "For reporting and action taking methods and procedures prevention from various entities including banks"*.

Based on these regulatory acts, there are four key areas banks must address with their anti-money laundering compliance program:

■ Know Your Customer (KYC)

■ Customer due diligence (CDD)

■ Customer and transaction screening

■ Suspicious activity reporting

Know Your Customer (KYC) involves identifying and verifying a customer's identity when they open a bank account. Mandatory for banks, KYC is the first critical step in an AML program. Additionally, all banks must take all the measures of "simplified CDD," "standard CDD," and "enhanced CDD" and implement the measures to identify and verify the permanent or occasional customers (natural persons, legal entities, and legal arrangements), in accordance with the requirements stipulated in the law. All banks must have in place policies, guidelines, or internal procedures on the acceptance, identification, recording, monitoring, risk management, and reporting of customers' transactions.

After the KYC control process, banks apply risk assessment to their new customers. Customer information is checked and screened against several online databases, including politically exposed persons (PEPs), government records, watchlists, and sanctions screening.

Banks must report to the FIU as provided in the reporting forms and the terms set out in *Instruction 28* of 2012 cited above, all transactions in cash equal or higher than ALL 1 million or the counter value in foreign currency (approximately USD 10,000), carried out as a sole transaction or as transactions related to each other within 24 hours. This includes verifying the origin of large sums of money and reporting cash transactions exceeding the USD 10,000 threshold.

With respect to the opening of bank accounts, the same can be opened even without the physical presence of the customer, upon the approval by the highest management level of the Bank, provided that after the combined risk assessment of the client, products, geographical distribution of services and distribution channels, the risk level for money laundering and terrorism financing results to be low.

In compliance with the EU Directive, banks are obliged to apply specific enhanced due diligence measures in relation to business relationships or transactions that include high-risk countries as per their assessment of the risk level.

More broadly, each bank is considered a reporting entity in Albania and as such is required to comply with the following:

■ Apply customer due diligence measures;

■ Build processes for identifying, measuring, monitoring, and mitigating risks arising from money laundering and financing terrorism in order to implement a risk-based approach. These processes should be supported by policies, procedures, dedicated structures, training, and control systems that effectively identify and manage risk exposure;

■ Implement adequate and appropriate AML/CFT systems including policies and procedures;

■ Continuously monitor the business relationship with the customer, based on the transactions profile, customers profile, and exposure against geographical risk.

There is an obligation to report to the FIU whenever the banks have a reasonable belief or suspect that the transaction required to be carried out by the client or another person may include proceeds of crime, or terrorism financing of funds deriving from criminal activity. This must be reported immediately to the FIU.

From an internal regulatory perspective, banks must have an effective AML compliance program that meets the regulatory requirements and manages money laundering risks. Failures in the AML compliance program can result in banks being punished by the Bank of Albania or FIU. AML compliance

programs should consist of all controls and directives applied to ensure banks meet obligations and are protected against regulatory penalties. All banks must also have an AML compliance officer that provides oversight for the AML compliance program and acts as a liaison for the financial authorities. The AML compliance officer should be a senior employee with the expertise and authority to carry out their role effectively.

4.6. Are there any legal provisions regulating banking secrecy in your jurisdiction?

The Albanian *Banking Law* foresees and regulates banking secrecy in articles 91 and 125 of this law. Article 91 foresees the obligation of banks to protect their professional secrecy. In particular, the administrators, employees, actual as well as previous agents of the bank, judicial authorities, and the inspectors or other employees of the Bank of Albania or of other respective foreign authorities of banking supervision, must keep the secrecy for every information obtained during their term in the bank and not use it for personal profits or third parties outside the bank whom they serve or have served. Article 91 also stipulates that the information on customers may be made available only to the Bank of Albania, the statutory auditor of the bank or branch of the foreign bank, administrators, agents, and employees of every information system or official service stipulated in article 23 of the *Law "On the Bank of Albania"*, the liquidator appointed by Bank of Albania, juridical authorities whose right derives from the law, as well as when it is necessary for the protection of interests of the bank during legal proceedings. Additionally, the banking law also provides that all breaches of these provisions are to be considered misdemeanors and the persons who are guilty of such breaches may be punished by fine or imprisonment of up to two years.

On the other hand, Article 125 of the Banking Law sets forth that the bank or branch of the foreign bank maintains the confidentiality of information about the client and does not use it for their own benefit or for third parties whom they serve or have served.

However, there are some of limitations to the privacy of bank customers mainly related to money laundering. More specifically, as mentioned in Section 4.6., the AML law stipulates among others that any credit institution that may witness a doubtful transaction or delivery of payment concerning unlawful practice, is bound to bring it to the knowledge of the Financial Intelligence Unit (FIU) without any delay, which means the customer information must be surrendered regardless of the banking secrecy.

V. TRENDS

5.1. What are the main trends in the banking sector in your jurisdiction?

In recent years, the banking sector in Albania has been consolidated, going from 16 to 11 banks. Large commercial banks such as Societe Generale have left the market and have been replaced by local banks.

5.2. What are the biggest challenges in the banking sector at the moment?

Recent reports from international institutions are emphasizing the need for the banking sector to diversify its loan portfolio as it currently is overexposed to the real estate sector (approximately 40%). This is a big challenge for the whole banking sector.

Another challenge is the digitalization of banking services. Fintech companies have increased in Albania and are trying to service the unbanked or underbanked in Albania (approximately 50-60% of the population). In order not to lose their market share, banks should further increase the digitalization of their services.

5.3. What's new in fintech?

In the past two years, we have seen a significant increase in the number of licensed e-money institutions in Albania. The main reason has been the implementation of the *Payments Services Law* (which transposes PSD 2 in Albania) and the open banking principle. As the law has not been fully implemented yet, we expect the trend to continue. As a result, banks are trying to compete in this segment as well and have heavily invested in electronic systems and internet solutions.

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I. LEGAL FRAMEWORK

1.1. Which main legislative and regulatory provisions govern the banking sector in your jurisdiction?

The banking sector in Austria is governed by several national and European legislative and regulatory provisions, in particular, the following:

■ The *Banking Act* (*Bankwesengesetz*; BWG) is the core regulation and provides the legal framework for banking and financial services in Austria. It regulates the establishment, operation, and supervision of banks, as well as the licensing and approval processes for banks and financial institutions.

■ The *Payment Services Act* (*Zahlungsdienstegesetz 2018*; ZaDiG) regulates payment services in Austria, including electronic payments, money transfers, and other related services. It sets out the rights and obligations of payment service providers and their customers, as well as the requirements for payment service licenses.

■ The *Financial Market Anti-Money Laundering Act* (*Finanzmarkt-Geldwaschegesetz*; FM-GWG) aims to prevent money laundering and terrorist financing in Austria. It requires banks and other financial institutions to implement measures to detect and prevent money laundering and to report suspicious transactions to the authorities.

■ The *Consumer Protection Act* (*Konsumentenschutzgesetz*; KSchG) provides consumer protection in Austria in the relation between entrepreneurs and consumers. The KSchG is also relevant for the banking sector. It sets out the rights of bank customers and the obligations of banks to provide clear and transparent information about their products and services. Besides the KSchG, also the *Consumer Credit Act* (*Verbraucherkreditgesetz*; VKrG), the *Distance and Outward Transactions Act* (*Fern- und Auswartsgeschafte-Gesetz*; FAGG), and the *Distance Financial Services Act* (*Fern-Finanzdienstleistungs-Gesetz*; FernFinG) are important for the business of banks with consumers.

■ The *Capital Requirements Regulation* (CRR): This European regulation, which is part of the Basel III framework, sets out the minimum capital requirements for banks and other financial institutions. It aims to ensure that banks have sufficient capital to withstand financial shocks and maintain their solvency.

■ The *Capital Markets Act* (*Kapitalmarktgesetz 2019*; KMG) regulates the issuance of certain securities and investments into collective schemes (*Veranlagungen*).

■ The *Securities Supervision Act* (*Wertpapieraufsichtsgesetz 2018*; WAG) governs securities regulation in Austria. It sets out the regulation of securities firms and the rules of financial services related to securities.

■ The *Electronic Money Act* (*E-Geld Gesetz 2010*) regulates the issuance of electronic money and sets out the requirements for the safekeeping of customer funds used for the issuance of electronic money.

■ Financial *Market Supervisory Authority Act* (*Finanzmarktaufsichtsbehoerdengesetz*; FMABG): This act established the Financial Market Authority (FMA) as the primary regulator of the financial sector in Austria.

Besides those a manifold of regulatory acts by FMA in form of Minimum Standards, Circulars, or Guides specify the statutory provisions and explain the regulatory approach to applying the statutory provisions.

■ FMA Minimum Standards are used by the authority to set out requirements and publish recommendations. These cover for example Minimum Standards for BWG Compliance, Minimum Standards for Lending Business and other transactions with counterparty risks, Minimum Standards for the Risk Management and Granting of Foreign Currency Loans, and Loans with Repayment Vehicles.

■ FMA Circulars are used to publish the interpretation of laws and regulatory provisions in relation to supervisory issues. Those exist *inter alia* in the context of Principles of Remuneration Policies and Practices, on Due Diligence Obligations for the Prevention of Money Laundering and Terrorist Financing, on Internal Organization for the Prevention of Money Laundering and Terrorist Financing or on the Criteria for the Assessment of Knowledge and Competence of Investment Advisors and Persons providing Information about Investment Products.

■ FMA Guides are intended to provide supervised institutions with know-how and to promote the development of a common understanding. Those are not obligatory and exist for example for Managing Sustainability Risk.

1.2. Which bodies are responsible for enforcing the applicable laws and regulations? What are their main competencies?

The banks are split up throughout Europe into significant and less significant credit institutions or groups of credit institutions. The significant credit institutions are directly supervised by the European Central Bank with the Single Supervisory Mechanism (SSM). The less significant institutions remain under the supervision of the national supervisory authorities and are only indirectly supervised by the European Central Bank.

In Austria, several bodies are responsible for enforcing the applicable laws and regulations in the banking sector. These include:

■ The Financial Market Authority (FMA) is the central regulatory body for the financial sector in Austria. It is responsible for supervising banks and other financial institutions, ensuring compliance with applicable laws and regulations, and protecting the interests of consumers and investors. The FMA has the power to impose fines and other penalties for non-compliance with applicable regulations and can revoke licenses or authorizations in case of serious breaches.

■ The Austrian National Bank (*Oesterreichische Nationalbank*; OeNB) is Austria's central bank and is responsible for implementing monetary policy, maintaining financial stability, and supervising the banking sector. In the area of banking supervision, the OeNB is responsible for fact-finding. It conducts on-site inspections and prepares analyses and expert reports. In addition, the OeNB is responsible for processing supervisory reports.

■ The Ministry of Finance: The Ministry of Finance is responsible for setting fiscal policy and overseeing the implementation of financial regulations. It works closely with the FMA and the OeNB to ensure the stability and integrity of the banking sector.

■ The Resolution Authority: The Resolution Authority is responsible for managing the resolution process of failing banks. In Austria, the Resolution Authority is integrated within the FMA and is responsible for planning and executing the resolution of banks and other financial institutions in financial difficulties. The Authority aims to ensure that any resolution is carried out in a manner that is least disruptive to the wider financial system while also minimizing the cost to taxpayers and depositors.

The local authorities are integrated into the Single Supervisory Mechanism (SSM), thus the European Central Bank and the European Banking Authority have a leading role in the banking supervision in Austria.

■ European Central Bank (ECB): The ECB has been responsible for the supervision of banks in the euro area since November 4, 2014. It is directly responsible for the supervision of significant credit institutions and indirectly responsible for the supervision of less significant credit institutions.

■ The European Banking Authority (EBA): The EBA has the task of creating a uniform set of rules for harmonized banking supervision on the basis of European legal texts (e.g., Capital Requirements Regulation or Capital Requirements Directive). It fulfills this mandate primarily by developing binding technical standards and guidelines.

1.3. What are the current priorities of regulators and how does the regulator engage with the banking sector?

FMA informs the public about its supervisory priorities for the next year. Currently, in 2023, the priorities are (source: Financial Market Authority, *Facts and Figures, Trends and Strategies 2023*):

■ Resilience and Stability: strengthening the crisis resilience of supervised financial service providers as well as safeguarding the stability of the Austrian financial market as a whole.

■ Digital transformation: exploiting the opportunities arising from digitalization while simultaneously addressing the associated risks in a consistent manner.

■ New business models: accompanying innovative business models in terms of supervision from as early a stage as possible, in order to promote the innovative power of the Austrian financial market, ensuring fair competitive conditions and guaranteeing appropriate consumer protection.

■ Collective consumer protection: further development of consumer protection in a rapidly changing environment under the buzzwords: digital transformation, changing consumer behavior, demographic development, and the change in interest rates.

■ Sustainability: To support the financial market and all its participants in regulatory and supervisory terms during the changeover to a sustainable economic model.

■ A clean financial center in Austria: safeguarding the orderliness and reputation of Austria as a financial center at all levels.

II. AUTHORISATION

2.1. What licenses are required to provide banking services in your jurisdiction? What activities do they cover?

The list of banking transactions that require a license can be found in Article 1 para. 1 of the BWG and it covers the following activities:

1. The acceptance of funds from other parties for the purpose of administration or as deposits (deposit business);
2. The provision of non-cash payment transactions, clearing services, and current-account services for other parties (current account business);
3. The conclusion of money-lending agreements and the extension of monetary loans (lending business);
4. The purchase of cheques and bills of exchange, and in particular the discounting of bills of exchange (discounting

business);

5. The safekeeping and administration of securities for other parties (custody business);

6. The issuance and administration of payment instruments such as credit cards, bankers' drafts, and travelers' cheques, with no limitation applicable to the term of crediting in the case of credit cards;

7. Trading for one's own account or on behalf of others in:

a) Foreign means of payment (foreign exchange and foreign currency business);

b) Money-market instruments;

c) Financial futures contracts, including equivalent instruments settled in cash as well as call and put options on the instruments listed in lit. a and d to f, including equivalent instruments settled in cash (futures and options business);

d) Interest-rate futures contracts, forward rate agreements (FRAs), interest-rate and currency swaps as well as equity swaps;

e) Transferable securities (securities business);

f) Derivative instruments based on lit. b to e; unless these instruments are traded for private assets;

7a. trading on one's own account or on behalf of others in financial instruments pursuant to Article 1 no. 7 lits. e to g, j and k of WAG 2018; published in *Federal Law Gazette I No. 107/2017*, except in the case of trading conducted by persons pursuant to Article 2 para. 1 nos. 6, 12, and 13 WAG 2018 as well as trading provided that it is conducted using private assets;

8. The assumption of suretyships, guarantees and other forms of liability for other parties where the obligation assumed is monetary in nature (guarantee business);

9. The issuance of covered bonds in accordance with the *Pfandbrief Act* (*Pfandbriefgesetz*; PfandBG) published in *Federal Law Gazette I No. 199/2021* (securities underwriting business);

10. The issuance of other fixed-income securities for the purpose of investing the proceeds in other banking transactions (miscellaneous securities underwriting business);

11. Participation in underwriting third-party issues of one or more of the instruments listed under no. 7 lit. b to f as well as related services (third-party securities underwriting business);

12. The acceptance of building savings deposits and the extension of building loans in accordance with the *Building Society Act* (*Bausparkassengesetz*; BSpG) (building savings and loan business);

13. The management of investment funds in accordance with the Investment *Fund Act 2011* (*Investmentfondsgesetz*; InvFG 2011), *Federal Law Gazette I No. 77/2011* (investment fund business);

13a. The management of real estate investment funds in accordance with the *Real Estate Investment Fund Act* (*Immobilien-Investmentfondsgesetz*; ImmoInvFG), *Federal Law Gazette I No. 80/2003* (real estate investment fund business);

15. The business of financing through the acquisition and resale of equity shares (capital financing

business);

16. The purchase of receivables from the delivery of goods or services, assumption of the risk of non-payment associated with such receivables – with the exception of credit insurance – and the related collection of such receivables (factoring business);

17. The conduct of money brokering transactions on the interbank market;

18. The brokering of transactions as specified in

a) No. 1, except for transactions conducted by contract insurance undertakings;

b) No. 3, except for the brokering of mortgage loans and personal loans by real estate agents, personal loan and mortgage loan brokers, and investment advisors;

c) No. 7 lit. a where this applies to foreign exchange transactions;

d) No. 8.

21. The acceptance and investment of severance payment contributions from salaried employees and self-employed persons (severance and retirement fund business);

22. The purchase of foreign means of payment (e.g., notes and coins, cheques, traveler's letters of credit, and payment orders) over the counter and the sale of foreign notes and coins as well as travelers' cheques over the counter (exchange bureau business);

(Please note that the above numbering is pursuant to Article 1 para. 1 of BWG and that numbers 14, 19, 20, and 23 have been repealed)

Pursuant to Article 1 para. 3 of BWG credit institutions are entitled to conduct exchange bureau business and or leasing operations without requiring an additional license. Credit institutions are allowed to perform activities ancillary to the respective banking transaction, in particular, brokering of

- building savings plans,
- undertakings and companies,
- investment fund shares, and
- equity shares.

Furthermore, credit institutions are allowed pursuant to Article

1 para. 3 BWG to provide services in the field of automated data processing as well as sale activities relating to credit cards, trading of coins, medals, and gold as well as the renting of safety deposit boxes (safes).

Credit institutions are also authorized to carry out the activities listed in Article 3 para. 2 nos. 1 to 3 of WAG 2018 (investment advice, portfolio management, receiving and transmitting of orders in relation to financial instruments) and – in the event that licenses are held for specific banking transactions – are authorized to conduct the payment services listed in Article 1 para. 2 of the ZaDiG (see also Article 1 para. 3 of BWG).

In the event that a license is held in accordance with Article 1 para. 1 nos. 1 and 3, or pursuant to para. 1 no. 2 or no. 6, credit institutions may also issue electronic money in accordance with the *Electronic Money Act 2010* (*E-Geldgesetz 2010*; E-GeldG 2010).

2.2. What is the procedure for obtaining a banking license? How long does this typically take?

The European Central Bank is competent for the licensing procedure for credit institutions pursuant to Article 4 (1) 1 CRR ("CRR-credit institutions" i.e., those credit institutions that accept deposits or other repayable funds from the general public and which grant loans on their own account) with regard to the Common Procedures

All credit institutions headquartered in Austria that are not directly supervised by the European Central Bank (referred to as "non-CRR credit institutions") are granted their license directly by the Financial Market Authority.

All applications are to be submitted with the FMA. In the case that the institution making the application fulfills the definition in accordance with the CRR, the FMA then forwards the applications together with a draft decision and the relevant documentation to the European Central Bank for the decision-making process. Since January 31, 2022, the IMAS Portal can be used for such applications,

The procedure for obtaining a banking license in Austria is a complex and lengthy process that involves several steps. The specific requirements and timelines may vary depending on the type of banking license being sought and the complexity of the applicant's business model.

Good cooperation and continuous communication with the FMA are crucial for having an efficient and successful licensing process. It is also necessary to pre-inform FMA about the plans to submit an application and to discuss the business plan beforehand.

Already in this phase before the formal submission of an application of the applicant's business plan, financial projections, risk management framework, and other key aspects of its proposed banking activities will be discussed between the applicant and the FMA.

The application must include detailed information about the applicant's business model, corporate structure, ownership structure, management team, financial projections, and compliance with applicable laws and regulations.

Once the application is received, the FMA will conduct a thorough review to assess the suitability of the applicant and its proposed business activities. This may involve a review of the applicant's financial and regulatory history, as well as interviews with key personnel.

Once the FMA is satisfied that it has received all required information and that the applicant meets all the necessary requirements for a banking license, it will grant the license. The license will specify the activities that the licensee is authorized to engage in, as well as any conditions or restrictions that apply.

The length of time it takes to obtain a banking license in Austria can vary depending on a range of factors, such as the complexity of the applicant's business model, the experience of the main personnel, infrastructure, and the capability that all services can be provided solidly and the completeness.

2.3. Can a foreign bank operate in your jurisdiction on the basis of its domestic license?

If a foreign bank may operate a business in Austria depends on the home authority which granted the license to the foreign bank.

■ License from an EEA Member State:

Credit institutions authorized in an EEA Member State are in principle already authorized on the basis of their license in their home member state to also provide banking operations in other Member States (single license principle).

Those credit institutions may provide cross-border activities either through a branch on the basis of the freedom of establishment or without a branch under the freedom to provide services. The intention to conduct banking activities on a cross-border basis must be notified by the credit institution to the respective home supervisory authority which will notify this intention to the FMA under the EU/EEA passporting regime.

■ License from a home state outside the EEA

Foreign banks that wish to conduct banking activities in Aus-

tria must obtain a banking license from the FMA in Austria as the regulatory body responsible for overseeing the banking sector in Austria and has the authority to grant banking licenses to both domestic and foreign entities. Foreign banks must meet the same requirements as domestic banks in order to obtain a banking license in Austria.

2.4. What are the restrictions on ownership, including foreign ownership of banks?

Pursuant to Article 21 para. 1 No 2 of BWG any case in which the limits of 10% (qualifying holding), 20%, 33%, and 50% of the voting rights or capital of a credit institution or CRR-credit institution based in a third country are reached, exceeded or not reached requires special approval by the FMA.

Regarding restriction, please see the requirements for special approval below in Point 2.5.

2.5. What are the requirements for a proposed acquisition and acquirer of a qualified holding in a bank? Would the same requirements apply in the case of an increase of a qualifying holding?

The FMA shall appraise the suitability of the proposed acquirer and the financial soundness of the proposed acquisition against all of the following criteria, in order to ensure the sound and prudent management of the credit institution in which an acquisition is proposed and having regard to the likely influence of the proposed acquirer on the credit institution:

1. the reliability of the interested acquirer pursuant to Article 5 para. 1 nos. 6, 7 and 9 of BWG;
2. the reliability, professional qualifications, and experience pursuant to Article 5 para. 1 nos. 6 to 9 of BWG of any person who will direct the business of the credit institution as a result of the proposed acquisition;
3. the financial soundness of the proposed acquirer, in particular in relation to the type of business pursued and envisaged in the credit institution in which the acquisition is proposed;
4. whether the credit institution will be able to comply and continue to comply with the prudential requirements based on Directives *2009/110/EC*, *2002/87/EC*, *2013/36/EU* and *Regulation (EU) No 575/2013* and, in particular, whether the group of which it will become a part has a structure that makes it possible to exercise effective supervision, effectively exchange information among the competent authorities and determine the allocation of responsibilities among the competent authorities (Article 5 para. 1 nos. 4 and 4a of BWG);
5. whether there are reasonable grounds to suspect that, in connection with the proposed acquisition, money laundering or terrorist financing within the meaning of Article 1 of *Directive (EU) 2015/849* is being or has been committed or attempted, or that the proposed acquisition could increase the risk thereof.

III. REGULATORY CAPITAL AND LIQUIDITY

3.1. How are banks typically funded in your jurisdiction?

Banks in Austria are typically funded through a combination of several sources, such as:

- Deposits: The primary source of funding are customer deposits. Austrian banks offer a range of deposit products, including savings accounts, current accounts, and term deposits, which provide customers with a safe and convenient place to store their money.

- Interbank lending: Austrian banks also borrow from other banks and financial institutions in the interbank market. This allows them to access additional funding when needed and to manage their liquidity more effectively. The interest rates on interbank loans are typically lower than those on other forms of borrowing.

- Debt securities: Austrian banks also issue debt securities, such as bonds and commercial paper, to raise funds from investors. These securities typically offer higher yields than bank deposits and can be traded on financial markets.

- Capital markets: Austrian banks may also access the capital markets to raise funds through the issuance of shares or other securities.

The funding mix of Austrian banks may vary depending on a range of factors, including market conditions, regulatory requirements, and the specific needs of the bank. Banks in Austria typically aim to maintain a diversified funding base, which helps to ensure that they have access to funding from a variety of sources and are not overly reliant on any one type of funding.

3.2. What capital and own funds requirements apply to banks in your jurisdiction?

Banks in Austria are subject to capital and own funds requirements that are designed to ensure that they have sufficient financial resources to absorb potential losses and maintain a sound financial position. These requirements are set out in BWG as well as related regulations and are consistent with the requirements set by the European Union's *Capital Requirements Directive* (CRD IV) and CRR.

Further, banks are subject to ongoing supervisory review to ensure that they comply with these requirements and that they maintain a strong financial position.

The main capital and own funds requirements that apply to banks in Austria are:

■ Minimum capital requirements: Banks must maintain a minimum level of capital, which is expressed as a percentage of their risk-weighted assets. The minimum capital requirement is set at 8% of risk-weighted assets, but banks are generally expected to maintain a higher level of capital to reflect their risk profile.

■ Capital conservation buffer: Banks must maintain a capital conservation buffer of 2.5% of risk-weighted assets. This buffer is designed to ensure that banks have sufficient capital to withstand future periods of stress.

■ Countercyclical capital buffer: The Austrian National Bank (OeNB) may require banks to maintain a countercyclical capital buffer of up to 2.5% of risk-weighted assets, depending on the state of the economy and the credit cycle.

■ Additional own funds requirements: Banks may be required to maintain additional own funds, such as for systemic risk purposes, based on their size and importance to the financial system.

■ Total loss-absorbing capacity (TLAC) requirements: Banks that are designated as global systemically important banks (G-SIBs) must maintain a minimum level of TLAC, which is designed to ensure that they have the sufficient loss-absorbing capacity to prevent taxpayer bailouts in the event of a failure.

3.3. Has your jurisdiction implemented the Basel III framework? Are there any major deviations?

The CRD IV and the CRR are either directly applicable or implemented through statutes in Austria as an EU member state. The CRD IV and the CRR set out the requirements for capital, liquidity, and risk management for banks in the EU.

While there are no major deviations from the Basel III framework in Austria, the EU has implemented some modifications to the framework in order to better suit the specificities of the EU banking sector. For example, the EU has imposed stricter limits on the use of internal models for calculating risk-weighted assets and has introduced additional capital buffers for systemically important banks.

IV. REPORTING, ORGANISATIONAL REQUIREMENTS, INTERNAL GOVERNANCE, AND RISK MANAGEMENT

4.1. What key reporting and disclosure requirements apply to banks in your jurisdiction?

Banks in Austria are subject to a range of reporting and disclosure requirements that are designed to promote transparency and ensure that regulators and other stakeholders have access to accurate and timely information about their financial condition. These requirements are set out in the BWG and related regulations and are consistent with the reporting and disclosure requirements set by CRD IV and CRR.

The key reporting and disclosure requirements that apply to banks in Austria include:

■ Financial reporting: Banks are required to prepare and publish annual financial statements that provide a comprehensive overview of their financial condition, including information about their assets, liabilities, equity, income, and expenses.

■ Capital adequacy reporting: Banks are required to report on their capital adequacy, including information about their capital levels, risk-weighted assets, and capital ratios.

■ Liquidity reporting: Banks are required to report on their liquidity position, including information about their liquidity ratios, funding sources, and liquidity risk management.

■ Large exposures reporting: Banks are required to report on their large exposures to individual counterparties, groups of connected counterparties, and related parties.

■ Stress testing: Banks are required to conduct stress tests to assess their ability to withstand adverse economic conditions, and to report on the results of these tests.

■ Disclosure of related party transactions: Banks are required to disclose their related party transactions, including transactions with their shareholders, directors, and senior management.

■ Public disclosures of information: Banks are required to make certain information available to the public, including information about their ownership structure, organizational structure, risk management policies, and internal controls.

In addition, banks are subject to ongoing supervisory review to ensure that they comply with these requirements and that they maintain a strong financial position.

4.2. What are the organizational requirements for banks, including with respect to corporate governance?

The organizational requirements for banks in Austria are set out in the BWG and various related regulations. These requirements are designed to promote effective corporate governance and ensure that banks are managed in a prudent and responsible manner. The key organizational requirements for banks in Austria include:

- Governance structure: Banks are required to establish a clear and transparent governance structure that includes a management body and a supervisory board.
- Fit and proper assessment: The members of the management body and key function holders are subject to a fit and proper assessment to ensure that they have the necessary skills, experience, and integrity to carry out their roles effectively. This assessment is conducted by the competent supervisory authority and is based on factors such as the individual's education, professional experience, and reputation.
- Risk management: Banks are required to establish a robust risk management framework that includes policies, procedures, and controls for identifying, assessing, and managing the various risks that they face.
- Internal control framework: Banks are required to establish an effective internal control framework that includes systems and procedures for monitoring and controlling their operations and ensuring compliance with applicable laws and regulations.
- Compensation: Banks are required to establish a compensation policy that aligns the interests of employees with the long-term interests of the bank and its stakeholders, and that does not encourage excessive risk-taking.

The fit and proper assessment process in Austria is an important tool for assessing the suitability of individuals who hold key positions in banks, and for promoting a culture of integrity and accountability within the banking sector. It involves a detailed review of the individual's background, qualifications, and experience. The competent supervisory authority evaluates whether the individual has the necessary skills, knowledge, and experience to effectively carry out their role, and assesses their reputation and integrity. The assessment process includes a review of criminal records, any regulatory or legal sanctions, and potential conflicts of interest. The supervisory authority may also conduct interviews with the individual and seek references from previous employers or other relevant parties.

Besides that governance regulation of the *Joint Stock Company Act* (AktG) and for listed companies also the Corporate Governance Codex applies.

4.3. What are the local rules for loans to the management body and their related parties?

Austrian rules for loans to the management body and their related parties are set out in the BWG and related regulations. Under the BWG, banks are prohibited from granting loans to their management board members, supervisory board members, or any other related parties, except under certain conditions. Such loans can only be granted if they are:

- in the normal course of business;
- on market terms; and
- with the approval of the supervisory board.

In addition, banks must ensure that loans to related parties do not exceed a certain threshold. According to the BWG, loans to any individual related party or group of related parties must not exceed 2% of the bank's own funds, while loans to all related parties combined must not exceed 10% of the bank's own funds.

The term "related party" is broadly defined under Austrian law and includes, among others, the spouse, children, and parents of a management board member or supervisory board member, as well as any legal entity in which a management board member or supervisory board member has a significant ownership interest.

The purpose of these rules is to prevent conflicts of interest and ensure that banks do not provide preferential treatment to their management board members or related parties. By requiring that loans to related parties be made on market terms and with the approval of the supervisory board, the rules aim to ensure that the bank's resources are used prudently and in the best interests of its stakeholders.

4.4. What are the main legal provisions governing risk management in the banking sector in your jurisdiction?

The regulatory framework in Austria is designed to be in line with international standards, including the Basel Committee's standards, to promote the safety and soundness of the banking sector in Austria.

The main legal provisions governing risk management in the banking sector in Austria are:

- The *Austrian Banking Act* (BWG): The BWG requires banks to establish an effective risk management system that identifies, measures, monitors, and controls all types of risks, including credit risk, market risk, liquidity risk, operational risk, and reputational risk.
- The *Capital Requirements Regulation* (CRR): The EU regulation sets out the prudential requirements for banks, including capital adequacy, risk management, and reporting and disclosure obligations, is directly applicable in Austria and is implemented through BWG.
- The *Austrian Regulation on Risk Management* (*Risikomanagementverordnung*): The regulation requires banks to establish a risk management policy and a risk management framework that includes procedures for identifying, assessing, monitoring, and

controlling risks.

■ The *Austrian Regulation on Liquidity Risk Management* (*Liquiditatsrisiko-verordnung*): The regulation requires banks to establish a liquidity risk management policy and a contingency funding plan to ensure that they have sufficient liquidity to meet their obligations under various stress scenarios.

■ The *Austrian Regulation on Credit Risk Management* (*Kreditrisikoverordnung*): The regulation requires banks to establish a credit risk management policy and to implement procedures for the identification, measurement, and monitoring of credit risk.

■ The FMA Minimum Standards for Lending Business and other transactions with counterparty risks

■ The FMA Minimum Standards for the Risk Management and Granting of Foreign Currency Loans and Loans with Repayment Vehicles

■ The FMA Minimum Standards for the Credit Business and other Transactions entailing Counterparty Risks

4.5. What are the legal requirements applicable to banks in combating money laundering and terrorist financing area?

Banks in Austria are subject to a comprehensive set of legal requirements aimed at combating money laundering and terrorist financing. The main legal requirements applicable to banks in Austria in this area include:

■ The *Austrian Banking Act* (BWG): This law requires banks to establish and maintain an effective anti-money laundering (AML) and counter-terrorism financing (CTF) program. The program should include internal policies, procedures, and controls designed to prevent and detect money laundering and terrorist financing activities.

■ The *Austrian Criminal Code* (*Strafgesetzbuch*; StGB): The Criminal Code criminalizes money laundering and terrorist financing activities in Austria. Banks are required to report any suspicious transactions to the relevant authorities and cooperate with law enforcement agencies in investigations related to money laundering and terrorist financing.

■ The Austrian Implementation of the *EU Anti-Money Laundering Directive*: The *4th and 5th EU Anti-Money Laundering Directive* was implemented in Austria through the following Acts:

The *Austrian Financial Markets Anti-Money Laundering Act* (FM-GwG; cf. section I.1.1): The FM-GwG regulates the activities of financial institutions, including banks, and aims to prevent money laundering and terrorist financing in the financial markets. This regulation sets out the detailed requirements for customer due diligence (CDD) measures that banks must undertake to prevent money laundering and terrorist financing. Banks are required to identify their customers and beneficial owners, verify their identities, and assess the potential money laundering and terrorist financing risks associated with the customer relationship. In addition, the FM-GwG requires banks to report suspicious transactions to the relevant authorities and maintain records of all transactions for at least five years.

Beneficial Owners Register Act (*Wirtschaftliche Eigentuemer Registergesetz*; WiEReG) requires legal entities, trusts, and similar arrangements to maintain accurate and up-to-date information on their beneficial owners, or the individuals who ultimately own or control them, in order to prevent money laundering and terrorist financing, and to increase transparency in the ownership structures of Austrian companies and trusts. Companies and other legal entities must identify their beneficial owners and provide certain information about them to a central register, known as the Beneficial Ownership Register (BOR), keep their information up-to-date and notify the BOR of any changes. The BOR is maintained by the Austrian Ministry of Finance and is accessible to designated authorities, such as law enforcement and financial regulatory bodies. Failure to comply with the WiEReG can result in fines and other penalties.

■ Several FMA-Regulations (*Verordnungen*) in relation to the prevention of money laundering and terrorist financing and corresponding FMA-Circulars (*Rundschreiben*) as guidance for the obliged entities, and which reflect the FMA's legal position in this field.

4.6. Are there any legal provisions regulating banking secrecy in your jurisdiction?

Austria has strict legal provisions regulating banking secrecy. Under Austrian law, banking secrecy is protected by the BWG and the StGB.

The BWG sets out the legal framework for banking secrecy in Austria in Article 38. It requires banks to keep confidential all information and data obtained in connection with their banking activities. This obligation of confidentiality extends to all employees of the bank and applies even after their employment has ended. The BWG also prohibits banks from disclosing confidential information without the express consent of their customers, except in limited circumstances, such as when required by law.

The StGB imposes criminal sanctions on any person who discloses confidential information obtained in the course of their work in a bank. The penalties for violating banking secrecy can include fines, imprisonment, or both.

However, banking secrecy is not absolute in Austria. Banks are required to disclose information to the authorities in certain circumstances, such as when required by law, when ordered to do so by a court, or when disclosure is necessary for the prevention or investigation of criminal activities.

V. TRENDS

5.1. What are the main trends in the banking sector in your jurisdiction?

Digitalization: Austrian banks are increasingly focusing on digital banking services, such as online and mobile banking. This trend has been accelerated due to the COVID-19 pandemic, as customers have shifted towards online banking.

Sustainability: Environmental, social, and governance (ESG) considerations are becoming increasingly important in the Austrian banking sector. Banks are incorporating ESG factors into their lending and investment decisions and are offering sustainable financial products to customers.

Consolidation: The Austrian banking sector has undergone consolidation in recent years, with several mergers and acquisitions taking place. This trend is expected to continue as smaller banks struggle to compete with larger players.

Fintech partnerships: Austrian banks are partnering with fintech companies to offer innovative financial products and services to customers. This collaboration is expected to continue as banks aim to stay competitive in the rapidly evolving financial services landscape.

Increased regulation: The banking sector in Austria is subject to increased regulation, particularly in the areas of consumer protection and data privacy. This trend is expected to continue as regulators seek to strengthen the stability and integrity of the financial system.

5.2. What are the biggest challenges in the banking sector at the moment?

Resilience and Stability: Real economic challenges such as energy, raw material and material shortages, fragile supply chains, an ailing economy and even fears of recession, persistently strong inflationary pressure, the abrupt turnaround in interest rates, and the extremely high volatility on the financial and capital markets will inevitably have direct and indirect effects on many financial market participants. It will be crucial for banks to define business strategies to make them resilient.

Digital transformation/AI: While digitalization presents opportunities for banks to improve efficiency and offer innovative services to customers, it also requires significant investment and expertise. Some banks may struggle to keep pace with the rapid changes in technology and customer expectations. Digital transformation and the expanded utilization of AI will have a massive impact on the economy and the business models of many industries.

5.3. What's new in fintech?

Regulatory Sandbox: FMA offers a regulatory sandbox that is a type of regulatory experimental space within which innovative solutions, technologies, products, services, and business models can be developed, tested, and taken as far as regulatory maturity with the support of the FMA in a controlled environment and for a defined period of time.

The companies are supported all along the way: from the first step of admission to final authorization, with individual advice being given both from a regulatory and technological perspective.

Alternative lending: The *European Crowdfunding Service Providers Regulation* (ECSPR) and its transposition into Austrian law by way of the *Crowdfunding Enforcement Act* (*Schwarmfinanzierung-Vollzugsgesetz*) followed in 2021, providing for a harmonized legal basis in Europe. Only authorized and supervised crowdfunding platforms are allowed to provide cross-border crowdfunding services pursuant to the ECSPR. Funding may only take the form of loans or transferable securities. Investments such as qualifying subordinated loans, participation rights, or silent or limited partnerships are not allowed. This new regime will bring a consolidation of the service provider on one hand but also expands the field of activities for larger crowd financing platforms.

Wealth management: Fintech companies are also offering innovative wealth management solutions that use artificial intelligence (AI) and machine learning (ML) algorithms to provide personalized investment advice and portfolio management services.

Digital payments: The fintech sector has been active in developing digital payment solutions that offer greater convenience and security to customers.

Regtech: Regulatory technology (regtech) solutions to help banks to comply with the increasing regulatory requirements in the financial services industry is an interesting field of development. These solutions use AI and ML algorithms to automate compliance processes and reduce the risk of regulatory breaches.

Virtual Currencies and Blockchain technology: Despite the recent setbacks in regard to virtual currencies, this innovation still will have some impact on the banking and payment sector.

CEE LEGAL MATTERS COMPARATIVE LEGAL GUIDE: BANKING/FINANCE 2023

BOSNIA AND HERZEGOVINA

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I. LEGAL FRAMEWORK

1.1. Which main legislative and regulatory provisions govern the banking sector in your jurisdiction?

The governance structure of Bosnia and Herzegovina (BiH) comprises the institutions of the state of Bosnia and Herzegovina, the governments of the two territorial and administrative entities – the Federation of Bosnia and Herzegovina (FBiH) and the Republika Srpska (RS) – as well as Brcko District (BD). At the entity level, both the FBiH and the RS have significant constitutional autonomy and regulate independently the matters which the Constitution of Bosnia and Herzegovina has not assigned to the state government. The financial system of BIH is under the jurisdiction of the administrative entities and is governed by a number of legislative and regulatory provisions while monetary policy is governed at the state level.

Some of the main provisions that apply to banks and other financial institutions operating in BiH include:

- The Law on Central Bank in BiH (*Official Gazette BIH no. 1/97, 29/02, 8/03, 13/03, 14/03 – corr., 9/05, 76/06 and 32/07*);
- The Law on Banks in FBiH, RS and BD (*Official Gazette FBiH, no. 27/17, Official Gazette RS, no. 04/17, 19/18, 54/19 and Official Gazette BD, no. 5/03, 19/07, 3/22*);
- The Central Bank of Bosnia and Herzegovina Act (*Official Gazette BiH, no. 1/97, 29/02, 8/03, 13/03, 14/03 – corr., 9/05, 76/06, 32/07*);
- The Law on Banking Agency in FBIH and RS (*Official Gazette FBiH, no 75/17, Official Gazette RS, no. 59/13, 04/17*);
- The Law on National Payment Transactions in FBiH, RS and BD (*Official Gazette FBiH no. 48/15, 79/15- corr., Official Gazette RS no. 52/12, 92/12, 58/19, 38/22, Official Gazette BD no. 5/01, 23/16)*;
- The Law on Anti Money Laundering and Terrorism Financing in BiH and BD (*Official Gazette BiH no. 47/14, 46/16, Official Gazette BD, no. 14/03*);
- The Law on Deposit Insurance in Banks of Bosnia and Herzegovina (*Official Gazette BiH, no. 32/20);*
- The Law on Foreign Exchange Operations in FBiH, RS, and BD (*Official Gazette FBiH no. 47/10, Official Gazette RS no. 96/03, 123/06, 92/09, 20/14, 20/18, Official Gazette BD no. 23/16*);

1.2. Which bodies are responsible for enforcing the applicable laws and regulations? What are their main competencies?

Bearing in mind the very complex structure of BiH as a country, this is also reflected in the banking system. Thus, BiH has responsible bodies both at the state level and entity levels.

At the state level, the central bank, known as the Central Bank of Bosnia and Herzegovina (CBBH) is responsible for monetary stability, issuing and controlling the monetary policy of BiH, supporting, and maintaining appropriate payment and settlement systems, and coordinating activities of the entity Banking Agencies, which are in charge of bank licensing and supervision. The CBBH can provide banking services for the benefit of foreign governments, foreign central banks, and monetary authorities, and for the benefit of international organizations in which it or Bosnia and Herzegovina participate but cannot give credit to the nay institution.

In particular, the banking regulatory and supervisory authority for the Federation of BiH is the Federal Banking Agency (FBA), while the responsible authority for Republika Srpska is the Banking Agency of Republika Srpska (BARS) (Banking Agency). The FBA and BARS are independent, autonomous, and non-profit institutions with competencies for prudential regulation, supervision (and resolution) of banks, microcredit organizations, leasing and factoring companies, and saving-credit organizations. The FBA and BARS work to ensure the stability and soundness of the banking sector in the BiH by enforcing compliance with banking laws and regulations, conducting on-site inspections of banks, and taking corrective actions when necessary to address any problems that are identified. They report to the Parliaments of the FBiH and the Republic of Srpska respectively, who supervise their operations.

The Banking Agency determines its basic tasks, and some of these tasks are: a) issuing licenses for the establishment and operation of banks, microcredit organizations, and leasing companies, b) issuing permits for changes in the organizational structure of banks, microcredit organizations, and leasing companies, c) issuing consent for the appointment of bank management, d)issuing licenses for internal payment transactions, e) initiation, management, and supervision of the procedure of temporary administration, liquidation and bankruptcy of banks, i.e. rehabilitation of banks, f) cancellation of banking licenses for banks, microcredit organizations and leasing companies, and other tasks.

In addition to their supervisory functions (licensing, supervising, and issuing corrective measures), FBA and BARS are also authorized to adopt prudential regulations, issued in the form of decisions, instructions, and rulebooks/guidelines. Banks must comply with all regulations issued by the FBA/BARS.

Decisions and rulebooks are adopted by the respective Management Boards, while instructions and guidelines are adopted by the Director of the Agency and explain in more technical detail how to apply provisions of the law or decisions. The two agencies coordinate on any changes, in order to keep the regulatory frameworks aligned. With regard to primary legislation per se, laws are brought into effect via the Ministry for Finance, while the agencies can give comments and technical advice. The final approval is then for the Parliament.

The State Ministry of Finance, the different entities' Ministries of Finance, and the Financial Directorate of BD do not have direct authority over banks operating in BiH. However, these institutions do play a role in shaping financial and fiscal policy at their levels, which can indirectly affect the operations of banks in BiH. In addition, the BIH Ministry of Finance is responsible for managing the national budget, managing public debt, and preparation of projects and arrangements that are implemented through domestic banks (revolving funds), cooperation with the Central Bank of Bosnia and Herzegovina, domestic banking and financial institutions, monitoring of regulations regulating the work of the Central Bank of Bosnia and Herzegovina, banking and foreign exchange system, insurance system, and capital markets, providing information and technical support to the Central Bank of BiH. As such, it plays a key role in the overall financial stability of the country, which can impact the operations of banks in BiH.

In regard to the resolution authority in BiH within the FBA and BARS, an independent organizational unit is established in which one or more ombudsmen for the banking system (Ombudsman) act to promote and protect the rights and interests of natural persons as users of financial services. The Ombudsman, as one of the bearers of the protection of users' rights in the Federation and the Republic of Srpska, enables disagreements and disputes between entities of the banking system and users to be resolved fairly and quickly by independent parties with a minimum of formality through conciliation, mediation or in another peaceful way. The Ombudsman is independent in the performance of his tasks, he is responsible to the Management Board for their execution and enforcement and does not act as a representative of the agency. The settlement agreement that the participants in the peaceful resolution of the conflicting relationship reach with mediation by the Ombudsman has the force of an enforcement document.

1.3. What are the current priorities of regulators and how does the regulator engage with the banking sector?

For the FBA and BARS, one of the main priorities are to keep promoting transparency and fairness in the banking sector and to continue taking measures and activities to preserve and strengthen the stability of the banking sector and the protection of depositors, to improve the safety, quality, and legal operation of banks in FBiH. In 2023 the Banking Agency will continue to keep monitoring the risk profile and capital position of all banks, including the fulfilment of capital requirements as a result of the Supervisory Review and Evaluation Process assessment, control on the application of the decision on credit risk management and determination of expected credit losses, including the assessment of internal models for assessing credit risk parameters, monitor the implementation of strategies for dealing with non-performing exposures and annual operational plans for banks where the share of NPLs in total loans is greater than 5%, monitor interest rate growth and its impact on the banking sector, and undertaking activities to mitigate the effects and continuing continuous cooperation with the competent supervisory authorities for the supervision of banking groups from the EU and third countries whose members are based in FBiH, with the aim of more efficient supervision and improvement of supervisory practices, and cooperation and exchange of information with the ECB and the EBA on matters of supervision and banking regulations, as well as with international financial institutions.

To carry out their duties, the FBA and BARS have a number of tools and mechanisms at their disposal to engage with the banking sector in BiH. Some of the ways in which the Banking Agency engages with the banking sector include:

■ On-site inspections: The Banking Agency conducts on-site inspections of banks to assess their compliance with laws and regulations and to identify any potential risks or vulnerabilities.

■ Off-site surveillance: The Banking Agency monitors the financial health of banks through off-site surveillance, which involves collecting and analyzing financial data and other information about banks.

■ Supervisory reports: The Banking Agency publishes supervisory reports on the banking sector in BiH, which provide information on the financial health of the sector and highlight any areas of concern.

■ Meetings with bank management: The Banking Agency meets with the management of banks on a regular basis to discuss their operations and any issues or concerns that may arise.

■ Issuing regulations, acts, and guidance: The Banking Agency has the authority to issue regulations, acts, and guidance to banks to ensure compliance with laws and regulations and to promote the stability of the banking sector.

■ Sanctions and enforcement actions: If a bank is found to be in violation of laws or regulations, the Banking Agency has the authority to impose sanctions and take enforcement actions,

such as issuing fines or revoking a bank's license.

II. AUTHORIZATION

2.1. What licenses are required to provide banking services in your jurisdiction? What activities do they cover?

In BiH, the bank must obtain a license from the Banking Agency in order to provide banking services in the country and registration in the court register in order to acquire the status of a legal entity. In the District Brcko, the application for issuing a banking license shall be submitted by the choice of the founder to the FBA or the BARS.

Banking licenses are granted for an indefinite period and are not transferable to other persons. The banking license of each bank specifies the banking activities that such a bank shall be authorized to engage in. The banking license is a condition for registration at the Court Register of business entities. The bank is obliged to fulfill all the conditions under which the license was issued during its operations. BARS and FBA have different criteria for banking license withdrawal, but all appear to be within the bounds of what is expected in the EU.

(1) The bank can perform the following operations:

a) receiving and depositing deposits or other funds with the obligation to return,

b) granting and taking credits and loans,

c) issuing guarantees and all forms of surety,

d) domestic and international payment transactions and transfers of money, in accordance with special regulations,

e) purchase and sale of foreign currency and precious metals,

f) issuance and management of means of payment (including payment cards, traveler's, and bank checks),

g) financial leasing,

h) purchase, sale, and collection of receivables (factoring, forfeiting, and others),

i) participation, purchase, and sale of money market instruments for one's own or someone else's account,

j) purchase and sale of securities (broker and dealer operations),

k) management of a portfolio of securities and other values,

l) support operations securities market, agent jobs, and underwriting, in accordance with the regulations governing the securities market,

m) investment advisory jobs and custodial jobs,

n) financial management and consulting services,

o) data collection services, making analyses, and providing information on the creditworthiness of legal entities and natural persons independently performing registered business activities,

p) safe deposit box rental services,

r) mediation in insurance affairs, in accordance with regulations governing insurance brokerage,

s) other jobs that represent support for specific banking jobs.

The bank is obliged to conduct its operations in accordance with the law, the agency's regulations, the conditions, and restrictions established by the banking license, and the corresponding business and accounting principles and standards.

2.2. What is the procedure for obtaining a banking license? How long does this typically take?

In BiH, the procedure for obtaining a banking license is outlined in the Law on Banks and implementing by-laws, which are the primary legal framework for the regulation and supervision of the banking sector in the country. According to the Law on Banks, the bank represents a commercial company and is established in the form of a joint stock company. Any individual or legal entity that wishes to establish a bank in BiH must have a founding act or contract and a statute approved by the Banking agency and must submit an application for a banking license to the Banking agency. The application must be accompanied by a range of documents and information, including:

- Transparent ownership: Banks must be owned by individuals or entities that meet certain requirements. These requirements are intended to ensure that the owners of banks have the financial resources necessary to operate a bank effectively.

- Capital requirements: Banks must meet minimum capital requirements in order to be eligible for a license. These requirements are intended to ensure that banks have sufficient financial resources to meet their obligations and operate in a safe and sound manner. The minimum amount of paid-in founding capital of the bank and the amount of capital that the bank must maintain as a minimum cannot be below BAM 15 million (approximately EUR 7,5 million) (Minimum basic capital). The bank's shares must be paid in full in cash before the bank's registration, as well as during each subsequent increase in the total value of the shares. Things and rights can be

entered as well, but the capital in money cannot be lower than BAM 15 million.

■ Management: Banks must have a management team that meets certain qualifications. These qualifications are intended to ensure that the management team has the knowledge and experience necessary to operate a bank effectively.

■ Eligibility of significant shareholders: a significant shareholder in a bank is an individual or legal entity that holds, directly or indirectly, 20% or more of the total voting rights at the bank's general assembly or exercises a significant influence on the management of business policy of the bank. To be eligible as a significant holder in a bank in BiH, an individual or legal entity must be a trustworthy person and possess sufficient financial capacity considering the proposed size of the bank and the type of its activities, which the Banking Agency values in each specific case.

■ Business plan: Banks must submit a business plan to the CBBH outlining their proposed operations and demonstrating that they meet the requirements for obtaining a license.

■ Other requirements: Banks must also meet other requirements set by the Law on banks such as having an appropriate management structure in accordance with the planned size of the bank, an appropriate risk management system to which the bank could be exposed in its operations with an appropriate system of internal controls that includes clear administrative and accounting procedures and appropriate internal and external audit systems and appropriate salary policy, which should reflect and promote adequate and efficient risk management;

A banking license is issued after payment of capital and fulfillment of other conditions and includes the appointment of the bank management. Such a license cannot be transferred to another person and is always valid for an indefinite period of time.

The Banking Agency has to render a decision on the application not later than 60 days after receiving the duly completed application. In any case, the Banking Agency decides on issuing or refusing to issue a banking license within 12 months from the date of receipt of the application. An application for bank registration in the Court register shall be submitted within 30 days starting from the date when the Banking Agency issued a banking license. The bank acquires the capacity of a legal entity as of the moment being entered into the Court Register. A bank that has received a license to operate from the Banking Agency is obliged to become a member bank of the Deposit Insurance Agency of Bosnia and Herzegovina.

2.3. Can a foreign bank operate in your jurisdiction on the basis of its domestic license?

If a foreign bank decides to operate in BiH it must incorporate a locally registered legal entity and obtain a domestic banking license, provided that it meets the requirements set out in the Law on Banks as any other bank operating in the country and obtain the necessary additional approvals: the opinion/consent of the competent institution of the founder's country of origin regarding capital investment in a bank that will operate on the territory of Bosnia and Herzegovina and the regulatory body of the country of origin, which performs control or supervision on a consolidated basis of that founder.

The foreign bank may also, with the approval of the Banking Agency, open a representative office, as an organizational part through which they present themselves, collect and provide information about the bank's operations. The representative office does not have the status of a legal entity and may not perform banking operations.

Bearing in mind that BiH is not a member of EU passporting as a free movement of financial products and services by banks that are authorized in any EU or EEA state is not possible.

2.4. What are the restrictions on ownership, including foreign ownership of banks?

In BiH, all rules regarding restrictions of ownership apply to both domestic and foreign investors and are designed to ensure the stability and soundness of the banking sector in Bosnia and Herzegovina and to protect the interests of depositors and other stakeholders.

In BiH, there are several restrictions on the ownership of banks, including foreign ownership. According to the Law on Banks, no person or legal entity may own more than 10% of the voting shares in a bank unless they have received prior approval from the Banking Agency. A person or legal entity, which has a qualified holding in the bank must obtain the prior approval of the Banking Agency for any further indirect or direct acquisition of bank shares on the basis of which he acquires equal to or more than 20%, 30%, or 50% participation in the capital or voting rights in the bank.

If a bank has a qualified share in another legal entity, that legal entity cannot acquire a qualified share in that bank and vice versa.

The bank may not acquire its own shares without the prior consent of the Banking Agency. The acquisition of the bank's own shares is carried out from funds derived from the bank's profits. The bank is obliged to dispose of the acquired own

shares within one year from the date of their acquisition. If the bank does not dispose of the acquired own shares within one year from the date of acquisition of its own shares, it is obliged to withdraw and cancel these shares at the expense of its shareholders' capital.

2.5. What are the requirements for a proposed acquisition and acquirer of a qualified holding in a bank? Would the same requirements apply in the case of an increase of a qualifying holding?

In BiH, there are specific requirements that must be met by a proposed acquirer of a qualified holding in a bank. Qualifying holding is defined as when a person or a legal entity (alone or through related parties) has at least 10% of capital ownership or share in the voting rights of an institution or the ability to influence the management.

According to the Law on Banks, a person or legal entity that wishes to acquire a qualified holding in a bank must first submit a request to the Banking agency for the issuance of prior approval. The Banking Agency will then review the proposed acquisition to determine whether it especially assesses the applicant's eligibility and financial condition, his management skills, and influence on the bank based on the following criteria: business reputation and reputation that are valued in relation to his financial and business activities, criminal records, assessment of the management abilities, the applicant's financial condition and its impact on the bank's operations, indicators that may be important for evaluating the impact of the applicant on risk management in the bank, the existence of reasonable grounds for suspicion of money laundering and the financing of terrorist activities, and the ability of the bank to meet the requirements established by this law and by-laws.

If the Banking Agency determines that the proposed acquisition meets the necessary requirements, they will issue approval for the acquisition to proceed within 60 days from the date of receipt of the request with complete documentation. If the Banking Agency does not reject the proposed acquisition in writing within the period referred to in the previous sentence, the acquisition is considered to have been approved. If the acquisition is not approved, the acquirer will not be permitted to acquire the qualified holding in the bank.

A person who has qualified participation in the bank must obtain the prior approval of the Banking Agency in the same manner for any further indirect or direct acquisition of bank shares on the basis of which he acquires equal to or more than 20%, 30%, or 50% participation in the capital or voting rights in the bank.

III. REGULATORY CAPITAL AND LIQUIDITY

3.1. How are banks typically funded in your jurisdiction?

Banks in Bosnia and Herzegovina are typically funded through a combination of sources, including deposits from customers, borrowing from other financial institutions, and the formation of their own capital.

Deposits from customers are a common source of funding for banks and may include savings deposits, checking accounts, and other types of accounts that allow customers to deposit money with the bank. Deposits holders can be 1. the population (individuals, households) – the basic sector that holds deposits with banks, 2. non-profit institutions (citizens' associations, religious associations, sports clubs), 3. state and public enterprises (ministries, local administration bodies, and self-government), 4. trading companies, i.e., domestic business enterprises, 5. financial institutions (domestic and international), and 6. non-residents. Due to the majority of foreign ownership, the banks in BiH are able to maintain the necessary level of liquidity without difficulty with the support of foreign banks that represent bank groups and whose banks from BiH are members. The most common form of support in maintaining the necessary liquidity is represented by subordinated loans or long-term deposits from the bank or through bank recapitalization.

Non-deposit sources of funds are supplementary resources of banks, necessary for filling the financial potential. The share of non-deposit sources of funds compared to deposit sources is constantly increasing. Borrowing on the money market can be arranged within minutes and the funds are immediately transferred to the bank that needs them. Also, most non-deposit funds do not require keeping reserves, which reduces the costs of this type of financing. Non-deposit sources are formed from credit sources, securities, and capital. Credit sources consist of loans between commercial banks and loans from other financial organizations. Funds collected by issuing different types of securities can be short-term (treasury bills, certificates of deposit) or long-term (shares or bonds, long-term certificates of deposit). Capital represents permanently invested funds in the bank account.

Banks may also raise capital by issuing new ordinary shares, which can be purchased by investors, funds generated by the issue of preferred shares, surplus, retained earnings, and capital reserves.

The specific mix of funding sources used by a particular bank will depend on a variety of factors, including the bank's business model, its risk appetite, and the availability of funding sources.

3.2. What capital and own funds requirements apply to banks in your jurisdiction?

In BiH, banks are subject to capital and own funds requirements that are designed to ensure the stability and soundness of the banking sector. Capital and own funds refer to the financial resources that a bank has available to absorb losses and meet its financial obligations. The minimum requirements regarding the amount of share capital, regulatory capital, and capital rates of the Bank are defined by the Law on Banks, the Decision on the calculation of bank capital of the Banking Agency of the Federation of Bosnia and Herzegovina, and other legal regulations that regulate this area.

Some of the key capital and own funds requirements that apply to banks in BiH include:

- Tier 1 capital is a sum of the Common Equity Tier 1 after regulatory adjustment and the Additional Tier 1 after regulatory adjustment.
- Common Equity Tier 1 – CET 1 - The bank's Common Equity Tier 1 – CET 1 consists of items that are available to cover the risk or loss of the bank during its regular operations, in case of bankruptcy or liquidation. Common Equity Tier 1 is the highest quality layer of capital and consists of share capital, share premium account related to Common Equity Tier 1 instruments, retained earnings, accumulated other comprehensive income, other reserves, and reserves for general banking risks, after deductions for regulatory adjustments.
- Additional Tier 1 – AT 1 - Additional Tier 1 consists of issued capital instruments after deduction for regulatory adjustments, which do not belong to Common Equity Tier 1. This capital consists of capital instruments issued and paid in and the purchase of which was not directly or indirectly financed by the bank and the share premium account relating to the Additional Tier 1 instruments.
- Tier 2 Capital – T2 - The bank's Tier 2 capital (T2) consists of the bank's Tier 2 items after deduction for regulatory adjustments. The bank's Tier 2 items consist of capital instruments and subordinated loans that do not meet the requirements for items of Common Equity Tier 1 and Additional Tier 1, share premium accounts related to Tier 2 instruments, and general value adjustments for credit losses of up to 1.25% of the risk-weighted exposures. Tier 2 capital may not exceed one-third of the Tier 1 capital.
- The bank's regulatory capital - is the amount of funding sources the bank is obliged to maintain for the purpose of safe and stable operations, i.e., fulfillment of obligations to creditors. Regulatory capital is the sum of Common Equity Tier 1 and Tier 2 capital, after regulatory adjustments.

Therefore, in line with the Decisions on the capital calculation the bank must at all times meet the following capital requirements: :

a) CET 1 ratio 6.75%;

b) T1 ratio 9%;

c) regulatory capital rate of 12%.

In addition to the regulatory minimum adequacy rates, the Bank is also obliged to provide a protective layer for the preservation of capital, which must be maintained in the form of regular core capital in the amount of 2.5%.

In any event, the bank's regulatory capital must not fall below the amount of the founding capital of BAM 15 million that, in accordance with the provisions of the law, is required when issuing a banking license.

3.3. Has your jurisdiction implemented the Basel III framework? Are there any major deviations?

In order to comply with the EU regulations, the process of reforms to improve the regulatory framework in BIH has already started. New regulations cover a period of over ten years since they have been in effect in the EU. In April 2017, a new Law on Banks was announced in the FBH, and at the end of 2017, decisions and instructions of the FBH Banking Agency in the risk management area were announced. During 2018, the reform process was continued in BiH, so supplements were made to the existing regulatory requirements related to internal assessments of the banks' liquidity adequacy. The transition process is extremely demanding, both for commercial banks and regulators. To adequately respond to all regulatory requirements, the banks will need to invest significantly in the development of new tools, processes, and specialist training for employees.

In line with European Banking Authority Report from 2019 the good profitability and efficient management of NPLs, as well as the high capital requirements imposed by FBA and BARS (CET1 at 6.75%, Total Capital at 12%, i.e., 50% higher than required under Basel III and the CRR), the BiH banking system is adequately capitalized, showing a CET1 ratio of 16.2% in RS and of 16.5% in FBiH. The high level of capital adequacy is also confirmed by the leverage ratio, at 10.4% in RS and 10.7% in FBiH.

IV. REPORTING, ORGANISATIONAL REQUIREMENTS, INTERNAL GOVERNANCE, AND RISK MANAGEMENT

4.1. What key reporting and disclosure requirements apply to banks in your jurisdiction?

In Bosnia and Herzegovina, banks are subject to various reporting and disclosure requirements designed to ensure transparency and promote the stability and soundness of the banking sector. These requirements are set forth in the Law on Banks, Decisions on the publication of Data and Information of the Bank (*Official Gazette FBiH, no. 39/21, Official Gazette RS, no. 89/17*), the Decision on the form and content of reports submitted by banks to the Banking Agency (*Official Gazette RS, no. 120/21, 74/22*) and the Decision on reports submitted by banks to the Banking Agency for supervisory and statistical purposes (*Official Gazette RS, no. 86/20*), and other regulations that apply to the banking industry in Bosnia and Herzegovina. Some of the key reporting and disclosure requirements that apply to banks in Bosnia and Herzegovina include:

■ Preparation of financial statements: Banks are required to prepare financial statements on a regular basis, in accordance with international financial reporting standards (IFRS) or other recognized accounting standards. These financial statements must be audited by an independent auditor and must be made available to the public.

■ Submission of reports to the regulatory authorities: The bank is obliged to prepare and deliver to the Banking Agency reports and data on its financial condition and operations, including risk exposure, large exposures, asset quality, reserves for credit losses, business with persons in a special relationship with the bank, liquidity, solvency, and profitability, as well as on planned business activities of the bank and its subsidiaries in accordance with this law and the regulations of the Banking Agency. In addition, the bank is obliged to submit, at the request of the agency: a) data on the financial situation, operations, and exposure to risk on a consolidated basis and b) data for the member of the banking group that is necessary for the assessment of the situation and risks of the bank or banking group. At the request of the Banking Agency, the bank is obliged to submit a report and information on all matters important for the implementation of supervision or supervision or for the execution of other tasks within the competence of the agency.

■ The bank is obliged to submit to the Banking Agency, along with the annual financial report, the annual report on the implementation of control functions, which was adopted by the bank's supervisory board.

In regard to the disclosure, the bank is obliged to disclose the following information at least once a year on its official website, in a way that is easily visible to users, that is, to interested participants in the financial market. The bank is obliged to publish the name, headquarters, and organizational parts of the bank, as well as quantitative and qualitative data on the bank's operations and organizational structure, the bank's risk profile, and other information that is not considered protected or confidential in accordance with the regulations, and which is of importance to inform the public about its financial condition and operations, such as:

a) ownership structure and members of the bank's supervisory board and management;

b) remuneration policy;

c) scope of application of regulatory requirements, on an individual or consolidated basis;

d) the bank's strategy, objectives, and risk management policies;

e) regulatory capital, protective layers of capital, capital requirements, and adequacy of regulatory capital;

f) financial leverage rate;

g) liquidity requirements;

h) exposure based on the bank's equity investments;

i) interest rate risk in the banking book;

j) internal capital adequacy assessment process (CAAP) and internal liquidity adequacy assessment process (ILAAP);

k) unencumbered (unpledged) and encumbered (pledged) assets of the bank;

l) low-quality and restructured exposures and collateral acquired by taking over and implementing enforcement proceedings.

Also, it is important to mention that the bank in BiH is obliged to inform the Baking Agency without delay about the following:

a) the general meeting held and all decisions made at that general meeting,

b) any planned change in the bank's capital of 10% or more,

c) the cessation of certain operations within the scope of the bank's activities,

d) upon learning that a natural or legal person has acquired a qualified participation or that the holder of a qualified participation has sold or otherwise alienated his shares so that, as a

result, his participation has increased above or decreased below the amount by which has received prior consent,

e) shareholders of the bank and persons related to them who have 5% or more of shares with the right to vote at the bank's assembly,

f) persons related to the bank and

g) composition of groups of related parties to which the bank is exposed.

A bank whose shares are listed for trading on a regulated market is obliged to inform the Banking Agency about the shareholders who are holders of qualified shares and about the size of those shares.

The management of the bank is obliged to inform the Banking Agency without delay about the following:

a) if the liquidity or solvency of the bank is threatened, and

b) if there are circumstances for the termination of the validity of the banking license, the reasons for the cancellation of the banking license, or the reasons for the cancellation of the authorization to perform the approved activities.

4.2. What are the organizational requirements for banks, including with respect to corporate governance? Please briefly describe the requirements and the procedure of assessment of the suitability of the members of the management body and key function holders.

The specific corporate governance requirements that apply to banks in Bosnia and Herzegovina are set forth in the Law on Banks. Some of the key organizational requirements for banks in Bosnia and Herzegovina with respect to corporate governance include:

■ The Assembly: The bank's assembly consists of the bank's shareholders. The right to vote at the Assembly belongs to the shareholder who was registered in the registry 30 days before the Assembly. Shareholders exercise the right to vote directly or through a proxy. As a rule, the Assembly is held at least once a year, at the location of the bank's headquarters. The Supervisory Board convenes the Assembly.

■ The bank assembly is responsible for adopting and amending the statute, the bank's business strategy, plan, and programs, forming the capital of the bank through the issue of shares or increase of ordinary/priority shares, capital increase/decrease, adoption of the annual report on the bank's operations, distribution of profits and payment of dividends, status changes, as well as the individual selection and dismissal of the supervisory board. The assembly also has the power to appoint and remove external auditors, and to make decisions on major transactions and other important matters.

■ Management Board: Banks must have a board of directors, which is responsible for the execution of the decisions of the assembly and the supervisory board of the bank, overseeing the management of the bank and implementation of strategic decisions on behalf of the bank and informing the supervisory board and the Banking Agency regarding the financial status of the bank. The board of directors must be composed of at least three members, and one of them is the President of the Board. Only a person who has received prior approval from the Banking Agency can be appointed as the President and a member of the Management Board. In order to be able to perform tasks within the competence of the administration, they must be employed in the bank, full-time.

■ Members of the Management Board can be persons who: have a good reputation, higher education, the required level of education, are not in a conflict of interest in relation to the bank, non-shareholders and members of the Supervisory Board, and others. A member of the Management Board cannot be a person who: is a member of the Supervisory Board of another bank in BiH, if the possibility of exercising that function is excluded by another law, and others. It is considered that a person who does not have a good reputation, who has been legally convicted, and a person against whom proceedings are being conducted for criminal offenses in the field of finance, capital market, money laundering, and financing of terrorist activities, or who has been issued a security measure prohibiting the performance of banking or other financial activities or the performance functions of the board member.

■ Members of the bank's management are jointly and severally liable to the bank for damage that occurs as a result of actions, omissions, and failure to fulfill their duties unless they prove that they acted with the care of a good and conscientious businessman in fulfilling their duties of managing the bank.

■ The Supervisory Board: is an independent body responsible for the supervision of the bank's activities. It consists of at least five members, who are elected and dismissed by the Assembly. There can be more than five members, provided that it must always be an odd number. It must have at least two independent members. These are persons who do not have direct/indirect qualified participation in the ownership of the bank, nor are they members of the banking group to which the bank belongs, etc. A member of the Supervisory Board can only be a person who has received prior approval from the Banking Agency to perform the function of a member of the Supervisory Board.

■ The main tasks include ensuring that the bank complies with laws and regulations, convenes Assembly sessions and

determines the proposed agenda, determines the proposal of business, plan, policy, and strategy, adopts the general terms and conditions of the bank's operations and other general acts of the bank, appoints and dismisses the bank's management and supervises its work, appoints and dismisses secretary of the bank, audit committee, the remuneration committee, the risk committee, the appointment committee, the voting committee, and other specialized committees, monitoring the financial health and takes appropriate actions when it detects any signs of financial distress, conducting regular audits, providing oversight of the management of the bank, participating in the resolution of failed banks and cooperation with other supervisory authorities. In addition, the Supervisory Board of the bank informs the Banking Agency about the date and place of the Assembly meeting so that the representative of the Banking Agency can attend.

The new Laws on Banks additionally define the position, rights, and responsibilities of risk management, internal controls, auditing, the Secretary, the Procurator, and bank associations.

4.3. What are the local rules for loans to the management body and their related parties?

In Bosnia and Herzegovina, there are specific rules that apply to loans made by banks to the management body and related parties of the bank. The rules for loans to the management body and related parties of a bank in Bosnia and Herzegovina are set forth in the Law on Banks and Decision on Bank Operations with Persons in a Special Relationship with the Bank (*Official Gazette FBiH no. 81/17, Official Gazette RS no. 15/18, 99/20*). Some of the key rules that apply to these loans include:

■ Disclosure: Banks must disclose any loans to the management body and related parties in their quarterly reports to the Banking agency 30 days after the end of the reporting quarter and based on the final data. This helps to ensure transparency and allows depositors and other stakeholders to see how the bank is using its funds.

■ Approval: The bank can perform legal transactions with persons in a special relationship with the bank only in accordance with the legislation and the bank's policies which, at the proposal of the bank's management, the supervisory board of the bank is obliged to adopt and monitor their application. The supervisory board of the bank is responsible for the bank's actions related to the management loans. This helps to ensure that these loans are made in the best interests of the bank and are not used to benefit a small group of individuals at the expense of the bank's other stakeholders.

■ Risk assessment: Banks must conduct a risk assessment of loans to the management body and related parties based on all relevant information, details, and terms of transactions to ensure that these loans are viable and do not pose an undue risk to the bank. This may include reviewing the creditworthiness of the borrower and the terms and conditions of the loan.

■ Limits: There may be limits on the amount that a bank can lend to the management body and related parties. The bank may perform business transactions if the bank's exposure to that natural person reaches or exceeds EUR 50,000 EUR (EUR 25.000 in RS) only with prior approval of the Supervisory board, that a person, a member of a management board, is not participating in the approval of any legal transaction between him and the bank and that bank may grant transactions to natural persons, members of the management board, up to 1% of the amount of the recognized capital of the bank.

4.4. What are the main legal provisions governing risk management in the banking sector in your jurisdiction?

In Bosnia and Herzegovina, the main legal provisions governing risk management in the banking sector are set forth in the Law on Banks and other regulations that apply to the banking industry in Bosnia and Herzegovina. Some of the key legal provisions that relate to risk management in the banking sector in Bosnia and Herzegovina include:

■ Responsibility for risk management: The supervisory board is responsible for the establishment of an efficient management system in the bank and for the supervision of that system and is obliged to ensure that the bank's management identifies the risks to which the bank is exposed, as well as controls these risks in accordance with approved policies and procedures. The board of directors of a bank is responsible for the implementation of the adopted strategies, policies, rules, and procedures in the daily operations of the bank. Additionally, the bank is obliged to define the authorizations and responsibilities clearly and precisely in risk management for all organizational levels, all levels of work processes, and decision-making in the bank. During the establishment and application of the risk management system, the bank is obliged to ensure that the assumption of risk is functionally separated from the tasks of identification, measurement, monitoring, and control of risk, and in this sense, depending on the size and complexity of the business, the bank has to define organizational parts in its organizational structure, that is, employees who will be directly responsible for risk management at the operational level.

■ Risk assessment: Banks are required to conduct a risk assessment of their operations and to identify the risks that they are exposed to. The risk assessment should include a review of the bank's business model, its products and services, its risk appetite, and the risks associated with its operations. The

bank is obliged to provide an independent assessment of the functioning of the risk management system through internal and external audits.

■ Risk management policies and procedures: the Banks are required to establish processes and procedures in risk management according to the defined strategy, policies, and procedures, which include identification and assessment of significant risks, risk measurement, measures to limit and mitigate risks, monitoring, analysis, and control of risks, as well as appropriate lines for continuous reporting to the supervisory board and management. Also, to efficiently, reliably, and timely report on risks, with adequate IT support that ensures comprehensive, timely, and reliable collection and processing of data necessary for measuring, monitoring, and reporting on the bank's exposure to risks according to regulatory requirements and for the bank's internal needs in the risk management system. These policies and procedures should be reviewed and updated regularly.

■ Risk management systems and controls: Banks are required to have systems and controls in place to manage the risks that they are exposed to. These systems and controls should be designed to identify and assess risks, as well as to mitigate and manage those risks. Therefore, the bank must conduct stress tests – tests of the bank's sensitivity to risks (individual and integral), using several scenarios, that is, assumptions about changes in external and internal factors that can have a significant impact on risks in the bank's operations. The systems and controls should be reviewed and updated regularly.

The risk management system in the bank must be established in such a way as to include all the risks that the bank considers significant and to which it is exposed or could be exposed in its operations, and it should define them in its strategy, policies, and procedures for risk management, and as a minimum the following risks: a) credit risk; b) liquidity risk; c) market risks (position risk, currency risk, commodity risk, and other market risks); d) operational risk; e) interest rate risk in the banking book; f) country risk; g) compliance risk; h) concentration risk; i) settlement risk; j) strategic risk; k) reputational risk; l) other risks.

4.5. What are the legal requirements applicable to banks in combating money laundering and terrorist financing area?

In Bosnia and Herzegovina, banks are subject to legal requirements designed to combat money laundering and terrorist financing. These activities pose a serious threat to the stability and integrity of the financial system and are therefore heavily regulated in Bosnia and Herzegovina.

The legal requirements applicable to banks in combating money laundering and terrorist financing in Bosnia and Herzegovina are set forth in the Law on Prevention of Money Laundering and Financing of Terrorism and other regulations that apply to the banking industry in Bosnia and Herzegovina. Some of the key legal requirements that apply to banks in this area include:

■ Customer due diligence: Banks are required to conduct customer due diligence when opening new accounts or engaging in certain types of transactions. This includes verifying the identity of their customers and obtaining information about the purpose and intended nature of the account or transaction. Banks must also be alert to suspicious activity and report any suspicious transactions to the regulatory authorities.

■ Recordkeeping: Banks are required to maintain records of their transactions and customer information for a certain period of time. This includes keeping records of account opening documents, transaction records, and other relevant information. These records must be made available to the regulatory authorities upon request.

■ Internal controls: Banks must have internal controls in place to prevent and detect money laundering and terrorist financing. These controls should be designed to identify and assess risks, as well as to mitigate and manage those risks. The internal controls should be reviewed and updated regularly.

■ Training: Banks must ensure that their employees receive training on money laundering and terrorist financing, including an authorized person for the prevention of money laundering, and how to identify and report suspicious activity.

■ Reporting: With the aim of providing information to the Financial Intelligence Department of the BiH State Agency for Security and Investigations (FOO), and for the performance of other duties in accordance with the provisions of this Law on Prevention of Money Laundering and Financing of Terrorism, the bank appoints an authorized person and one or more deputies about which he informs FOO within seven days from the date of appointment. An authorized person ensures correct and timely reporting to FOO. The bank is obliged to submit to the FOO the data on a) any attempted or completed suspicious transaction, b) suspicious assets independently from the transaction, c) about any suspicious client or person, d) a cash transaction whose value is or exceeds the sum of BAM 30,000, and e) related cash transactions whose total value amounts to or exceeds the sum of BAM 30,000.

4.6. Are there any legal provisions regulating banking secrecy in your jurisdiction?

The main legal provisions regulating banking secrecy in Bosnia and Herzegovina are set forth in the Law on Banks and other

regulations that apply to the banking industry in Bosnia and Herzegovina.

Under these legal provisions, banks in BiH are required to maintain the confidentiality of the financial affairs of their customers and are prohibited from disclosing this information to third parties without the customer's consent. This means that banks are not allowed to share information about their customers' accounts, transactions, or other financial affairs with anyone outside of the bank unless they have been specifically authorized to do so by the customer. There are a few exceptions to this rule, however, including situations where the disclosure of customer information is required by law or is necessary to protect the interests of the bank or its customers.

The legal provisions regulating banking secrecy in BiH are designed to protect the privacy of bank customers and to ensure the stability and soundness of the banking sector. They help to ensure that customers can trust that their financial affairs will be kept confidential by their bank and that their bank will not disclose sensitive information about their finances to others without their consent.

V. TRENDS

5.1. What are the main trends in the banking sector in your jurisdiction?

The figures from banking reports show that the banking system in BiH is liquid, well-capitalized, profitable, and operating in a moderately dynamic economic environment. However, the economy of Bosnia and Herzegovina is largely aligned with the economic cycle in Europe and many companies are also major exporters. Preliminary forecasts highlight the risks of slow economic growth in the leading economies and markets to which BIH is tied. Under the assumption that inflationary pressures are temporary, and even triggered only by temporary factors or shocks in the energy market, it is certain that in the medium term, there will be moderate corrections of reference interest rates.

The risks of maintaining inflation and possible changes in the level of interest rates already in 2023 cannot be ruled out. When and if they happen, changes in the level of interest rates will be transmitted to the BIH market, but at a slower pace, due to already mentioned good indicators and the state of liquidity of the BiH banking system. Banks managed to compensate for decreased interest by increasing the share of non-interest income based on the delivery of other fee-based traditional services and other optimization (mainly on the side of costs). However, banks announce their continuation of active adjustment and support to the economy.

Regarding the NPLs there has been a steady decrease in the share of non-performing loans as a result of the active approach to recovery and measures aligned with EU best practices, however, there is a need for constant review of the market.

Political conditions and EU enlargement may have additional significant effects on economic growth, stability, and demographic conditions bearing in mind the latest assigned EU candidate status to BiH.

5.2. What are the biggest challenges in the banking sector at the moment?

The key challenge is to maintain the dynamics of compliance and application of regulatory requirements, in accordance with the dynamics established in the EU. Key activities include very intensive coordination with institutions within BiH. The Banking Agencies are strengthening the guidelines for corporate governance in banks and monitoring its application, setting clearer principles regarding third-party risks and externalization, and implementing a new framework for liquidity management and financial reporting.

BIH needs to solve the issue of harmonizing key laws at the BiH level with relevant requirements and guidelines from the EU. Any delay in harmonizing the framework for preventing money laundering and financing of terrorist activities at the BiH level is not acceptable and exposes BiH to significant risks.

Activities will be focused on the continuation of optimization in the areas of supervision with the emphasized need for the continuation of digitization of processes. Application of best practices and standards in the areas of regulation and supervision remains the main task in 2023.

5.3. What's new in fintech?

Fintech in BiH still lags behind the traditional way of doing business, however, has made significant progress in the BiH banking system in recent years. Many banks in the country have started to adopt digital technologies to improve the efficiency and accessibility of their services. This has included the implementation of online banking, mobile banking, and digital payment systems. Additionally, several fintech companies have emerged in BiH to provide financial services such as digital lending and crowdfunding. The use of fintech has increased financial inclusion in BiH, particularly for individuals and small businesses that have limited access to traditional banking services. However, there is a need for more regulation and support for fintech companies in order to enable them to continue to grow and improve the financial sector in the country. In BiH, there is still no specific law that would cover all the models that Fin-Tech companies deal with, and this is exactly what prevents these companies from expanding their business.

Generally, the cryptocurrency in BiH is not yet regulated, and the problem is also a matter of jurisdiction, given that monetary transactions and payment transactions are at the entity level, while the Central Bank of BiH and its currency are at the state level. Due to the lack of regulation, cryptocurrency trading takes place in a market that is beyond the reach of tax authorities, because the laws on value-added tax, income, and profit do not regulate this area. The biggest problem for all those involved in trading or mining cryptocurrencies was that they could not realize their earnings in Bosnia and Herzegovina. With the opening of the Balkan Crypto exchange, that problem has also been solved. Also, in the last three months, thanks to a couple of applications in the BiH market, it is possible to pay the bill in several places in BiH using a QR code with cryptocurrencies and to buy cryptocurrencies at the first ATM bitcoin in Sarajevo

However, in Republika Srpska, cryptocurrency trading recently has been regulated by amending the Law on the Securities Market of the Republic of Srbska by the end on 2022. Legal entity which is not registered with the Commission in accordance with the Law cannot provide services related to virtual currencies. A service provider with virtual currencies must be registered with the Securities Commission of the RS, which establishes and maintains records. The Rulebook on the record of service providers related to virtual currencies entered into force by the end of the January 2023. Therefore, persons (legal and natural) operating with virtual currencies were obliged, no later than January 31, 2023 to notify the Commission together with a description of the internal control measures that are established in order to fulfill the obligations established in the regulations on the prevention of money laundering and submit a request for entry in the records with the prescribed attachments.

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CEE LEGAL MATTERS COMPARATIVE LEGAL GUIDE: BANKING/FINANCE 2023

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1. LEGAL FRAMEWORK

1.1. Which main legislative and regulatory provisions govern the banking sector in your jurisdiction?

Credit institutions in Bulgaria are subject to the requirements of the common financial regulatory framework (the so-called Single Rulebook) and have to implement the harmonized prudential rules under EU law. The Single Rulebook includes the EU legislation implementing *Basel III (Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms* (CRR) and *Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms* (CRD IV)), *Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms* (BRRD) and *Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (recast)* (DGSD).

The CRR and other EU regulations are directly applicable in Bulgaria. The EU directives have to be transposed into local law, usually in the form of an Act of the Bulgarian Parliament. CRD IV has been transposed mainly through the provisions of the CIA, BRRD – through the BRRD Act, and the DGSD – through the DG Act (please see below for detailed descriptions of the relevant Bulgarian Acts). The primary legal framework set out by the EU regulations and the Bulgarian Acts of Parliament is further developed and detailed by secondary legislation (in the banking legislation context, these are mainly ordinances of the Bulgarian National Bank – BNB).

We have set out below a list of the key local Acts and secondary legislation comprising the regulatory framework applicable to banks in Bulgaria (but this list is by no means exhaustive):

- the *Credit Institutions Act* (published in *State Gazette issue 59 dated 21 July 2006, in effect from 1 January 2007, as amended*) (Credit Institutions Act; CIA);
- the *Recovery and Resolution of Credit Institutions and Investment Firms Act* (published in *State Gazette issue 62 dated 14 August 2015, in effect from 14 August 2015, as amended*) (BRRD Act);
- the *Bank Deposit Guarantee Act* (published in *State Gazette issue 62 dated 14 August 2015, in effect from 14 August 2015, as amended*) (DG Act);
- the *Banking Bankruptcy Act* (published in *State Gazette issue 92 dated 27 September 2002, in effect from 28 December 2002, as amended*);
- the *Bulgarian National Bank Act* (published in *State Gazette issue 46 dated 10 June 1997, in effect from 10 June 1997, as amended*) (BNB Act);
- *Ordinance No 2 of the BNB of 22 December 2006 on the licenses, approvals, and permissions granted by the Bulgarian National Bank according to the Credit Institutions Act (title amended State Gazette issue 36/3009)* (published in *State Gazette issue 6 of 19 January 2007, as amended*) (BNB Ordinance No 2 (Licenses and Approvals));
- *Ordinance No 7 of the BNB of 24 April 2014 on organization and risk management of banks* (published in *State Gazette issue 40 dated 13 May 2014, as amended*) (BNB Ordinance No 7 (Bank Risk Management));
- *Ordinance No 8 of the BNB of 27 April 2021 on Banks' Capital Buffers* (published in *State Gazette issue 40 dated 14 May 2021*) (BNB Ordinance No 8 (Capital Buffers));
- *Ordinance No 10 of the BNB of 24 April 2019 on the Internal Control in Banks* (published in *State Gazette issue 40 dated 17 May 2019*);
- *Ordinance No 11 of the BNB of 1 March 2007 on Bank Liquidity Management and Supervision* (published in *State Gazette issue 22 dated 13 March 2007, as amended*) (BNB Ordinance No 11 (Liquidity Management));
- *Ordinance No 20 of the BNB of 24 April 2019 on the Requirements to the Members of the Management and Controlling Bodies of a Credit Institution and on the Assessment of the Suitability of Their Members and Key Function Holders* (published in *State Gazette issue 40 dated 17 May 2019, as amended*) (BNB Ordinance No 20 (Board Members));
- *Ordinance No 22 of the BNB of 16 July 2009 on the Central Credit Register* (published in *State Gazette issue 22 dated 16 July 2009, as amended*) (BNB Ordinance No 22 (CCR));
- *Ordinance No 37 of the BNB of 16 July 2018 on the internal exposures of banks* (published in *State Gazette issue 61 dated 24 July 2018*) (BNB Ordinance 37 (Internal Exposures);
- the *Payment Services and Payment Systems Act (published in State Gazette issue 20 dated 6 March 2018, as amended*) (PSPSA);
- *Ordinance No 16 of the BNB of 29 March 2018 on granting licenses and approvals, entry into the Register under Article 19 of the Payment Services and Payment Systems Act, and requirements for the activity of operators of payment systems with settlement finality* (published in *State Gazette 32 dated 13 April 2018, as amended*) (BNB Ordinance No 16 (PSPSA Licenses and Approvals)).

1.2. Which bodies are responsible for enforcing the applicable laws and regulations? What are their main competencies?

Bank Supervision

The Bulgarian National Bank (BNB) is the Central Bank of Bulgaria and the national competent authority within the meaning of Article 4(1)(40) of the CRR designated and empowered by national law, among others, to carry out banking supervision in Bulgaria.

The role and powers of the BNB are set out in the BNB Act.

According to the BNB Act, the BNB among others:

- maintains price stability by ensuring the stability of the national currency;
- acts as the sole issuing institution with the exclusive authority to issue banknotes and coins in Bulgaria;
- supports the creation and functioning of efficient payment systems and exercises oversight of the payment systems; supervises the activity of operators of payment systems, payment services providers, and e-money institutions; and
- regulates and supervises the activity of other banks in Bulgaria with a view to maintaining the stability of the banking system and protecting depositors' interests.

The BNB is also the regulator for the non-bank financial sector in Bulgaria.

In October 2020, Bulgaria joined the European Banking Union and the Single Supervisory Mechanism (SSM) through a process known as "close cooperation" established by the *Council Regulation (EU) No 1024/2013 of 15 October 2013* conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (SSM Regulation). As part of the SSM, the European Central Bank (ECB) has the leading supervisory role and carries out supervision over banks in Bulgaria in cooperation with the BNB. Under the SSM Regulation, the ECB is exclusively competent to authorize and to withdraw authorizations of credit institutions established in the Member States participating in the Single Supervisory Mechanism, as well as to assess the notifications for the acquisition and disposal of qualifying holdings in credit institutions, and in these instances, the BNB issues the relevant national acts based on an instruction by the ECB.

In accordance with the cooperation within the SSM, the so-called "significant institutions" are supervised directly by the ECB (currently these include UniCredit Bulbank AD (a subsidiary of UniCredit S.p.A.), DSK Bank AD (a subsidiary of Hungarian OTP Bank Nyrt), United Bulgarian Bank AD (a subsidiary of KBC Group N.V.) and Eurobank Bulgaria AD (a subsidiary of Greek Eurobank Ergasias Services and Holdings S.A.)). The BNB is supervising smaller banks (the so-called "less significant institutions"), with ECB having indirect supervisory oversight and the authority to take over the direct supervision of any bank at any time.

Regulated investment activities and markets in financial instruments

The BNB collaborates with the Financial Supervision Commission (FSC) which is the competent authority with respect to regulated investment activities. A bank can carry out regulated investment activities under the *Markets in Financial Services Act* (published in *State Gazette issue 15 dated 16 February 2018, as amended*) or crowdfunding services, if its license permits such investment activities. Before issuing a license that allows for such activities, the FSC has to be formally consulted and if its response is not affirmative, the BNB has to decline a license for the relevant investment activities. The FSC is also to be consulted in instances where an investment intermediary has to be reclassified and licensed as a bank (please see Section 2.1.).

Resolution of banks

The BRRD Act designates the BNB as the national resolution authority for any credit institutions supervised by the BNB.

With effect from October 1, 2020, following Bulgaria's accession to the Banking Union and the Single Resolution Mechanism, the function of the resolution of credit institutions is shared between the BNB and the Single Resolution Board (SRB). The SRB is responsible for the banks that are subject to direct supervision by the ECB, whereas the BNB's resolution powers cover all other credit institutions operating in Bulgaria.

In its role of a resolution authority, the BNB acts through its Governing Council which is assisted by a special directorate (the Resolution of Credit Institutions Directorate) which is structurally separate and independent from the banking supervision function and the other functions of the BNB.

Other relevant authorities

Other authorities which are competent to enforce specific laws and regulations applicable to banks in Bulgaria include the State Agency for National Security (SANS, in respect of AML rules), the Personal Data Protection Commission (in respect of data protection legislation), the Consumer Protection Commission and the Competition Protection Commission, to name but a few.

1.3. What are the current priorities of regulators and how does the regulator engage with the banking sector?

One of the key priorities before the Bulgarian National Bank is getting Bulgaria ready to join the Eurozone. This is the final stage of integration processes that have been ongoing for many years now (including, more recently, joining the Exchange Rate Mechanism II (ERM II) in July 2020 and the establishing of "close cooperation" under the SSM Regulation (please see Section 1.2.) with effect from October 1, 2020). To be able to finally complete its accession to the Eurozone, Bulgaria still has quite of few tasks ahead which range from meeting all euro convergence criteria (specifically with respect to inflation where we currently fall short) to further adapting Bulgaria's relevant legislative framework and the overall logistics for adopting the Euro. In terms of required legislative changes, the BNB works closely with the Ministry of Finance and other authorities on the new legislation necessary for Bulgaria to be ready to accede to the Eurozone (such as the proposed bill for the Euro Adoption Act, and a pending bill to amend the BNB Act). The BNB also has a key role in the various logistical and technical aspects of the adoption of the Euro, together with Bulgarian commercial banks (including a range of tasks from the technical standard for minting Bulgarian euro coins, to making sure cashier points across the country are up to the task, to adapting payment and core banking systems).

II. AUTHORISATION

2.1. What licenses are required to provide banking services in your jurisdiction? What activities do they cover?

According to the CIA, the banking activities in Bulgaria fall into two categories: exclusive banking activities and non-exclusive banking activities (please see below as to what services fall within each category).

The "exclusive" banking activities can only be carried out on the territory of Bulgaria by:

- banks incorporated, and licensed to operate, in Bulgaria (this category includes local subsidiaries of foreign (EU and non-EU) banks);
- branches of foreign (non-EU) banks licensed to operate in Bulgaria; or
- EU credit institutions that have passported their authorization in Bulgaria which enables them to provide services through a branch or directly in Bulgaria.

The "non-exclusive" banking activities may be carried out by banks (if included in their authorization) or by other regulated entities (such as non-bank financial institutions which are registered with, and supervised by, the BNB).

A bank license issued by the BNB entitles the licensee to perform the banking activities specified in the license on the territory of Bulgaria and, subject to the EU passporting regime, on the territory of the other Member-States. A license for a branch of a foreign (non-EU) bank entitles the licensee to perform the banking activities specified in the license only on the territory of Bulgaria; such license cannot be passported outside of Bulgaria.

"Exclusive" banking activities include:

- accepting deposits or other repayable funds from the public;
- accepting valuables on deposit; and
- acting as a depository or trustee institution.

"Non-exclusive" banking activities include:

- provision of payment services within the meaning of the *Payment Services and Payment Systems Act*;
- issue and administration of other means of payments (travelers' cheques and letters of credit) outside of the scope of the payment services above;
- financial leasing;
- guarantee transactions;
- trading for own account or for the account of clients in foreign currency and precious metals but excluding derivative financial instruments on foreign currency and precious metals;
- investment services and activities as well as ancillary services provided by investment intermediaries under the *Markets in Financial Instruments Act*;
- money brokerage;
- acquisition of receivables under loans and another type of financing (factoring, forfeiting, etc.);
- issuance of electronic money;
- acquisition and management of participating interests;
- safe custody services;
- collection, provision of information, and reference on customer creditworthiness;
- providing crowdfunding services within the meaning of *Regulation (EU) 2020/1503 of the European Parliament and of the Council on European crowdfunding service providers for business*,

and amending *Regulation (EU) 2017/1129 and Directive (EU) 2019/1937*; and

- any other activities as may be specified by an ordinance of the BNB.

An investment intermediary can be reclassified and will have to be authorized as a credit institution if it meets the following conditions (in accordance with the regime under *Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms* and *Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms, and the corresponding changes in the CRR*):

- its business includes dealing on its own account or underwriting or placing financial instruments on a firm commitment basis (or both);
- it is not a commodity and emission allowance dealer, a collective investment undertaking, or an insurance undertaking; and
- the total value of its consolidated assets is equal to or exceeds the BGN equivalent of EUR 30 billion (or, if less, it is part of a group and other applicable thresholds at the group level have been met).

According to the CIA, a bank may register a representative office in Bulgaria with the Bulgarian Chamber of Commerce and Industry (BCCI) for marketing, profile raising, promotional, information gathering or other similar auxiliary functions provided that such representative office shall not carry out any commercial activity. Under the CIA, such representative office of a foreign bank is not subject to licensing but the BNB has to be notified within 14 days from its registration with the BCCI.

2.2. What is the procedure for obtaining a banking license? How long does this typically take?

The licensing procedure follows the following main phases:

- preparation phase – the applicant prepares the business case and collects the various documents that have to accompany the application in each case;
- preliminary consultations – according to the CIA, an applicant shall hold preliminary consultations with the Deputy Governor of the BNB in charge of the Banking Supervision Department, prior to filing any application for any license, permission, or approval;
- filing the application and all required documents;
- various consultations including consultations with the competent supervisory authorities of other Member States;
- decision on the issuing of a license;
- satisfying any conditions for the issuing of a license and confirmation of commencement of activity by the Deputy Governor in charge of the Bank Supervision Department of the BNB.

The documents required of the applicant depend on the type of applicant and the relevant license.

Licensing of a bank

The applicant for a banking license must file a written application accompanied by a number of documents as set out in the CIA and the BNB Ordinance No 2 (Licenses and Approvals), including the following:

- the constitutional documents of the applicant and relevant corporate authorizations;
- documents evidencing the subscribed shares and the paid contributions;
- a detailed business plan, including a comprehensive description of the proposed banking activities for which the license is required, client and product structure, the objectives, policies, and strategy of the applicant as well as financial forecast over a three-year period;
- description of the management and organizational structure including the proposed activity of the different organizational units, the sharing of responsibilities between the executive directors and the various other administrators, the information system of the bank including data security protocols; if the applicant is part of a group, all relevant information with respect to the organization structure of the group;
- description of the internal control system, and description of the risk management system;
- information regarding the members of the supervisory board and the management board of the applicant;
- information and documentation regarding all persons/entities that have subscribed 3% or more of the voting shares, as well as information regarding the 20 biggest shareholders;
- information regarding the beneficial owner of the persons who have direct or indirect qualifying holding in the applicant;
- any further information or evidence that may be required for the assessment of the application.

The BNB shall hold preliminary consultations with the competent supervision authorities of another Member State

before granting a license to (i) a bank that will be a subsidiary of a bank, insurer, or investment firm that has been granted authorization in another Member State; (ii) a bank which will be a subsidiary of a parent undertaking of another bank, the insurer of an investment firm which has been granted authorization in another Member State; (iii) a bank which is controlled by persons exercising control over another bank, insurer or investment firm which has been granted authorization in another Member State. The consultations shall encompass issues concerning the shareholders, reputation, and experience of the management, evaluation of compliance with supervisory requirements as well as any other information as may be necessary for the granting of the license. Further, the BNB Ordinance No 2 (Licenses and Approvals) requires consultations with the competent authorities of any third (non-EU) country if a person who has subscribed 25% or more of the shares of the applicant is a bank with a seat in that country or a holding company of, or under common control with, a bank with a seat in that country.

Licensing of a branch

The applicant for a license for a branch of a foreign (non-EU) bank must file a written application accompanied by a number of documents as set out in the CIA and the BNB Ordinance No 2 (Licenses and Approvals), including the following:

- a certified copy of the registration extract containing information about the registered address, the registered scope of business, the amount of the capital, the management system, and the persons representing the bank;
- a certified copy of the relevant authorization for the conduct of banking business in the home country;
- certified copies of the bank's constitutive documents and relevant corporate authorizations;
- a business plan for the operations of the branch, including a description of the banking activities which it intends to carry out;
- the organizational structure of the branch;
- the annual financial statements for the last three years;
- the authorization for the opening of a branch from the banking supervision authority of the bank's home country;
- a written statement from the banking supervision authority of the bank's home country containing information about the financial position of the bank and a commitment to cooperation with the BNB;
- information about the persons entrusted with the management of the branch (including their qualifications and professional experience).

Further, the licensing of a branch is subject to the following requirements:

- the competent home banking supervision authority exercises effective supervision over the bank and its branches abroad;
- there is an agreement on supervisory cooperation between the BNB and the competent supervisory authority;
- the bank is renowned in the international financial market and its financial position is reliable and stable;
- the organizational structure of the bank is appropriate for the activities it intends to carry out;
- the managers of the branch comply with the requirements under Bulgarian law and have the required reputation;
- the law of the third country does not create obstacles to the exercise of effective supervision on a consolidated basis or to the provision of the necessary information;

The license of a branch cannot include activities that the bank is not entitled to carry out in its home country.

Review period and overall timeframe

The regulator has to make a decision on any application for the issuance of a license within three months from receipt of a complete set of documents but, in any event, within no more than 12 months from receipt of the application.

Within the review period (i.e., within the three-month period from submitting a complete application), the applicant should provide further evidence that it has satisfied the statutory requirements under the CIA, including that any minimum capital requirements have been met, the necessary premises and technical equipment for starting the activity are in place, the applicant has set up risk management, compliance, and internal audit functions and has appointed management and administrators with the necessary qualification and experience. The Deputy Governor in charge of the Bank Supervision Department of the BNB issues a confirmation permitting the licensee to commence the licensed activity upon receipt of evidence that the conditions above have all been satisfied.

If a license has been refused, a new application could be filed not earlier than 12 months after the refusal has entered into force. A license shall be canceled if the licensee failed to commence activity within 12 months.

2.3. Can a foreign bank operate in your jurisdiction on the basis of its domestic license?

A bank authorized in another Member State may passport its existing authorization and carry out regulated activities for which it is authorized under its existing authorization, either directly or through a branch in Bulgaria, subject to a notification to the BNB by its home Member State competent authority.

A bank that has passported its authorization can commence its activity in Bulgaria upon notification by the BNB or, if earlier, upon expiry of two months from the date on which the passporting notification has been received by the BNB from the home Member State competent authority. The BNB may impose conditions on the activity of the bank in Bulgaria if, at its discretion, this is required to ensure compliance with any applicable law aimed at protecting the public interest.

2.4. What are the restrictions on ownership, including foreign ownership of banks?

Companies registered in tax haven jurisdictions and persons controlled by them, directly or indirectly, are prohibited from applying for a banking license under the CIA or having participated in a credit institution in Bulgaria that constitutes a qualifying holding within the meaning of the CIA (the relevant legislation setting out this prohibition is the *Act on the Economic and Financial Relations with Companies Registered in Preferential Tax Treatment Jurisdictions, the Persons Controlled by Them and their Beneficial Owners (title amended, State Gazette issue 48/2006, effective 1 July 2017*) (published in *State Gazette 1 dated 3 January 2014, with effect from 1 January 2014, as amended*) (Tax Haven Companies Act)). There are applicable exemptions under the *Tax Haven Companies Act* including, among others, with respect to publicly traded companies or where the parent of the tax haven company is resident for tax purposes in a jurisdiction with which Bulgaria has a double taxation treaty or similar and its beneficial owners have been registered in the Bulgarian Commercial Register and Register of NPLE.

The assessment of the applicant's shareholders is an important part of the overall assessment of the regulator in granting a banking license. A banking license may be refused, among others, if:

- the BNB decides, at its discretion, that the shareholders controlling more than 3% of the votes may, with their acts or influence on the decision-making, harm the reliability or security of the bank or its operations; or
- the persons who have subscribed for 10% or more of the shares, do not meet the requirements for the acquisition of a qualifying holding or a higher shareholding in compliance with the CIA or, at BNB's discretion, the assets of such persons and the scale and financial results of the business carried out by them do not correspond to the proposed acquisition of a shareholding in the bank or raise doubts as to the reliability and capability of such persons, where necessary, to provide capital support to the bank; or
- the origin of the funds used capital contributions by the persons who have subscribed for 3% or more of the shares is not clear and legitimate.

2.5. What are the requirements for a proposed acquisition and acquirer of a qualified holding in a bank? Would the same requirements apply in the case of an increase of a qualifying holding?

The prior approval of the BNB is required for the acquisition by any person (natural or legal) or persons acting in concert, directly or indirectly, of shares or voting rights related to shares in a bank licensed in Bulgaria if as a result of the acquisition their shareholding becomes qualified (10% or more) or reaches or exceeds a relevant threshold of 20%, 33%, or 50% of the total shareholding or voting rights or the bank becomes a subsidiary. This also applies if the relevant transaction has been concluded on the stock exchange or other regulated market.

If the relevant acquisition occurs as a result of circumstances outside of the control of the acquirer, the acquirer has to apply for authorization within one month thereafter and, prior to obtaining such authorization, the voting rights attached to the shares so acquired shall be suspended and such shares shall be not counted against any relevant quorum requirements.

The BNB shall hold preliminary consultations and cooperate with the competent supervising authority of another Member State in instances where the applicant is or controls a regulated entity in that other Member State.

The following factors, among others, are considered by the regulator in its assessment of the application for approval: (i) the reputation of the applicant, (iii) the reputation, knowledge, skills, and experience of the members of the management board (board of directors) and supervisory board who will direct the bank's activities upon completion of the proposed acquisition, (iv) the financial stability of the applicant with a view to the specific nature of the current or proposed activity of the bank, (v) compliance with any applicable supervisory requirements, and (vi) no grounds to suspect or increased risk of money laundering or financing of terrorism.

III. REGULATORY CAPITAL AND LIQUIDITY

3.1. How are banks typically funded in your jurisdiction?

According to a report conducted by the IMF on the Assessment of the Financial Stability from 2017, the banking system in Bulgaria is deposit funded (with 83% of bank liabilities as of the date of the report being a deposit). Wholesale funding has been used sparingly since the Great Recession of 2008/9 but could increase its importance given the inflation and rise of interest rates (see Section 5.2.) and the search for higher yield by depositors (especially non-retail).

As a matter of regulatory law and prudential requirements, any financial institution holding a banking license in Bulgaria must:

- adopt funding and liquidity plans;
- maintain liquid funds to cater for mismatches between cash inflows and cash outflows;
- maintain a system for interest rate risk monitoring in all operations;
- adjust promptly the maturity structure of assets and liabilities upon a change in market conditions;
- maintain the necessary information about the calculation of its liquidity position at any moment.

This said, liquidity requirements are uniform across the EU as set out in CRR, which outlines the key provisions and definitions regarding liquidity coverage requirements (the amount of minimum liquid assets that must be held to meet assets outflows) for financial institutions as well as liquidity reporting requirements.

Additionally, BNB Ordinance No 11 (Liquidity Management) provides detailed provisions on the definition of liquid assets for the purposes of liquidity management, maturity structure of assets, liabilities, and off-balance-sheet items as well as requirements for the provision of monthly liquidity reports to BNB as part of its supervision over credit institutions. Banks should maintain internal liquidity management rules and adequate liquidity management systems (including management information systems enabling the monitoring, tracking, and control of liquidity risk).

According to the CIA, liquidity in respect of branches of EU credit institutions is supervised by the BNB in cooperation with the home Member State authority. Bulgarian law liquidity requirements do apply to branches of EU credit institutions that have passported their license to Bulgaria.

Branches of third (non-EU) country credit institutions licensed in Bulgaria are generally subject to more intense supervision by the BNB compared to the branches of EU credit institutions, and Bulgarian law liquidity requirements apply to them as well.

3.2. What capital and own funds requirements apply to banks in your jurisdiction?

Minimum registered capital

A bank is to be registered in the form of a joint stock company with a minimum capital requirement under the CIA at the time of incorporation of BGN 10 million (approximately EUR 5 million). It is a mandatory requirement that the shareholders participate in the capital by cash installments (monetary contributions) only. This requirement is valid for the initial raising of the minimum required capital upon incorporation of the bank. Any subsequent capital increase may be accomplished by contributions in kind provided that authorization from the BNB has been obtained first. The capital cannot fall below the minimum of BGN 10 million at any time. Another mandatory requirement is that the payments against subscribed shares have to be effected with the own funds of the shareholders.

Capital adequacy

Capital adequacy requirements under Bulgarian law follow EU law provisions, specifically the own funds' requirement under the CRR, including definitions of the qualifying instruments for Common Equity Tier 1 capital, Tier 1 capital, and Tier 2 instruments and their minimal ratios. Additionally, CRR provides capital requirements for specific types of risk like credit risk, market risk, operational risk, and possible risk-reducing techniques. Pursuant to the CIA the BNB is required the implement the technical standards of the European Banking Authority (EBA) regarding capital adequacy.

Capital buffers

Pursuant to CRD IV, the BNB has the discretion to determine the amount of capital buffers, however, within the ranges set out in CRD IV, which must be maintained by all credit institutions in Bulgaria. BNB Ordinance No 8 (Capital Buffers) sets forth the capital buffers levels. Currently, the countercyclical capital buffer rate applicable to credit risk exposures in Bulgaria is 1.5% with an uptick to 2% for the period Q3 2023 to Q2 2024.

3.3. Has your jurisdiction implemented the Basel III framework? Are there any major deviations?

Credit institutions in Bulgaria are subject to the requirements of the Single Rulebook, including the EU legislation implementing *Basel III* (CRR and CRD IV).

IV. REPORTING, ORGANISATIONAL REQUIREMENTS, INTERNAL GOVERNANCE, AND RISK MANAGEMENT

4.1. What key reporting and disclosure requirements apply to banks in your jurisdiction?

4.1.1. Supervisory Reporting

Commission Implementing Regulation (EU) 2021/451 outlines the reporting requirements for credit institutions and lays down uniform reporting formats and templates, instructions on and a methodology for how to use those templates, the frequency, and dates of reporting, as well as IT solutions for the reporting. The reporting framework covers the following areas:

- Own funds and own funds requirements – COREP;
- Financial reporting – FINREP;
- Losses stemming from lending collateralized by immovable property;
- Large exposures and concentration risk;
- Leverage ratio;
- Liquidity Coverage;
- Net stable funding ratio;
- Additional liquidity monitoring metrics;
- Counterbalancing capacity;
- Maturity ladder; and
- Asset encumbrance.

4.1.2. Reporting on remunerations

The EBA has issued guidelines outlining the reporting requirements for remuneration in credit institutions, such guidelines being applicable to Bulgarian credit institutions:

- Guidelines on remuneration practices, the gender pay gap, and approved higher ratios;
- Guidelines on the data collection exercises regarding high earners; and
- Guidelines on disclosure of non-performing and forborne exposures.

4.1.3. Reporting of funding plans by credit institutions

Pursuant to a recommendation of the European Systemic Risk Board (ESRB) of December 20, 2012 on funding of credit institutions the EBA has published guidelines and reporting templates for funding plans of credit institutions. Pursuant to the recommendation such reporting must be done semi-annually.

4.1.4. Internal Exposures

Pursuant to the CIA and BNB Ordinance No 37 (Internal Exposures) banks should submit quarterly reports in relation to internal exposures (i.e., exposures to related parties – see Section 4.3.).

4.1.5. Minimal Reserves

Credit institutions must hold with the BNB minimal reserves in BGN and any other foreign currency used by them in their day-to-day business. In order to establish the amount of minimal reserves, banks must provide weekly reports to the BNB for the available amount on hand.

4.1.6. Register Bank accounts and Vaults with the BNB

Credit institutions must submit information to the Register of Bank Accounts and Vaults with the BNB regarding the bank accounts opened by physical persons and entities.

4.1.7. Central Credit Register

Credit institutions must submit information on a monthly basis regarding the indebtedness and credits of their clients under loans to the Central Credit Register (CCR) in accordance with BNB Ordinance No 22 (CCR).

4.1.8. Payment Statistics

Credit institutions must report their receivables from and liabilities to non-residents, as well as transactions with non-residents related to services, remunerations, receipts, and other payments in relation to the payment statistics. The information provided must be on a monthly and quarterly basis.

4.1.9. Other reporting obligations include the following:

- quarterly reporting under BNB Ordinance No 16 (PSPSA Licenses and Approvals) and the PSPSA with respect to participants in payment systems (including in respect of payment services provided by the branch and completed transfer orders to payment systems with settlement finality); and
- daily reporting of transactions on the local financial markets (interbank money market and forex market).

4.1.10. Albeit not a reporting obligation, credit institutions have to become participants in RINGS (the system for real-time gross settlement operated by the BNB). The requirements for becoming a participant in RINGS and the corre-

sponding obligations, including reporting requirements, are set out in rules published by BNB.

4.2. What are the organizational requirements for banks, including with respect to corporate governance? Please briefly describe the requirements and the procedure of assessment of the suitability of the members of the management body and key function holders.

The organizational requirements for banks are set out in the CIA and the *Bulgarian Commerce Act*. Banks with a seat in Bulgaria must be incorporated in the form of a joint stock company. There are two possible types of management systems of a Bulgarian joint stock company: (i) a one-tier management system whereby the board of directors is appointed by the general meeting of shareholders, and (ii) a two-tier management system consisting of a managing board appointed by the supervisory board and a supervisory board appointed by the general meeting of shareholders.

The board of directors or the management board appoints one or more executive director(s) of the company from among its members to represent the company in a way determined by the general meeting of shareholders. The representative powers of the company's executive directors can be restricted by a resolution of the general meeting of the shareholders, however, any such restrictions are not opposable to third parties.

According to the CIA, a bank shall be managed and represented by at least two persons (executive directors) acting jointly. The executive directors may not sub-delegate the overall management and representation of the bank to one of them but may delegate specific rights only to third parties. The executive directors shall be physically present at the management address of the bank and at least one of the representatives should comprehend Bulgarian language.

The members of the management board (the board of directors) and of the supervisory board of a bank, as well as the procurators of banks, are subject to fit and proper assessment by the regulator for their qualification and professional experience and must be approved prior to their appointment. There are also restrictions for the members of the management board (the board of directors) and of the supervisory board for participating in the management or controlling bodies of other companies (not applicable for participation in the management bodies of companies within the same group) which are set out in detail in BNB Ordinance No 20 (Board Members).

At least one of the members of the supervisory board or the non-executive members of the board of directors of a bank shall be independent (or, if the bank qualifies as "significant" or its shares are admitted to trading on a regulated market, no less than one-third of the members of its supervisory board or the non-executive members of its board of directors shall be independent).

4.3. What are the local rules for loans to the management body and their related parties?

According to CIA, the unanimous decision of the managing body of a credit institution (and the approval by the supervisory board if applicable) is required for the credit institution to form exposures (in excess of certain de minimis thresholds) towards related parties, notably:

- administrators of the bank;
- persons or entities which hold directly or indirectly more than 10% of the votes in the general meeting of the shareholders;
- any shareholder, which has appointed a member of the managing or the supervisory board of the credit institution;
- bank officers;
- spouses, brothers, sisters, and lineal relatives up to and including the third degree of consanguinity to a person covered in the previous items; and
- persons controlled directly or indirectly by the credit institution.

Such exposures must be on arms' length terms.

4.4. What are the main legal provisions governing risk management in the banking sector in your jurisdiction?

According to BNB Ordinance No 7 (Bank Risk Management), banks have to maintain a robust risk management structure. The managing body of a bank shall approve and periodically review all risk management strategies and policies. Credit institutions are required to establish and maintain an independent risk management structure with sufficient internal resources and adequate access to the managing body of the bank. The risk management of a bank shall include systems, processes, organizational units, and designated officers whose main purpose will be to independently identify, monitor, report, and manage risks taken by the bank. The head of the risk management division of the credit institution shall be an independent senior manager (i.e., he/she should not combine operational and risk management functions) with clear responsibilities that can be removed from his position only with the prior approval of the managing body of the bank. Additionally, the managing body of the bank is required to establish a risk committee consisting of members of the managing body that shall be responsible for the determination of the overall current and

future risk appetite and strategy of the credit institution.

4.5. What are the legal requirements applicable to banks in combating money laundering and terrorist financing area?

The AML and CFT requirements in Bulgaria are regulated by the *Anti-Money Laundering Measures Act* (published in *Stage Gazette issue 27 dated 27 March 2018, as amended*) (AMLA), and the *Combating Terrorism Financing Measures Act* (published in *Stage Gazette issue 16 dated 18 February 2003, as amended*), which have incorporated the basic provisions of the IV and V AML Directives. According to the AMLA and the implementation of the AML Directive IV and V, AML rules apply to the banks licensed or carrying out activities in Bulgaria including through a branch or directly based on the freedom to provide services. Additionally, branches of non-EU banks registered in Bulgaria are also subject to local AML requirements. Based on the above, banks carrying out activities in Bulgaria (including through branches) as obliged entities under AMLA, are required to adopt internal rules for control and prevention of money laundering within a 4-month term from their registration. Further, the internal rules should be sent to the director of the SANS (see Section 1.2.) which is the competent supervisory authority in respect of compliance with the AML rules, within a 14-day term from their adoption for approval. Once approved by SANS, the rules are compulsory for the relevant obliged entities. The BNB also has the competency to scrutinize the implementation of adequate AML policies and procedures, including strict KYC requirements which are outlined in several guidelines published by the BNB and SANS.

4.6. Are there any legal provisions regulating banking secrecy in your jurisdiction?

The CIA defines banking secrecy as "facts and circumstances concerning the balances and transactions on accounts and deposits of the bank's customers" and requires that such information remains confidential. There are circumstances when confidential information may be disclosed to third parties, namely some examples include (i) judicial authorities (i.e where criminal proceedings have been initiated), (ii) the court, (iii) the financial supervision authorities in the Republic of Bulgaria, the Bulgarian Deposit Insurance Fund and SANS. The list of applicable exceptions, when confidential information can be disclosed, is set out in the CIA.

V. TRENDS

5.1. What are the main trends in the banking sector in your jurisdiction?

The process of banking sector consolidation is expected to continue. There have been several large acquisitions in the banking sector in recent years, including the acquisition of Société Générale Expressbank by DSK Bank AD which closed in 2019, and their subsequent merger, the acquisition of Raiffeisenbank (Bulgaria) EAD by KBC Bank N.V. (Belgium) in the second half of 2022 and its subsequent merger into United Bulgarian Bank AD (the other subsidiary of KBC Bank in Bulgaria) and the announced acquisition of BNP Paribas Personal Finance by Eurobank Bulgaria AD which is expected to close in the first half of 2023.

One of the effects of consolidation is widening the gap between the so-called "first group of banks" (i.e., the top five banks according to the classification of the Banking Supervision Department at the BNB) from the second group of smaller local banks. As of the end of 2022, the banks in the first group held 67.2% of the assets in the banking system. The expectations are that banks in both groups (large and small) will continue to look for opportunities for consolidation in an effort to protect their market share.

Digital transformation is another trend in the sector that will undoubtedly continue. Many banks have placed digitalization on top of their agendas even before the global pandemic, but COVID-19 catalyzed digital transformation even further.

5.2. What are the biggest challenges in the banking sector at the moment?

As with the rest of the world, the main challenge of the banking sector is the inflationary pressure from the rise of commodity prices, the decoupling of the world economy, and the monetary policy of central banks in the last 15 years. Given the significant exposure of the banking sector to the retail housing market there is fear that the rate increases by central banks could lead to higher default rates and an increase of bad loans.

Another challenge is the gap between the "big five" and the smaller banks and their capacity to withstand the increasing operational costs of doing business in an age where digitalization and compliance costs are rising and challenger solutions such as fully digital banks and payment services providers are taking market share.

5.3. What's new in fintech?

TARGET 2 migration

In late March 2023, the migration to the new platform for TARGET services was completed, with the BNB, commercial banks, and payment systems – participants in the Bulgarian national component system (TARGET2-BNB) of the TARGET2 system for large-value payments in euro joining the new consolidated TARGET Services platform. The platform combines on a technical and functional level the TARGET2

payment system, the securities settlement platform TARGET2-Securities (T2S), and the service for instant transfers in euro TIPS. The new consolidated platform is expected to improve the overall efficiency and security of the existing systems and services.

As a result of the implementation of the project, it is envisaged that from July 2023 all credit transfers in the country, including those in the public sector, will be carried out in accordance with the requirements of the SEPA credit transfer schemes of the European Payments Council. In this way, a comprehensive change in the payment infrastructure aimed at its full alignment with SEPA standards will be completed.

Central Bank Digital Currencies

According to statements by executive officers and Governors of the BNB, the BNB is closely following the actions of the ECB which is going through an investigation phase in relation to CBDC (which explores technical and regulatory aspects of a digital euro), such process expected to be completed in the second half of 2023. The Eurosystem is considering a digital euro app/ wallet with pan-European reach. Given Bulgaria's ambition to access the Eurozone in the near future the results of the investigation phase could have a transformative effect on the fintech and payment system of Bulgaria in the upcoming years.

Preparation for PSD 3

The *Second Payment Services Directive* facilitated the development of the EU fintech sector, including the Bulgarian fintech ecosystem. The changes to PSD, referred to as PSD 3, are expected to include improvement to strong customer authentication as well as further standardization of dedicated interfaces used to facilitate open banking activities.

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CEE LEGAL MATTERS COMPARATIVE LEGAL GUIDE: BANKING/FINANCE 2023

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I. LEGAL FRAMEWORK

1.1. Which main legislative and regulatory provisions govern the banking sector in your jurisdiction?

The banking sector in Croatia is governed by the provisions laid down in the *Credit Institutions Act*, the *Act on Croatian National Bank*, the *Payment System Act*, the *Foreign Exchange Act*, the *Electronic Money Act*, the *Act on Deposit Insurance*, the *Credit Unions Act*, the *Act on Financial Conglomerates*, the *Act on the Resolution of Credit Institutions and Investment Firms*, the *Act on compulsory liquidation of credit institutions*, the *Consumer Credit Act*, the *Consumer Protection Act*, the *Act on Housing Savings and State Promotion of Housing Savings*, the *Act on the Comparability of Fees Related to Payment Accounts*, the *Payment Account Switching and Access to Basic Accounts*, the *Act on adoption of euro as the official currency*, the *Companies Act*, the *Capital Markets Act*, the *Act on Prevention of Money Laundering and Financing of Terrorism*, the *Act on the implementation of Regulation (EU) 2020/1503 on European crowdfunding service providers*, the *Act on the Implementation of Regulation (EU) 2017/2402 on establishing a general framework for securitization and establishing a specific framework for simple, transparent and standardized securitization*, the *Act on the implementation of Regulation (EU) 2019/2088 on disclosures related to sustainability in the financial services sector* and *Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investments*.

In addition, it is governed by the provisions laid down in *Regulation (EU) No 575/2013 on prudential requirements for credit institutions* (as amended; CRR), *Regulation (EU) No 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions*, *SSM Framework Regulation (EU) No 468/2014*, *Regulation (EU) No 537/2014 on specific requirements regarding statutory audit of public-interest entities* (as amended), *Regulation (EU) No 806/2014 of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund.*

1.2. Which bodies are responsible for enforcing the applicable laws and regulations? What are their main competencies? Please refer to the resolution authority as well.

The following bodies are responsible for enforcing the applicable laws and regulations in the banking sector:

i. The European Central Bank (ECB) – ECB carries out its tasks within the Single Supervisory Mechanism (SSM) composed of the ECB and national competent authorities, and it is responsible for the effective and consistent functioning of the SSM. ECB is exclusively competent, for prudential supervisory purposes, to issue and withdraw authorizations to all supervised credit institutions upon receiving a draft decision proposal from Croatian National Bank.

ii. The Croatian National Bank (CNB) – with regards to its regulatory activity, CNB issues and withdraws certain authorizations and approvals, proposals for issuing approvals to ECB, and adopts other decisions in accordance with the laws governing the operation of credit institutions and the operation of credit unions, payment service providers, electronic money issuers and payment systems, payment operations, the issuance of electronic money as well as foreign exchange operations and the operation of authorized exchange offices. The CNB exercises supervision and oversight of credit institutions and the operation of credit unions, payment service providers, electronic money issuers and payment systems, payment operations, and the issuance of electronic money. The CNB performs the tasks of supervision and resolution of credit institutions within the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM).

With regards to resolution authorities for credit institutions, they are the following:

i. Single Resolution Board – the central resolution authority within the banking union. The Single Resolution Board is directly responsible for significant credit institutions (whose total value of its assets exceeds EUR 30 billion; the ratio of its total assets over the GDP of Croatia of establishment exceeds 20% unless the total value of its assets is below EUR 5 billion; which is considered an institution of significant relevance with regard to the domestic economy or which has established banking subsidiaries in more than one participating Member States (as defined by the *Council Regulation (EU) No 1024/2013)* and its cross-border assets or liabilities represent a significant part of its total assets or liabilities);

ii. Croatian National Bank – the national resolution authority. CNB is responsible for credit institutions that are not part of a group and groups in which at least one member is a credit institution, and for credit institutions that are not considered significant credit institutions;

- Croatian Deposit Insurance Agency manages the national resolution fund and is empowered to collect ex-ante and ex-post contributions paid to the Single Resolution Fund.

- The Ministry of Finance of the Republic of Croatia is the ministry competent for the exercise of the tasks under the *Act on the Resolution of Credit Institutions and Investment Firms* (e.g., decisions on the use of state instruments of financial stabilization, participation in the increase of the credit institution's share capital in the name of Republic of Croatia, temporary state ownership, etc.).

1.3. What are the current priorities of regulators and how does the regulator engage with the banking sector?

Recent CNB's priorities included various preparations and actions required to ensure an orderly process of adoption of the euro as the official currency in the Republic of Croatia and joining the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) in the full capacity.

The CNB conducts supervision of credit institutions as follows:

1) performs supervision by collecting and analyzing reports and information, continuously monitoring the operations of credit institutions and other persons who are subject to the provisions of the *Credit Institutions Act*, or other laws and regulations adopted on the basis of that or other laws or applicable regulations of the EU obliged to report to the CNB;

2) performs direct supervision over the operations of the credit institutions (including "dawn raids" after obtaining an appropriate warrant from the High Administrative Court of the Republic of Croatia);

3) imposes supervisory measures (including supervisory measures in the early intervention phase);

4) issues opinions, approvals, consents, and evaluations of credit institutions in accordance with Credit institutions, CRR, and other regulations of the EU governing the operations of credit institutions.

In general, the CNB shall, before passing a decision in accordance with this Credit Institutions Act or CRR, which could have a negative effect on the legal interests of the party, inform the party of all facts, circumstances, and legal issues that are important for making a decision and invite the party to express its opinion in writing, and CNB shall attach a draft of the decision stating the important facts, circumstances and legal issues on which the CNB bases its decision. If CNB deems it appropriate, it may give the parties the opportunity to comment on the facts, circumstances, and legal issues that are important for reaching a decision at an oral hearing.

II. AUTHORISATION

2.1. What licenses are required to provide banking services in your jurisdiction? What activities do they cover?

Banking services and financial services in the territory of the Republic of Croatia can be provided by:

1) a credit institution based in the Republic of Croatia that has received approval for the provision of banking services from the ECB (granted after CNB reviewed the application for approval and provided a draft decision proposal regarding approval to the ECB);

2) a credit institution from another EU member state which, establishes a branch office in the territory of the Republic of Croatia (local presence) or is authorized to directly provide banking and/or financial services in the territory of the Republic of Croatia (but only on a temporary basis) without the need for local presence (license passporting);

3) a branch office of a credit institution from a third country that has received approval from the CNB to provide banking and/or financial services in the territory of the Republic of Croatia (local presence).

Banking services are: the taking of deposits or other repayable funds from the public and the granting of credits for own account from these funds, and can be provided after meeting the above licensing requirements.

Core financial services are: **1)** taking deposits or other repayable funds; **2)** lending, including consumer credit, mortgage credit and, where permitted by a special law, financing of commercial transactions, including forfeiting; **3)** factoring, **4)** financial leasing; **5)** issuance of guarantees or other commitments; **6)** trading for own account or for the accounts of clients (in money market instruments, transferable securities, foreign exchange, including exchange transactions, financial futures and options, exchange and interest-rate instruments); **7)** payment services; **8)** credit reference services (e.g. collection, analysis and provision of information on the creditworthiness of legal and natural persons that conduct their business independently), **9)** issuing and administering other means of payment, **10)** safe custody services, **11)** money broking, **12)** participation in issues of financial instruments as well as the provision of services relating to issues of financial instruments, **13)** portfolio management and advice, **14)** safekeeping of financial instruments and services related to the safekeeping of financial instruments, **15)** consulting legal entities regarding capital structure, business strategy and similar issues and providing services related to business mergers and the acquisition of shares and holdings in other companies, **16)** issuance of electronic money, **17)** investment and auxiliary services and activities.

2.2. What is the procedure for obtaining a banking license? How long does this typically take?

Credit institution established in the Republic of Croatia

A credit institution established in the Republic of Croatia must obtain approval for providing banking services before being able to register as a credit institution. The ECB and the CNB are involved in different stages of this licensing procedure in which the entry point for all applications is the CNB, irrespective of whether the significance criteria are met or not. The CNB and the ECB cooperate closely throughout the whole

procedure, which, for all supervised credit institutions, ends with the ECB taking the decision on approval.

The licensing procedure starts with the applicant submitting to CNB the request for approval for providing banking and/or financial services with all of the required documentation prescribed in detail in CNB's Decision on documentation accompanying the application for authorization of a credit institution and an application for authorization to provide financial services (e.g. program of activities, financial information, business plan, organizational structure and system of internal controls, drafts of internal acts, information on initial capital, information on the management and supervisory board, information about the founders).

The CNB informs the ECB of the receipt of the request and assesses whether all the conditions stipulated in Article 67 of the *Act on Credit Institutions* have been met for the issuance of the approval (e.g., appropriate initial capital, authorized representatives, ability to provide banking and/or financial services, risk management, possibility of supervision, etc.). If the CNB determines that the conditions for issuing the approval from the *Act on Credit Institutions* have not been met, it will reject the request and notify the ECB thereof.

If the CNB determines that the request meets the conditions for issuing the approval prescribed by Croatian law, it drafts a decision proposing that the ECB issues the approval to the applicant and delivers it to ECB (the CNB also delivers the aforementioned draft decision to the applicant). The CNB may propose that recommendations, conditions, and/or restrictions be attached to the decision on issuing approval.

The ECB assesses the request on the basis of the conditions for the issuance of approval prescribed by the applicable EU law. If ECB assesses that these conditions are not met, the ECB will give the applicant the opportunity to make a written statement about the facts and objections that are essential for the assessment.

The ECB decides on the draft decision on the issuance of approval that it received from the CNB within the term of ten business days (unless a decision was made to extend the final decision term for one more term of ten business days). The ECB can accept the draft decision of the CNB on the issuance of approval and thereby agree to the approval or object to the draft decision of the CNB on the issuance of approval.

The whole above licensing procedure usually takes around 12 months from submitting the complete application to CNB.

2.3. Can a foreign bank operate in your jurisdiction on the basis of its domestic license?

Credit institutions from EU member states

A credit institution from another EU member state may provide banking and/or financial services (that is already authorized to provide in its country), i.e., services subject to mutual recognition in the territory of the Republic of Croatia either **(i)** through a branch office (local presence) or **(ii)** directly without the need for local presence (license passporting) but only on a temporary basis.

It shall be deemed that a credit institution from another EU member state directly provides services subject to mutual recognition in the territory of the Republic of Croatia if it has not formed a branch office and **(i)** concludes contracts within the territory of the Republic of Croatia, the subject of which are lending services (territorial element); or **(ii)** offers, through its representatives, intermediaries or by some other means, such services within the territory of the Republic of Croatia to natural persons or corporate entities with domicile, normal place of residence or head office in the territory of the Republic of Croatia (initiative element). In the described case, when either the territorial or initiative element is present, the credit institution from another EU member state may start to perform lending services in the territory of Croatia only after the CNB has received an appropriate notification with a list of services subject to mutual recognition aimed to be provided from the regulator from the credit institution's member state (license passporting). Services can be provided directly only temporarily. According to Croatian law, it shall be deemed that services are provided on a temporary basis if they are not provided regularly, frequently, or on an ongoing basis.

Banking and/or financial services subject to mutual recognition can be provided on a permanent basis and regularly if a credit institution from another member state establishes a branch office in the territory of the Republic of Croatia. Credit institution from another member may submit a request for the entry of its branch office in the court register and start providing services in the territory of the Republic of Croatia after the expiry of two months from the date on which the CNB received the appropriate notification from a competent authority from the credit institution's home Member State.

Third-country credit institution

Under the *Croatian Credit Institutions Act*, a third-country credit institution may provide banking and/or financial services, within the territory of the Republic of Croatia only through a branch office (local presence) and provided that it is authorized to provide such services in its home country.

In order to establish a branch office in the Republic of Croatia,

a credit institution from a third country must obtain approval from the CNB which will contain the list of banking and/or financial services the branch office of the third-country credit institution is approved to provide within the territory of the Republic of Croatia. Third-country credit institutions can establish only one branch office in the Republic of Croatia.

The process for obtaining approval from the CNB consists of submitting a request for approval together with the statutorily prescribed documentation and performance of required actions (e.g., providing various corporate information, information on the deposit insurance system to which the credit institution from a third country (the founder) belongs, obtaining approval from the third-country regulatory authority, audit reports from the last three years, filling a request to CNB for approval of persons authorized to represent the branch, etc.). In addition, the amount of minimum EUR 5 million must be deposited to the account opened with a credit institution in Croatia in order to obtain CNB's approval, and which amount shall be transferred to a settlement account of the branch office opened with CNB after establishing a branch office.

2.4. What are the restrictions on ownership, including foreign ownership of banks?

Under the *Companies Act*, natural persons or legal entities that are convicted of the criminal offense of financing terrorism or the criminal offense of money laundering (for the duration of the legal consequences of the conviction), or that have been imposed an international measure restricting the disposal of property (for the duration of these measures) are not permitted to become founders/shareholders of the credit institutions.

The holder of a qualified share in a credit institution can only be a legal entity or natural person, and persons acting jointly, who received prior approval from ECB for the acquisition of a qualified share, and in the amount for which such approval was received.

2.5. What are the requirements for a proposed acquisition and acquirer of a qualified holding in a bank? Would the same requirements apply in the case of an increase of a qualifying holding?

A qualified share means a direct or indirect investment in a credit institution that makes up 10% or more of the capital or voting rights or that enables significant influence on the management of that credit institution.

The holder of a qualified share in a credit institution can only be a legal entity or natural person, and persons acting jointly, who received prior approval from ECB for the acquisition of a qualified share, and in the amount for which such consent was received. In order to acquire shares of a credit institution, a legal or natural person and persons acting jointly are required to submit a request for prior approval to the CNB (accompanied by required documentation prescribed in CNB's Decision on prior approval for the acquisition of a qualified share in a credit institution), on the basis of which they individually or jointly, directly or indirectly, acquire a qualified share in the credit institution.

In order to **(i)** acquire shares of a credit institution that make up 10% of the capital or voting rights and **(ii)** for a further direct or indirect increase of the qualified share in an amount that is equal to or greater than 20%, 30%, or 50% of the share in the capital or voting rights in the credit institution, it is necessary to obtain the decision of the ECB giving prior approval for the acquisition of a qualified share.

The assessment of acquisitions and increases of qualifying holdings includes an analysis of and meeting of all of the requirements relating to **(i)** the good reputation of the proposed acquirer; **(ii)** the appropriate reputation, knowledge, skills, and experience of any member of the management body who will direct the business of the credit institution as a result of the proposed acquisition; **(iii)** the appropriate financial soundness of the proposed acquirer; **(iv)** the impact of the proposed acquisition on the target's ability to maintain compliance with all prudential requirements, including any potential impact on the possibility of exercising effective supervision in future; and **(v)** whether the proposed acquisition involves money laundering or terrorist financing or could increase the risk thereof. CNB will check the criminal records of the acquirer of a qualified holding for various criminal offenses referred to in the *Credit Institutions Act*.

The same requirements would apply in the case of an increase of a qualifying holding as described above.

III. REGULATORY CAPITAL AND LIQUIDITY

3.1. How are banks typically funded in your jurisdiction?

The banks are typically funded through their users' deposits. According to publicly available data, a bank's funding is 70-75 % comprised of users' deposits, 15 % of its own capital, and the rest consists of loans received and bonds issued.

3.2. What capital and own funds requirements apply to banks in your jurisdiction?

The initial capital for banks operating in the Republic of Croatia is at least EUR 5 million.

The adoption of the euro by Croatia on January 1, 2023, means that banks located in Croatia will be subject to minimum reserve requirements from that date in accordance with

Regulation (EU) 2021/378.

In regard to the bank's own funds, i.e., internal capital, a bank in the Republic of Croatia is obliged to ensure that at all times it has an amount of capital adequate to the types, scope, and complexity of the operations it performs and the risks it is exposed to or could be exposed to in the provision of these services. Therefore, the bank is obliged to establish and implement an appropriate, effective, and comprehensive strategy and procedures for continuous assessment and maintenance of the amount, type, and distribution of internal capital. The bank is obliged to regularly review the strategy and procedures in order to ensure that they are comprehensive and commensurate with the type, scope, and complexity of the work it performs.

Capital requirements within the scope of implementation of macroprudential measures are divided into four groups of capital requirements, namely:

■ Capital conservation buffer (CCoB),

■ Countercyclical capital buffer (CCyB),

■ Systemic risk buffer (SRB), and

■ Systemically important institutions buffer (G-SII and O-SII).

3.3. Has your jurisdiction implemented the Basel III framework? Are there any major deviations?

With regards to implementing acts of the *Basel III* framework, *Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms* (CRD IV) has been transposed into Croatian law (through *Credit Institutions Act*), and *Regulation (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms* (CRR) is in force in Croatia.

IV. REPORTING, ORGANISATIONAL REQUIREMENTS, INTERNAL GOVERNANCE, AND RISK MANAGEMENT

4.1. What key reporting and disclosure requirements apply to banks in your jurisdiction?

The key reporting and disclosure requirements pertain to the bank's obligation to report to the CNB, namely the following:

■ all facts entered in the court register, namely every submitted application for entry of data in the court register and every completed entry of data changes in the court register;

■ convening and date of holding the shareholders meeting;

■ the shareholders meeting held and all decisions made at that meeting;

■ any planned change in the share capital of the bank of 10% or more;

■ cessation of the provision of certain banking and/or financial services;

■ learning that a natural or legal person has acquired a qualified share, i.e., that a qualified holder has sold or otherwise disposed of his shares so that his share has therefore increased above or decreased below the amount for which he had received prior consent;

■ shareholders of the bank and persons related to them who have 3% or more of shares with the right to vote on the shareholders meeting of the bank;

■ close connections between banks and other natural and legal persons;

■ the composition of the group of related persons to whom the bank is exposed.

In addition, banks are also obliged to report to CNB information on Capital conservation buffer (CCoB), Countercyclical capital buffer (CCyB), Systemic risk buffer (SRB), and Systemically important institutions buffer (G-SII and O-SII).

An additional rule exists for a bank whose shares are listed for trading on a regulated market to notify the CNB at least once a year about shareholders who are holders of qualifying shares and the size of those shares.

Specific rules apply to the management of the bank to inform the CNB of the following without delay:

■ if the liquidity or solvency of the bank is threatened;

■ if there are circumstances for the termination of the validity of the license or the reasons for the termination of the license for the provision of a particular financial service and;

■ if the financial condition of the bank changes so that the regulatory capital of the bank falls below the amount prescribed in Article 92 of the CRR, i.e., below the amount ordered by the CNB (the CNB may order the additional regulatory capital).

4.2. What are the organizational requirements for banks, including with respect to corporate governance?

Under the *Credit Institutions Act*, a bank is obliged, in proportion to the type, scope, and complexity of the work it performs and the risks inherent in the business model, to establish

and implement an effective and reliable organizational system that includes:

- a clear organizational structure with well-defined, transparent, and consistent lines of authority and responsibility within the bank, established in such a way as to avoid conflicts of interest;
- effective management of all risks to which it is exposed or could be exposed in its operations;
- appropriate internal control systems that include appropriate administrative and accounting procedures;
- remuneration policies that are consistent with appropriate and effective risk management, that promote appropriate and effective risk management, and that are gender neutral and;
- recovery plan.

As for the suitability of the members of the management board of a bank, the member may be a person who, at any time, meets the following conditions:

- which has a good reputation, honesty, and conscientiousness,
- who has the appropriate professional knowledge, ability, and experience necessary for managing the affairs of a bank, and who, together with other members of the board, has the experience necessary for the independent management of the affairs of the bank, and especially for understanding the affairs and significant risks of the bank,
- who is capable of expressing an independent opinion, i.e. where there is no conflict of interest that cannot be managed in a way that ensures independence of opinion,
- that fulfills the requirements for a member of the management board according to the provisions of the *Companies Act*, and
- which can dedicate enough time to fulfill the obligations under its jurisdiction.

Obtaining prior approval of the CNB is required for the appointment of management board members of a bank. The supervisory board of the bank is required to submit the request for approval for the appointment of management board members for a mandate of up to five years.

4.3. What are the local rules for loans to the management body and their related parties?

According to the *Companies Act*, the company may grant loans to members of the management board, procurators, and members of their immediate families only based on the decision of the supervisory board. The decision may only refer to certain loan agreements or loan types, and the loan agreement must be concluded no later than three months from the date of the decision approving the loan. Interest and repayment of the loan must be specified in the decision. If a loan is granted contrary to the aforementioned, it must be returned immediately, regardless of the provisions of the contract, unless the supervisory board subsequently makes a decision approving the granting of the loan.

4.4. What are the main legal provisions governing risk management in the banking sector in your jurisdiction?

Under the *Credit Institutions Act*, the supervisory board of a bank appoints a risk committee. The members of the risk committee are appointed from among the members of the supervisory board of the bank. The committee must have at least three members, one of whom must be appointed as the chairman of the committee.

The following are the duties of the risk committee:

- to advise the supervisory board on the overall current and future risk-taking tendency and strategy and to assist in the supervision of the implementation of this strategy by senior management, while not calling into question the responsibility of the bank's management and supervisory board in the overall risk management and supervision of the bank;
- review whether the bank's business model and risk strategy were taken into account when pricing claims and liabilities to clients, and if that price does not reflect the risk assumed in relation to the business model and risk strategy, propose to the management of the bank a plan to eliminate deficiencies;
- with the aim of establishing and implementing appropriate receipts policies, to review whether risk, capital, liquidity, and the probability and expected period of profit realization were taken into account when determining the incentives provided by the receipts system.

The bank must use its risk management system to include credit risk, concentration risk, securitization risks, residual risk, market risks, operational risk, liquidity risk, interest rate risk in the book of positions that are not traded, the risk of excessive financial leverage and other risks to which it is exposed or could be exposed in its business (Significant Risks). For the management of all of the Significant Risks the bank is obliged to provide adequate resources, including the appropriate number of workers with the necessary expert knowledge and experience in risk management, and for asset valuation, the use of external credit ratings and internal models for these risks. The bank is also obliged to establish appropriate risk reporting lines to the management and the supervisory board that cover

all Significant Risks and risk management policies and their changes.

For the sake of consistent application of risk management strategies and policies, the bank is obliged to determine and consistently apply appropriate administrative, accounting, and other procedures for an effective system of internal controls, and in particular:

- to calculate and review the number of capital requirements for these risks and
- to determine and monitor large exposures, changes in large exposures and to check compliance of large exposures with the bank's policies in relation to that type of exposure.

The bank's internal systems must be applied consistently, the bank must use a standardized methodology or a simplified standardized methodology for identifying, evaluating, managing, and mitigating risks resulting from possible changes in interest rates that affect the economic value of capital and net interest income from operations that are led in the book of non-traded positions. Standardized methodology or simplified standardized methodology pertains to the one prescribed by the European Commission in a Regulatory Technical Standard.

4.5. What are the legal requirements applicable to banks in combating money laundering and terrorist financing area?

Under the *Act on Prevention of Money Laundering and Financing of Terrorism* (AML Act) banks are required to implement measures, actions, and procedures for the prevention and detection of money laundering and terrorist financing in its entire business, i.e. before and/or during each transaction, as well as when entering into legal transactions in which property is acquired or used, and in other forms of disposing of funds, rights, and other property that can be used for money laundering and terrorist financing. The said obligation includes the following:

- creation of a risk assessment of money laundering and financing of terrorism;
- establishment of policies, controls, and procedures for effective reduction and effective management of the risks of money laundering and financing of terrorism;
- implementation of measures of in-depth analysis of the party in the manner and under the conditions determined by the AML Act;
- appointment of an authorized person and a deputy authorized person for the implementation of measures to prevent money laundering and financing of terrorism, taking into account the organizational structure, a sufficient number of deputies of the authorized person, and ensuring appropriate conditions for their work;
- enabling regular professional training and education of employees and ensuring regular internal audits of the system for preventing money laundering and terrorism financing;
- creating and regularly updating the list of indicators for identifying parties and suspicious transactions and funds for which there are reasons to suspect money laundering or terrorist financing;
- notification and delivery to the Office for the Prevention of Money Laundering (Office) of prescribed and requested data, information, and documentation on transactions, funds, and persons;
- storage and protection of data and keeping records of data prescribed by the AML Act;
- the obligation to establish an appropriate information system with regard to their organizational structure and exposure to the risk of money laundering and terrorist financing for the purpose of comprehensive risk assessment of parties, business relationships, and transactions, as well as constant monitoring of business relationships and with the purpose of timely and complete notification to the Office; and
- implementation of other obligations and measures prescribed by the AML Act and by-laws adopted on the basis of it.

4.6. Are there any legal provisions regulating banking secrecy in your jurisdiction?

Under the *Credit Institutions Act*, members of organizational bodies of a bank, shareholders, employees, and other persons who, due to the nature of the work they perform with or for a bank, have access to confidential data, must keep bank secrecy and may not disclose it to third parties, use it against the interests of the bank and its clients or enable third parties to take advantage of it. The obligation to keep bank secrecy exists even after the termination of employment, i.e. after the termination of the status of shareholder, as well as after the termination of the contractual relationship on the performance of work. Exceptions do exist in regard to, inter alia: **a)** providing certain information to the CNB, the Financial Inspectorate of the Republic of Croatia, or the competent authority for the purposes of supervision or control, and within the scope of their competence; **b)** with the prior express consent of the client; **c)** fulfilling the obligations prescribed under mandatory regulations.

V. TRENDS

5.1. What are the main trends in the banking sector in your jurisdiction?

The current main trends are the continuation of the slight increase in interest rates on loans and deposits, with the exception of the average interest rate on savings deposits of households, where the multi-year trend of gradual decrease continues. In March 2023, the last call for subsidized housing loans was announced.

5.2. What are the biggest challenges in the banking sector at the moment?

According to the vice governor of the CNB, big and complex challenges are related to digital transformation, increasing competition from technology companies, and climate change. The governor of the CNB also pointed out cyber security and automation of the banks as challenging ongoing events in the banking sector.

5.3. What's new in fintech?

The most noticeable fintech trends in relation to the banking sector in Croatia are: **a)** embedded finance – the most prominent actor on the Croatian market being Leanpay, a service that offers installment payments after online purchases through the application without having to go through the bank system; **b)** open banking – banks allowing Fintech start-ups or applications with mandatory user consent to access bank account data, but not the functionality of the bank itself; **c)** Aircash: The first non-banking service with a Mastercard card; d) Crypto payments have emerged in one of the biggest grocery stores in Croatia, as well as in one of the biggest insurance companies.

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CEE LEGAL MATTERS COMPARATIVE LEGAL GUIDE: BANKING/FINANCE 2023

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I. LEGAL FRAMEWORK

1.1. Which main legislative and regulatory provisions govern the banking sector in your jurisdiction?

The provisions regulating the banking sector are set out in different laws, including but not limited to:

■ *Act V of 2013 on the Civil Code*;

■ *Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises* (Banking Act);

■ *Act CCXXXV of 2013 on Certain Payment Service Providers*;

■ *Act CCXXXV of 2013 on Payment Service Providers*;

■ *Act LXXXV of 2009 on the Pursuit of the Business of Payment Services* (Payment Services Act);

■ *Act XXX of 1997 on Mortgage Loan Companies and on Mortgage Bonds* (Mortgage Loan Companies Act);

■ *Act CXXXIX of 2013 on the National Bank of Hungary*;

■ *Act CXXII of 2011 on the Central Credit Information System* (Credit Information System Act);

■ *Act LIII of 2017 on the Prevention and Combatting of Money Laundering and Terrorist Financing* (Money Laundering Act);

■ *MNB Decree 35/2017 (XII. 14.) on Payment Services Activities*; and

■ *MNB Decree 33/2021 (IX. 15.) on the detailed provisions relating to activities in operating the payment system*.

However, due to enhanced consumer protection, many other laws are applicable to financial services, if provided to consumers. These laws include the following:

■ *Act CLXII of 2009 on Consumer Credit*;

■ *Government Decree 361/2009 (XII. 30.) on the conditions of circumspect retail lending and the verification of creditworthiness*;

■ *Government Decree 45/2014 (II. 26.) on the detailed requirements of the agreements concluded between a consumer and a business party*;

■ *Government Decree 462/2015 (XII. 29.) on the rules relating to the procedure for granting and negotiating mortgage loans, the provision of advisory services on credit, and the professional knowledge of the staff*;

■ *Government Decree 83/2010 (III. 25.) on the determination, calculation, and disclosure of the annual percentage rate of charge*;

■ *NGM Decree 56/2014 (XII. 31.) of the Minister for National Economy on rules of information relating to credits to consumers*;

■ *NGM Decree 3/2016 (I. 7.) of the Minister for National Economy on the rules of providing information on mortgage loans*; and

■ *MNB Decree 32/2014 (IX. 10.) on the repayment installments proportionate to the income and the loan-to-value ratios*.

In addition, good practices of service providers are monitored and ensured by the National Bank of Hungary, which issues recommendations and opinions in this respect. A recommendation is issued with the aim to provide general advice on a specific problem and is addressed to all affected regulated entities. An opinion is issued in individual cases if a question regarding the correct legal interpretation of a specific provision is submitted to the National Bank of Hungary. Recommendations and opinions are not binding but the National Bank of Hungary expects regulated entities to comply with them.

1.2. Which bodies are responsible for enforcing the applicable laws and regulations? What are their main competencies?

Accurate application of the laws and regulations concerning the banking sector and financial services are enforced by the National Bank of Hungary, the Financial Arbitration Board, and the competent courts.

National Bank of Hungary

The National Bank of Hungary supervises the financial intermediary system by supervising the entities, the persons, and the activities covered by, amongst others, the Banking Act, the Mortgage Loan Companies Act, the Payment Services Act, and the Credit Information System Act. Its supervision extends to:

■ deciding the applications submitted for licenses and other authorizations;

■ maintaining registers relating to the banking sector;

■ examining the systems of regulated entities for the provision of information and their data reporting; and

■ examining whether the regulated entities comply with the Hungarian and the European Union laws and enforce the resolutions issued by the National Bank of Hungary.

The National Bank of Hungary carries out (i) authorization procedures, (ii) examination procedures, (iii) proceedings for the protection of consumers' interests, (iv) market surveillance procedures, and (v) supervisory control proceedings.

Authorization procedures are to provide licenses for the foundation, merger, and operation of regulated entities, portfolio transfer, and include the proceeding of termination of activities.

Examination procedures cover compliance by the regulated entities with the Hungarian and European Union laws and the enforcement by regulated entities of the resolutions issued by the National Bank of Hungary.

Proceedings for the protection of consumers' interests monitor the compliance by the regulated entities with the laws and regulations on business-to-consumer commercial practices as well as the basic requirements and restrictions with regard to commercial advertising activities, and the fulfillment of their obligations arising from consumer disputes of a financial nature.

Market surveillance procedure shall be initiated upon identifying any operations carried out without a license or in the absence of notification in the fields of, amongst others, financial or auxiliary financial services, stock exchange services, investment fund management services, investment services, and agency activities.

Supervisory control proceedings mean a site inspection. Should the National Bank of Hungary detect that a regulated entity has breached any provision set out in the relevant legislation or the decision issued by an authority, the National Bank of Hungary shall instruct the regulated entity to remedy the such infringement and warn it of the potential legal consequences or commence the proper proceeding against such entity.

The National Bank of Hungary functions as the resolution authority in Hungary. The resolution is an administrative procedure aimed to reorganize and restructure an institution on the grounds of public interest, ensuring the continuity of its critical functions and restoring its viability. Liquidation remains the primary way of withdrawal of insolvent institutions from the economic market, however, the resolution procedure provides for the possibility that in case the institution is already insolvent or is likely to become insolvent, the National Bank of Hungary may order the resolution procedure, provided that the purposes of resolution can be reached more efficiently through a resolution rather than liquidation (i.e., the resolution is for the benefit of public interest).

The following four resolution tools may be applied by the National Bank of Hungary:

- asset sale: sale of the ownership interests (shares) in or issued by the institution or the assets, rights, and obligations of the institution;

- bridge institution: the ownership interests (shares) in or issued by the institution under resolution or the assets, rights, and obligations of the institution under resolution shall be transferred temporarily to an institution owned in whole or part by the Resolution Fund in order to maintain and sale the functions and the services of such institution;

- asset separation: if needed for the operation of the institution, the assets, rights, or obligations of the institution under resolution or the bridge institution shall be transferred to an institution owned by the Resolution Fund or the state; and

- bail-in tool: certain liabilities are written down or converted, if not adequately covered by capital.

Financial Arbitration Board

The National Bank of Hungary shall carry out through the Financial Arbitration Board the settlement of disputes between consumers and the regulated entities relating to the conclusion and performance of agreements for the supply of services with the aim to reach an out-of-court settlement. To that end, the Financial Arbitration Board must attempt to reach a conciliation agreement or, failing this, adopt a decision to ensure consumer rights simply, swiftly, and efficiently under the principle of cost-efficiency.

The Financial Arbitration Board is a professionally independent body operated by the National Bank of Hungary, composed of the chairman of the Financial Arbitration Board and the arbitration board members.

Courts

The courts have the competence to settle disputes concerning the rights and obligations, whether it be contractual or non-contractual, arising out of or in connection with, the existence, validity, effectiveness, and termination of, an agreement concluded in relation to the financial or auxiliary financial services, such as the provision of a loan by a credit institution. The competence of the courts extends to the determination as to whether a regulated entity has complied with the applicable laws and regulations when providing advisory services to, giving information to, or concluding an agreement with, a client in relation to the financial or auxiliary financial services and such client suffers damage in respect thereof.

The National Bank of Hungary may bring court action on behalf of consumers against a regulated entity or person (i) violating any provisions concerning the banking sector, or (ii) using any unfair standard contract term in connection with its activities, provided that such unlawful activity affects a wide range of consumers.

In addition, collaterals may be enforced by the beneficiary through a court proceeding carried out by a bailiff assigned to the court.

1.3. What are the current priorities of regulators and how does the regulator engage with the banking sector?

Amidst the impacts the COVID-19 global pandemic has had on the national economy was a significant drop in the ability of borrowers (both consumers and business associations) to duly perform their payment obligations arising out of loan agreements as well as in the appetite of potential borrowers to apply for new credits and loans. A payment moratorium was introduced as a result of which the obligation of the borrowers to pay any principal, interest, and fees arising out of loan agreements could be, by operation of law, amended so that a payment moratorium was granted to the borrowers in respect of their payment obligations. After being extended several times, the payment moratorium was withdrawn on a gradual basis by the Hungarian Government which is now focusing on legislation that can prevent the loan transactions from becoming non-performing due to the accumulated principal and accrued interests.

The National Bank of Hungary has announced several types of the Funding for Growth Scheme (*Novekedesi Hitelprogram*) with the aim to support small and medium-sized enterprises in accessing loans and to strengthen financial stability. Within the framework of the Funding for Growth Scheme, the National Bank of Hungary provides credit institutions with zero-interest refinancing loan with a maturity of 10 years (subject to certain conditions, 15 years or 20 years) which they lend to small and medium-sized enterprises under a capped annual cost in the form of loans or financial leases, on the one hand, and for the refinancing of financial enterprises for the same purpose, on the other hand. The Funding for Growth Scheme eases access to loans by small and medium-sized enterprises, thereby facilitating the implementation of projects, the launching of which has been hindered for a while by the high financing costs. Following its announcement, enterprises showed considerable interest in loans provided within the framework of the Funding for Growth Scheme. Furthermore, according to the vision of the National Bank of Hungary outlined in its strategy related to the set of green instruments, Hungary's sustainable convergence may be realized through the economy's green transition, which is conditional upon the development of a financial system in Hungary, which takes into consideration and enforces criteria for environmental sustainability. The housing loan market serves as a starting point for supporting the integration of green criteria, since the energy efficiency of the stock of dwellings is low, and thus there is major room for modernization. Along these principles, the National Bank of Hungary has launched – as part of the Funding for Growth Scheme – the *FGS Green Home Programme* (*NHP Zold Otthon Program*) in an effort to foster the enforcement of environmental sustainability (green) criteria in the Hungarian housing market.

A new act on bankruptcy and liquidation proceedings has been at the center of the attention of the Hungarian legislator and regulator, as well.

II. AUTHORISATION

2.1. What licenses are required to provide banking services in your jurisdiction? What activities do they cover?

Banking services in Hungary mean the provision of financial or auxiliary financial services.

Financial services extend to the provision of the following activities in a business-like manner (i.e., gainful (for-profit) economic activity performed on a regular basis for compensation without a pre-specified number of clients):

- taking deposits and receiving other repayable funds from the public;
- providing credit and utilizing loan;
- financial leasing;
- payment services;
- issuance of electronic money;
- issuance of paper-based cash-substitute payment instruments which are not recognized as payment services;
- providing surety and guarantee as well as other forms of banker's obligations;
- commercial activities in foreign currency, foreign exchange – other than currency exchange services, bills and checks on own account or as commission agents;
- financial intermediation services;
- escrow services, safety deposit box services;
- credit reference services; and
- purchasing receivables.

Auxiliary financial services extend to the provision of the following services in a business-like manner (i.e., gainful (for-profit) economic activity performed on a regular basis for compensation without a pre-specified number of clients):

- currency exchange services;
- operation of payment systems;

■ money processing activities;

■ financial brokering on the interbank market;

■ activities for the issue of negotiable credit tokens; and

■ credit advisory services.

As a general rule, the financial and auxiliary financial services may be performed subject to the license issued by the National Bank of Hungary. However, such a license is not needed if the above activities are not carried out in a business-like manner (i.e., gainful (for-profit) economic activity performed on a regular basis for compensation without a pre-specified number of clients). In addition, there are cases where the activities are carried out in a business-like manner, yet they do not need authorization, only a notification procedure must take place (as specified below).

A foreign business association may provide financial or auxiliary financial services in Hungary exclusively through its Hungarian branch, except for the following: (i) credit institutions established in any Member State of the European Union or the European Economic Area and financial enterprises complying with certain conditions may carry out the activities on a cross-border basis, and (ii) a foreign financial institution established in any Member State of the Organisation for Economic Co-operation and Development may carry out certain (not all) activities on a cross-border basis if it has been authorized for such activities by the competent supervisory authority of the Member State where established.

In addition, there are cases where the performance of the financial or auxiliary financial services does not need authorization, only a notification procedure must take place towards the National Bank of Hungary. Credit institutions established in any Member State of the European Union or the European Economic Area and financial enterprises complying with certain conditions are not obliged to obtain the license of the National Bank of Hungary (i) if their activities are carried out on a cross-border basis, or (ii) if their activities are carried out through their Hungarian branches and authorized by the competent supervisory authority of their home state.

Financial and auxiliary financial services may be provided in a business-like manner (i.e., gainful (for-profit) economic activity performed on a regular basis for compensation without a pre-specified number of clients) by:

■ a licensed local financial institution;

■ a licensed local payment institution;

■ local branches of a licensed financial institution registered in any Member State of the European Union or the European Economic Area (notification procedure is needed);

■ local branches of licensed payment institutions registered in any Member State of the European Union or the European Economic Area (notification procedure is needed);

■ licensed financial institution registered in any Member State of the European Union or the European Economic Area on a cross-border basis (notification procedure is needed); and

■ licensed payment institution registered in any Member State of the European Union or the European Economic Area on a cross-border basis (notification procedure is needed).

Most of the financial and auxiliary financial services may be provided by all types of financial institutions. Financial institutions are credit institutions and financial enterprises.

However, not all types of financial institutions are entitled to provide each of the financial and auxiliary financial services. Also, payment institutions, electronic money institutions, and issuers of credit tokens are not entitled to provide all the financial and auxiliary financial services.

Apart from the above, the license issued by the National Bank of Hungary is needed for the below:

■ establishment of a credit institution or a financial enterprise;

■ the operation, amendment of scope of activities, termination of the operation of, a credit institution or a financial enterprise;

■ operation of a payment institution or an electronic money institution;

■ notification of the activities of a payment institution whose sole business is the provision of account information services or an issuer of credit tokens;

■ authorization of a crowdfunding service provider;

■ transformation, merger, or division of a credit institution or a financial enterprise;

■ election, the appointment of a senior executive of a credit institution, a financial enterprise, a payment institution, or an electronic money institution;

■ acquisition of a qualifying holding in a credit institution or a financial enterprise and increase of the qualifying holding;

■ acquisition of a qualifying holding by a credit institution in a nonresident enterprise;

■ portfolio transfer by a credit institution, a financial enterprise, or a payment institution;

- activities of an intermediary;
- operation of a Hungarian branch of certain foreign companies to pursue financial, auxiliary financial services, or payment services in Hungary; and
- other matters such as the amendment of the constitutional document of a credit institution.

2.2. What is the procedure for obtaining a banking license? How long does this typically take?

Establishment in Hungary

In the case of the establishment of a credit institution in Hungary, there is a two-phased licensing process. Firstly, an establishment license must be obtained. The National Bank of Hungary requests the opinion of the competent supervisory authorities of other European Union or European Economic Area Member States prior to issuing the establishment license if the credit institution to be established (i) is a subsidiary of a credit institution established in another European Union or European Economic Area Member State, (ii) is a subsidiary of the parent company of a credit institution established in another European Union or European Economic Area Member State, or (iii) has an owner (either a natural or a legal person) with controlling influence that has also controlling influence in a credit institution established in another European Union or European Economic Area Member State. The establishment license shall be repealed if the credit institution fails to submit to the National Bank of Hungary the request for an operating license within six months from receipt of the establishment license. Secondly, an operating license must be obtained.

In the case of the establishment of a financial enterprise, an establishment license must be obtained which also includes a license to operate.

In the case of a payment institution, an operating license must be obtained.

In each of the above cases, the licensing request must be accompanied by various documents specified on the website of the National Bank of Hungary. The documentation must be submitted to the National Bank of Hungary electronically. Following the submission of the documentation, the National Bank of Hungary may request additional information from the applicant at any time. In practice in each licensing process, the National Bank of Hungary requests additional information in two or three rounds.

In respect of the licensing of a credit institution, a financial enterprise, or a payment institution, the official deadline for the National Bank of Hungary to issue its decision is three (3) months starting on the date when the National Bank of Hungary has received all requested information, which can be extended with an additional three months. Taking into account the information requests of the National Bank of Hungary following the initiation of the process, the average time needed to obtain a license for a credit institution, a financial enterprise or a payment institution is six to nine months.

Operation through a Hungarian branch or on a cross-border basis

In the case of a branch or cross-border services of a credit institution, there is a mandatory regulatory process of local registration in local registries as a cross-border service provider, in accordance with the relevant European Union laws. If a credit institution registered in another European Union or European Economic Area Member State intends to establish a branch in Hungary or pursue financial or auxiliary financial services on a cross-border basis in Hungary, it must notify its home regulator in advance of the activities it intends to pursue in Hungary. Within one month of receiving such notification, the home regulator would need to inform the National Bank of Hungary of the credit institution's planned activities and informs the affected institution accordingly. Upon receipt of the notice of the home regulator, the National Bank of Hungary informs the relevant credit institution regarding the regulations pertaining to consumer protection, particularly, having regard to the requirements to provide information to customers, the requirements for the business rules, and the regulations on the provision of services. The National Bank of Hungary requires that local operations may start only if the branch or the institution satisfies the applicable Hungarian consumer protection laws and any other general goods regulations as listed on the website of the National Bank of Hungary.

No license is needed, and the notification process specified in the case of a credit institution above may apply to a financial enterprise registered in another European Union or European Economic Area Member State in order to establish a branch in Hungary or to pursue financial or auxiliary financial services on a cross-border basis in Hungary if it meets certain requirements defined in the Hungarian laws. However, if such requirements are not met, a license must be obtained for the establishment of a Hungarian branch for a financial enterprise registered in another European Union or European Economic Area Member State.

The provisions applicable to payment institutions are similar to those applicable to credit institutions. Payment institutions established in any European Union or European Economic Area Member State do not need to obtain a license for services to be performed (i) on a cross-border basis or (ii) through its Hungarian branch, provided that in both cases the activities to be pursued in Hungary are authorized by the competent

supervisory authority of its home state.

It is worth mentioning that Hungarian law does not provide for any requirements for the license issued by the foreign supervisory authority or the foreign supervisory authority itself. The provisions of the Banking Act and the Payment Institutions Act shall apply to a credit institution, a financial enterprise and a payment institution (respectively) established in another European Union or European Economic Area Member State and authorized by the competent supervisory authority of its home country. No further specification is set out on which foreign supervisory authority must issue the license (a central bank or other agency) since the licensing process in a foreign country is subject to the laws of that foreign country.

However, the foreign entity wishing to perform the services in Hungary on a cross-border basis or through its Hungarian branch must be (i) a foreign credit institution (e.g., bank), (ii) a foreign financial enterprise, or (iii) a foreign payment institution. The Hungarian law does not recognize the possibility of benefiting from the licensing/notification process by any other type of foreign entity.

The notification process generally lasts approximately two months.

2.3. Can a foreign bank operate in your jurisdiction on the basis of its domestic license?

The Hungarian law recognizes the possibility for a foreign bank to operate in Hungary based on its domestic license either (i) on a cross-border basis or (ii) through its Hungarian branch. In both cases, there is a mandatory regulatory process of applying for a local registration in local registries as a cross-border service provider, in accordance with the relevant European Union laws. If a credit institution registered in another European Union or European Economic Area Member State intends to establish a branch in Hungary or pursue financial or auxiliary financial services on a cross-border basis in Hungary, it must notify its home regulator in advance of the activities it intends to pursue in Hungary. Within one month of receiving such notification, the home regulator would need to inform the National Bank of Hungary of the bank's planned activities and informs the affected bank accordingly. Upon receipt of the notice of the home regulator, the National Bank of Hungary informs the relevant bank regarding the regulations pertaining to consumer protection, particularly, having regard to the requirements to provide information to customers, the requirements for the business rules, and the regulations on the provision of services. The National Bank of Hungary requires that local operations may start only if the branch or the bank satisfies the applicable Hungarian consumer protection laws and any other general goods regulations as listed on the website of the National Bank of Hungary.

It is worth mentioning that Hungarian law does not provide for any requirements for the license issued by the foreign supervisory authority or the foreign supervisory authority itself. The provisions of the Banking Act shall apply to a bank established in another European Union or European Economic Area Member State and authorized by the competent supervisory authority of its home country. No further specification is set out on which foreign supervisory authority must issue the license (a central bank or other agency) since the licensing process in a foreign country is subject to the laws of that foreign country.

2.4. What are the restrictions on ownership, including foreign ownership of banks?

The constitutional document of a bank established in the form of a public company limited by shares may regulate the maximum level of voting rights that may be exercised by a shareholder. The constitutional document may contain provisions to stipulate the maximum level of voting rights of any group of shareholders.

Shareholders having an ownership interest of 5% or more in a bank shall notify the bank of their indirect holding in the bank and any change therein by disclosing the data suitable for identification. The National Bank of Hungary suspends the voting right of the shareholder failing to fulfill such obligation until it has been met.

2.5. What are the requirements for a proposed acquisition and acquirer of a qualified holding in a bank? Would the same requirements apply in the case of an increase of a qualifying holding?

Any person with a qualifying holding in a bank shall fulfill the following requirements:

- being independent of any influences which may jeopardize the bank's careful, diligent, and reliable (prudent) operation;
- having a good business reputation;
- being capable to maintain the reliable and diligent leadership and control of the bank; and
- having transparency in business connections and ownership structure in order to allow the competent authority to exercise effective supervision over the bank.

The acquisition of a qualifying holding in a bank, and the acquisition of additional qualifying holding in a bank to reach the limit of 20%, 33%, or 50%, are subject to the consent of the National Bank of Hungary. The acquisition of a majority interest in a business association that has a qualifying holding in a bank is also subject to the consent of the National Bank

of Hungary.

The person having a qualifying holding in a bank shall notify the National Bank of Hungary two days prior to the execution of the agreement of the intent to terminate its qualifying holding in full or to reduce its qualifying holding below the limit of 20%, 33% or 50%.

Any person who has acquired a qualifying holding in a bank or has changed the size of its qualifying holding in a bank to reach or drop below the limit of 20%, 33%, or 50% shall notify the National Bank of Hungary in writing within 30 days from the execution of the agreement.

III. REGULATORY CAPITAL AND LIQUIDITY

3.1. How are banks typically funded in your jurisdiction?

Deposit growth and an increase in public sector sources of funding can be observed. The banks tend to increase market-based funding, while the gap between the debt issuances and maturing targeted longer-term refinancing operations (TLTRO) remains significant.

The total assets of the banks in Hungary increased by 15% in 2021 due to a rise in cash balances at the central bank, reflecting loan volume growth.

The use by banks of public sector funding such as the European Central Bank's TLTRO increased in 2021.

The past few years showed a deposit growth representing over seventy 70% of the banks' total funding. For the period from 2022 to 2024, Hungarian banks are planning an increase in deposits from households and NFCs with a growth rate above 25%.

According to funding plans, the banks intend to increase reliance on market-based funding by eleven 11% over the three-year forecast period.

3.2. What capital and own funds requirements apply to banks in your jurisdiction?

A bank may be established in Hungary with a minimum initial capital of HUF 4 billion. A financial enterprise pursuing credit and loan activities may be established in Hungary with a minimum initial capital of HUF 150 million.

The above amounts are the initial capital being the combined total of the registered capital, capital reserves, and profit reserves. The initial capital must be paid in cash. The initial capital may only be paid into a payment account kept with a credit institution that is not involved in the establishment proceeding, in which the founder has no ownership and which has no ownership in the founder. Use of the initial capital during the procedure for the authorization of establishment is not allowed.

There are requirements for both types of financial institutions' equity capital as well, i.e., the amount of a financial institution's equity capital may not be less than the minimum amount of initial capital. If the amount of a financial institution's equity capital falls below such threshold, the National Bank of Hungary shall have the power to give the financial institution a maximum of eighteen (18) months to bring its equity capital to compliance. If the amount of a financial institution's equity capital falls below the amount of the registered capital, the National Bank of Hungary shall have the power to instruct the financial institution's management board to convene the members' meeting.

Regulation of the capital requirements of banks is sophisticated and complex since banks – for the purpose of maintaining solvency and the ability to fulfill liabilities – shall have sufficient own funds at all times to cover the risks of its activities, covering at least the minimum capital requirement defined in the *Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012*, and the extra capital requirement prescribed in the framework of a supervisory review provided that it may not be less than the minimum amount of initial capital.

3.3. Has your jurisdiction implemented the Basel III framework? Are there any major deviations?

The Basel III framework has been implemented by the European Union with the Capital Requirements package, comprising:

- *Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRD IV)*; and
- *Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012 (CRR).*

The rules mainly address the amount of capital and liquidity that banks and investment firms hold.

On the one hand, the CRR is binding in its entirety and directly applicable in Hungary.

On the other hand, the implementation of CRD IV into Hungarian law was achieved by the Banking Act. In addition, *MNB Decree 10/2014 (IV. 3.)* was adopted in order to harmonize the

Hungarian legislation with the CRR.

IV. REPORTING, ORGANISATIONAL REQUIREMENTS, INTERNAL GOVERNANCE, AND RISK MANAGEMENT

4.1. What key reporting and disclosure requirements apply to banks in your jurisdiction?

There are various reporting obligations applying to financial institutions and payment institutions, including the local branches of institutions registered in a European Union or European Economic Area Member State. These are detailed in the below laws.

Pursuant to *MNB Decree 58/2015 (XII. 22.) on the obligation to provide basic data*, regulated entities must report their basic data to the National Bank of Hungary. Based on it, the following semi-annual reporting requirements are relevant:

- full name;
- short name;
- company form;
- basis number;
- registered seat;
- webpage;
- amount of dotation capital;
- name and contact details of the person responsible for data provision towards the National Bank of Hungary;
- name and contact details of the person responsible for keeping contact with the National Bank of Hungary;
- name and contact details of the person being an addressee of an official letter; and
- personal data of the auditor.

Pursuant to *MNB Decree 54/2021 (XI. 23.) on the obligation to provide various data in relation to the basic tasks of the National Bank of Hungary*, regulated entities must regularly report certain specific or transactional type data to the National Bank of Hungary.

MNB Decree 3/2023 (I. 19.) on the method and terms of calculating and paying the supervisory fee specifies the self-reporting obligation of the supervisory fee towards the National Bank of Hungary.

Pursuant to *MNB Decree 35/2018 (XI. 13.) on the obligation to provide data on credit transactions to the central bank information system*, regulated entities must report certain data of credit and loan transactions to the National Bank of Hungary on a monthly or quarterly basis.

4.2. What are the organizational requirements for banks, including with respect to corporate governance?

Banks may only operate in the form of a company limited by shares (*reszvenytarsasag*) or branches (*fioktelep*).

Personal and technical requirements for the operation of a bank consist of:

- statutory accounting and records systems;
- internal rules in accordance with prudential requirements;
- personnel requirements;
- infrastructure, information technology, technical and security, and premises suitable for carrying out the activities;
- control procedures and systems;
- property insurance;
- information and control systems for reducing operational risks, and a plan for handling emergency situations;
- clear organizational structure; and
- operation in premises that meet the security requirements prescribed in the relevant laws.

The personnel requirements relate to – in the case of a bank – the management board, the managing director, and the supervisory board, and – in the case of a branch – the person appointed by the foreign financial institution to lead the branch, and its direct deputy, and not the employees of the institution. The qualifications and number of such persons are set out in detail in the Banking Act.

The persons for these positions may be elected or appointed with the prior consent of the National Bank of Hungary.

In addition, the bank must engage an auditor (audit firm) certified to audit financial institutions. Further requirements are set out in the Banking Act to be met by the auditor (audit firm).

Senior executives, managing directors, management bodies

Senior executive means, in the case of banks incorporated as limited companies, the chair and the members of the management board and the supervisory board, and the managing

director. Senior executive means, in the case of branches, the person appointed by the foreign financial institution to lead the branch, and its direct deputy. Senior executives may be elected and appointed upon the prior authorization of the National Bank of Hungary.

Managing director means the president of a company elected by the management board with the right of control and employed by the company, or the chief officer appointed to manage the company, employed by the company, also including all deputies of such officer. Banks incorporated as limited companies shall have at least two managing directors.

The managing directors of a bank and the senior executives of a branch need to meet certain requirements (e.g., relevant studies, experience).

Reasons for disqualification as senior executives include conflict of interest, lack of relevant experience, violation of relevant legislation, criminal record, and lack of good business reputation, the cases of which are regulated in the Banking Act.

Management bodies comprise the management board and the supervisory board of the bank, including their members and directors, and also the senior executives of banks incorporated as branches.

All members of the management body with the right of control (acting in its role of decision-making) must be natural persons. At least two members shall be employed under an employment agreement by the bank (internal members). In the case of banks, at least two members shall be recognized as residents according to foreign exchange regulations – including persons with the right of free movement and residence – who have had a permanent residence in Hungary for at least one year. Internal members shall be elected from the managing directors of the bank. Any person who has been the auditor of the bank or a financial institution with close links to the bank within the preceding three years cannot be a member.

All members of the management body with supervisory function (monitoring and controlling the decision-making by the management body with the right of control) must be natural persons. The management body with the supervisory function shall have at least three but not more than nine members that may not be the employees of the bank, except for the employees' representatives.

Compliance function department

Banks must set up a unit independent of the department responsible for financial and investment services and ancillary services. The National Bank of Hungary shall be notified of the head of the compliance function department.

Also, a single compliance officer may be eligible under certain conditions (e.g., burdensome to the bank and does not adversely affect the compliance function).

Internal control, internal control department

Banks must set up an independent internal control unit supervised directly by the management body with a supervisory function. The internal control system shall be operated by the internal control unit, and the functions of the internal control unit shall be carried out by the internal controller.

The head of the internal control unit or the internal controller shall meet certain requirements (e.g., relevant studies, relevant experience, no criminal record).

Risk exposure and management committee

Banks with a market share of at least 5% in respect of their balance sheet total are required to establish a risk exposure and management committee monitoring on an ongoing basis the risk strategy and the risk appetite of the bank.

The business unit responsible for the risk management function covering all material risks of the bank

Banks with a market share of at least 5% in respect of their balance sheet total are required to set up and operate an effective, comprehensive, and independent business unit responsible for the risk management function covering all material risks of the bank.

Nomination committee

Banks with a market share of at least 5% in respect of their balance sheet total are required to establish a nomination committee.

Audit committee

Public-interest banks shall set up and operate an audit committee with certain exceptions set out in the Banking Act.

Banks with a market share of less than 5% in respect of their balance sheet total may set up a joint risk exposure and management and audit committee.

Auditor

Auditors must meet special requirements.

4.3. What are the local rules for loans to the management body and their related parties?

A credit institution (other than a credit union) may undertake risks comprising an exposure under the conditions set out in the Banking Act:

- to a member of the management board or the supervisory board of the credit institution or a business association having a close connection with the credit institution;
- to a close relative of the persons referred to above;
- to a business association controlled by any persons referred to above, and in relation to the sale of a business association controlled by any persons referred to above to a third party.

The above risk undertaking is subject to the unanimous decision of the management board and the consent of the supervisory board. The person concerned shall not vote on the decision. These restrictions shall not apply to:

- the overdraft facility in relation to the payment account held at the credit institution up to the amount specified in the internal policy;
- the salary advances made by employers and the residential loans up to the amount specified in the internal policy;
- the mortgage loans if the full amount of such exposure to a specific person does not exceed HUF 15 million; and
- the consumer credit agreements not covered in any of the above points if the full amount of such exposure to a specific person does not exceed HUF 5 million.

The above risk-undertaking may not provide for more favorable terms than the risk-undertakings for any other person not covered by the above list. The value of any exposure to a person stemming from the above risk-undertaking may not reach 80% of the limit set out in Article 392 of *Regulation (EU) No 575/2013*, provided that the value of any exposure for over one year may not reach 50% of the limit set out in Article 392 of *Regulation (EU) No 575/2013*.

4.4. What are the main legal provisions governing risk management in the banking sector in your jurisdiction?

Credit institutions are required to have comprehensive and effective governance regimes proportionate to the nature, scale, and complexity of the risks inherent in the financial services and auxiliary financial services they pursue, including but not limited to:

- well-defined, transparent, and consistent lines of responsibilities and functions;
- adequate internal control mechanisms to monitor, prevent and avoid conflicts of interest;
- effective processes to identify, measure, manage, monitor, and report the risks the credit institution is or might be exposed to; and
- gender-neutral remuneration policies and practices.

In a bid to promote effective risk management, the National Bank of Hungary regulates the prudential requirements relating to exposures in default and restructured receivables.

Credit institutions shall have in place written procedures and policies (i) for addressing risks where the recognized credit risk mitigation tools prove less effective than expected, (ii) for the evaluation, measurement, and management of the risks arising from potential changes in interest rates, and (iii) for the process for approving, amending, renewing, refinancing and monitoring credit and loan activities.

The management board of the credit institution shall be responsible for the risk exposures of the credit institution.

A credit institution with a market share of at least 5% in respect of its balance sheet total must establish a risk exposure and management committee monitoring on an ongoing basis the risk strategy and the risk appetite of the credit institution.

A credit institution with a market share of at least 5% in respect of its balance sheet total must set up a department responsible for the risk control function covering all material risks of the credit institution.

A credit institution with a market share of at least 5% in respect of its balance sheet total must set up a nomination committee that, amongst others, recommends candidates to fill management board and supervisory board vacancies.

Each credit institution that is not covered by supervision on a consolidated basis is required to have in place a recovery plan proportionate to the nature, scale, and complexity of the risks inherent in the financial services and auxiliary financial services it pursues. Such a recovery plan must be submitted to the National Bank of Hungary. Considering the potential impact the credit institution's possible insolvency may have on other credit institutions and the financial markets, the recovery plan shall contain, amongst others, (i) a summary of the key components of the plan and the overall recovery capacity of the credit institution, (ii) a communication and information plan for addressing adverse reactions in the market, (iii) the critical functions of the credit institution, (iv) steps designed to maintain the critical functions of the credit institution with regards to liquidity and solvency, and (v) an estimated time frame needed for each major action set out in the recovery plan.

4.5. What are the legal requirements applicable to banks in combating money laundering and terrorist financing area?

A service provider (such as a Hungarian financial institution pursuing financial services or a Hungarian payment institution pursuing payment services, including the Hungarian branch of a regulated financial institution or payment institution registered in any Member State of the European Union or the European Economic Area) must carry out customer due diligence when establishing a business relationship. As part of such due diligence procedure, the service provider must carry out customer identification. The Money Laundering Act sets out what documents the service provider must obtain from the customers and requires the service provider to check the validity of such documents.

Required documents consist of the following:

- in the case of a natural person, an official document suitable for identification purposes and an official address card for Hungarian citizens, or in the case of foreigners a passport or personal identification document provided that it embodies an authorization to reside in Hungary, a document evidencing the right of residence or a valid residence permit;

- in the case of a legal person, a document not older than 30 days verifying the registration of the company by the court of registration, or in case of other domestic legal persons whose existence is subject to registration by an authority or court, the document of registration, or in case of a foreign legal person the document evidencing that it has been registered under the laws of the country in which it is established.

Besides, the legal person customer must provide a statement on its ultimate beneficial owner.

The service provider shall make copies of the provided documents. As a general rule, any data, document, and copies thereof must be kept for eight years.

During the customer identification, the service provider may request information on the source of funds as well as documentary evidence for the purpose of verification of information disclosed relating to the source of funds. In certain cases, it is mandatory to obtain information on the source of funds (e.g., the customer is from a high-risk third country, or the customer or its beneficial owner qualifies as a politically exposed person).

Provided that its conditions are met, instead of the basic (simplified) customer due diligence procedure, an enhanced customer due diligence procedure shall be carried out.

The service providers must conduct internal risk assessments based on the nature of the business relationship, the type and value of the transactions, and the customer's circumstances, which is to be proportionate to the service provider's nature and size, whilst also taking into consideration the national risk assessment. During the internal risk assessment, the service providers must take appropriate steps to identify and assess the risk factors that are to be documented, kept up-to-date, and made available to the competent authorities during their licensing and supervisory activities.

The service provider categorizes customers into low, average, or high-risk categories.

A due diligence procedure must be carried out when establishing a business relationship with the customer as well as the relationship must be monitored continuously. Examples of cases when the customer due diligence must be carried out:

- when carrying out an occasional transaction that amounts to HUF 4.5 million or more;

- when carrying out an occasional transaction qualifying as a transfer of funds, exceeding HUF 300,000;

- when there is information, fact, or circumstance giving rise to a suspicion of money laundering or terrorist financing, provided that the due diligence procedure has not yet been carried out; and

- when there are doubts about the accuracy or adequacy of the previously obtained customer identification data.

The Money Laundering Act sets out the definition of the politically exposed person. Politically exposed persons must make an additional statement on their status as a politically exposed person and they are subject to an enhanced customer due diligence procedure.

The supervisory authority of financial institutions and payment institutions for AML regimes is the National Bank of Hungary. The National Bank of Hungary monitors the compliance of service providers with the provisions of the Money Laundering Act and it may take measures in case of an infringement of AML requirements. Penalties include withdrawing or suspending permits, or imposing a fine. Additionally, money laundering and non-compliance with the reporting requirement in relation to money laundering qualify as crimes under the Hungarian criminal code.

The National Bank of Hungary has the authority to take the following measures consistent with the gravity of the infringement:

- issue a warning to the service provider;

- order the service provider to cease the unlawful activity;
- order the service provider to revise its internal policy;
- withdraw or suspend the activity or operating licenses until the infringement is remedied;
- bring charges against the director or the employee of the service provider;
- initiate that until the infringement is remedied the director of the service provider be suspended from office or dismissed; and
- impose a fine, of not less than HUF 400,000 but not more than 10% of the annual net revenues of the service provider which shall not exceed HUF 2 billion.

In the taking of measures, the National Bank of Hungary must take into consideration amongst others:

- the size of the infringement;
- the intentional or negligent conduct by the persons responsible for the infringement;
- the impact the infringement has on the service provider or its customers;
- the level of cooperation of the responsible persons with the National Bank of Hungary; and
- the duration and frequency of the infringement.

4.6. Are there any legal provisions regulating banking secrecy in your jurisdiction?

In relation to the banking sector, the Hungarian laws set out detailed provisions on business secrets and bank secrets. However, other types of confidential information, including securities secrets and payment secrets, are also regulated by Hungarian laws.

Business secret

Business secrets mean any confidential fact, information, and other data connected to economic activities, which are not publicly known or not easily accessible to other persons pursuing the same economic activities, where the beneficiary of the secret has taken reasonable efforts that may be expected under the given circumstances to keep such information confidential.

The owner (shareholder) of a financial institution, the person planning to acquire a qualifying holding in a financial institution, the senior executives, and the employees of a financial institution must keep any business secrets made known to them in connection with the operation of the financial institution confidential without any time limitation. The cases where such confidentiality obligation does not apply are listed in the Hungarian laws, for instance, when providing the National Bank of Hungary with a business secret.

Bank secret

Bank secrets mean all facts, information, know-how, or data on clients in the possession of a financial institution relating to the identity, data, financial situation, business activities, ownership and business relationships of the client, the balance of and the transactions executed on the bank account of the client held at the financial institution and the agreements entered into between the client and the financial institution. Any person or entity receiving financial services from a financial institution shall be considered a client. The provisions on bank secrets shall also apply to any person or entity approaching a financial institution in order to receive services, but ultimately deciding not to use such services.

As a general rule, bank secrets may not be disclosed to a third party, except for those cases explicitly listed in the Hungarian laws. For instance, disclosure is permitted if it is needed for the financial institution to sell its claims against the client or to enforce such claims.

Mutual provisions on the business secret and the bank secret

Anyone having access to a business or bank secret must keep such secret confidential without any time limitation. Business and bank secrets may not be disclosed to a third party without the consent of the client or the financial institution (as applicable), subject to the exceptions mentioned above. In the event of termination of a credit institution without succession, the documents containing business or bank secrets can be used for archival research after 60 years from the date of the documents.

Any information that is deemed information of public interest, and such information is rendered subject to disclosure, may not be withheld on the grounds of being treated as a business secret.

V. TRENDS

5.1. What are the main trends in the banking sector in your jurisdiction?

Implementation of the ESG framework in the banking sector

There has been a growing focus on environmental, social, and governance (ESG) criteria that market participants, regardless of their sector, shall consider during their activities.

Improvement in the Hungarian banking sector is supported by *Regulation (EU) 2020/852 of the European Parliament and of*

the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088. While green investments are mostly found in the banking product range (e.g., government bond and corporate green bond issuance), ESG considerations are less widespread in financing, however, they are gaining importance gradually.

The National Bank of Hungary promotes the integration of ESG criteria by assessing climate risks and publishing them to market participants. The National Bank of Hungary adopted the *Green Monetary Policy Toolkit Strategy* in July 2021, which includes two priority programs: (i) the Green Mortgage Bond Purchase Programme and (ii) the Green Home Programme. In addition, the National Bank of Hungary was one of the first central banks to publish the Climate-Related Financial Disclosure in March 2022.

Attempt for full applicability of the document authentication in the financial sector

From September 1, 2022, citizens with a client gateway (*ugyfelkapu*) have the opportunity to sign documents electronically. The service provides an electronic signing solution for users (natural persons) without requiring that they have their own signature certificate or their own registration in the AVDH (Document Authentication) system. After authentication and verification of the appropriate level, users are able to apply for an electronic signature by using the service provider's own secret key, even from their mobile devices. After the identification and the authentication of the user, the Document Authentication creates the signature on the designated document, file, and on the (queried) data certifying the identity of the person, then it will supplement the signature structure created that way by the necessary data (time stamp, revocation data). Finally, it returns the successfully verified signature to the user.

Certain commercial banks have been using this solution to make declarations. The Hungarian Government has instructed the Cabinet Office of the Prime Minister to examine the full applicability of Document Authentication in the financial sector until March 1, 2023, in an effort to facilitate digital development.

Electronic land registry proceeding

Currently, all the documents submitted to the land registry must be in the paper-based format (hardcopy), however, as of February 1, 2024, the entire land registry proceeding will be carried out electronically (with the exception of a few documents of technical nature that may also be submitted to the land registry in paper-based format (hardcopy)).

The switchover to the electronic proceeding includes significant amendments in the legislation relating to property law, as well. From the above date on, legal representatives will be entitled to register certain rights with the land register without any official administrative procedure carried out by the land registry. The official administrative procedure will still remain an option to choose from. The possibility to have a right (e.g., a mortgage over real estate) registered with the land register by a legal representative without the participation of the land registry will call into question the authenticity of the land register since the merits of the agreements submitted to the electronic system will not be reviewed or examined by the land registry.

The detailed rules for the electronic system are set out in the *Government Decree 179/2023 (V. 15.) on the implementation of Act C of 2021 on the Real Estate Registration*.

5.2. What are the biggest challenges in the banking sector at the moment?

Challenges posed by high notarial fees

In 2018, a new decree was adopted on the fees chargeable by notaries public, pursuant to which, the acting notary public may not deviate from the amount calculated based on the decree and may not release the notarial deeds until the notarial fees have been paid in full.

Pursuant to Hungarian law, the notarial deeds are directly enforceable meaning that no preliminary court decision is needed for commencing the enforcement of a loan agreement or a security agreement. In case the obligor breaches a loan agreement or a security agreement that has been incorporated into a notarial deed, provided that certain administrative conditions are met, the lender may directly ask the notary public to commence the enforcement proceeding to be carried out by a bailiff. Under the above decree, the notarial fees have increased significantly, for instance, the notarial fee for incorporating a real estate financing documentation (i.e., one loan agreement and eight security agreements) into a notarial deed amounts now to approximately EUR 7,000.

Given that neither the Hungarian nor the foreign borrowers are eager to pay such high notarial fees (the commercial banks tend to impose on the borrower the obligation to pay the transaction expenses), it has become vital to find a solution that provides the lenders with a position as strong as if the finance documents were incorporated into a notarial deed.

Challenges related to wind and solar power financing

As part of the wind and solar power financing, the main question relating to the mortgage over real estate is which entity has the ownership title over the real estate on which the project is to be developed. In most cases, the real estate on which the project is being developed is not owned by the borrower

but by a third party not participating in the financing, thus, a position must be created where the borrower is entitled to use the real estate throughout the construction and operation of the plant safely. Due to such an ownership structure, the collaterals over the real estate are provided by the owner of the real property. The issue roots in Hungarian property law since there is no common understanding of whether the wind turbines and the solar panels installed on the real estate form part of the real estate itself. In most cases the real estate and the wind turbines or the solar panels are considered one real estate by the land registry, however, there have been cases when the land registry created a separate topographical lot number for the solar panels. In addition, it is not decided whether a solar panel counts as a movable or immovable property. The structure of the finance documents shall be set up on a case-by-case basis and may pose challenges to the legal advisors as to the creation of the collateral pool of the financing. The new land register and property laws may provide solutions to these discrepancies. In addition, a new bill to amend certain laws to increase the competitiveness of the economy was submitted for public consultation in May 2023, pursuant to which the construction right (epitmenyi jog) would be reintroduced into Hungarian law.

5.3. What's new in fintech?

Markets in crypto-assets (MiCA) regulation

The regulation of the European Parliament and of the Council on markets in crypto-assets has not yet been adopted but is waiting for a vote. Once adopted, the regulation will be directly applicable in Hungary.

According to press releases, the National Bank of Hungary is already preparing for the above regulation. Service providers placing general crypto-assets on the public market or wishing to introduce them on trading platforms in the European Union – provided that they are not covered by an exemption – will have to comply with detailed rules (e.g., a registered seat being in the European Union, preparation of a white paper on the characteristics of the crypto-assets and their risks).

In addition, the Hungarian tax law is also being prepared for the "regulated" presence of crypto-assets. As of January 1, 2022, personal income tax is payable on the income from transactions executed in respect of crypto assets. Income from transactions with crypto-assets shall mean profit realized on any transaction executed by a private individual in respect of crypto-assets during the tax year. Profit shall be considered realized (in respect of the excess amount) if the total amount of the proceeds from transactions executed in the year is higher than the evidenced expenses relating to the acquisition of the crypto-assets and transaction fees and commissions, including evidenced expenses incurred in connection with holding the crypto-assets.

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CEE LEGAL MATTERS COMPARATIVE LEGAL GUIDE: BANKING/FINANCE 2023

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I. LEGAL FRAMEWORK

1.1. Which main legislative and regulatory provisions govern the banking sector in your jurisdiction?

The main legal act regulating the activities of the banks in Lithuania is the *Law on Banks of the Republic of Lithuania* (Law on Banks). The Law on Banks establishes the banking system which consists of three types of banks: **(i)** the banks established in Lithuania, **(ii)** branches of foreign banks, and **(iii)** specialized banks established in Lithuania. This law regulates the activities of the banks and provides rules for the banking system ensuring stability, reliability, and efficiency of the banking system. The Law on Banks also regulates the establishment, licensing of the bank, and activities of foreign banks in Lithuania, and establishes requirements for the shareholders of the bank and management of the bank.

The *Law on the Financial Institutions of the Republic of Lithuania* (Law on Financial Institutions) is another important legal act regulating the activities of the banks. This law establishes the services which are considered financial services and can be rendered by the bank, grounds for revocation of the license, distribution of profit of the bank, and peculiarities of supervision of the activities of the banks.

1.2. Which bodies are responsible for enforcing the applicable laws and regulations? What are their main competencies?

The Ministry of Finance is the main body that is responsible for creating, organizing, coordinating, and controlling the implementation of public policy in the field of financial markets and financial services in Lithuania.

The Bank of Lithuania is the central bank of the Republic of Lithuania, established by the Parliament of the Republic of Lithuania (*Seimas*). The Bank of Lithuania is an integral part of the European System of Central Banks and pursues the objectives and tasks of the European System of Central Banks in accordance with the guidelines and instructions of the European Central Bank. The Bank of Lithuania, among other things, supervises the whole financial market participants, including banks. The three largest banks registered in Lithuania are supervised directly by the European Central Bank together with experts from the Bank of Lithuania (the supervisory authority).

The Bank of Lithuania supervises the financial market to the extent that it is not delegated to the European Central Bank under the provisions of *Regulation (EU) No 1024/2013*. As a supervisory institution, the Bank of Lithuania *inter alia* is entitled to issue legal acts and recommendations on the activities of supervised financial market participants and financial market supervision, issue binding instructions to supervised financial market participants and other persons, to impose impact measures on supervised financial market participants and other persons.

It also resolves out-of-court disputes between consumers and banks.

The Bank of Lithuania in certain cases also acts as the resolution authority, responsible for the preparation of detailed resolution plans that will be used to ensure the continuity of operations of the banks facing significant problems. As part of its resolution function, the Bank of Lithuania may sell a bank without the approval of the shareholders of the resolved bank, transfer a bank to a temporary institution to preserve the bank's core functions and facilitate permanent access to deposits, and segregate assets – creating a 'good' and a 'bad' bank, with the assets of the resolved bank being segregated accordingly, private bail-in – if the bank's financial situation deteriorates to the point where the bank's own funds or other means are insufficient, this measure would ensure that the critical functions of the bank can be rescued and that the costs of the resolution would be borne by the bank's owners and creditors, not by taxpayers.

Certain actions of the Bank of Lithuania while implementing its functions prescribed by laws might be taken only by obtaining the court's order. The actions of the Bank of Lithuania might be disputed in courts.

1.3. What are the current priorities of regulators and how does the regulator engage with the banking sector?

The priority objective of the Bank of Lithuania as announced on its website is to develop not only an innovative but also a sustainably developing and reliable payments market in Lithuania. Currently, the Bank of Lithuania is focusing more on compliance with the requirements of the law and the activities of payment market participants, communication with market participants, and education of market participants.

The Bank of Lithuania is quite an active institution, on a regular basis it organizes consultations with financial market participants and issues recommendations and guidelines on various topical questions. The Bank of Lithuania constantly publishes such consultations, guidelines, recommendations, and opinions on its website.

II. AUTHORISATION

2.1. What licenses are required to provide banking services in your jurisdiction? What activities do they cover?

Banks differ from other financial market participants as they are considered credit institutions under *Regulation (EU) No 575/2013*. Only credit institutions have the exclusive right to accept deposits and other repayable funds from non-professional market participants, while the provision of licensed financial services without a license is prohibited. Therefore, a credit institution seeking to accept deposits from retail market participants must first obtain a banking license.

The banking license (depending on its scope) *inter alia* entitles the bank to accept deposits and other repayable funds, provide payment services, issue electronic money, and provide other licensed services and non-licensed financial services. While the special bank shall have a right to provide only the following services:

- *acceptance of deposits and other repayable funds*;
- *lending (including mortgage lending)*;
- *financial leasing*;
- *the issuing and administration of travelers' cheques, bills of exchange, and other means of payment, provided that these activities do not include the service referred to in paragraph 5(4)*;
- *the provision of financial guarantees and financial sureties*;
- *financial intermediation (agency activities)*;
- *money management*;
- *credit assessment services*;
- *rental of safe deposit boxes*;
- *currency exchange (cash)*;
- *issuance of electronic money.*

2.2. What is the procedure for obtaining a banking license? How long does this typically take?

The licensing process in Lithuania consists of three processes. Initially, a pre-assessment is carried out, during which potential bank representatives are familiarized with the legal framework applicable in Lithuania and discuss the key aspects of establishing a bank. Subsequently, an application for a banking license is submitted to the Bank of Lithuania, which in turn assesses whether the bank has submitted all the necessary documents to obtain a license. If the Bank of Lithuania does not find any formal deficiencies in the application, it accepts the application for examination. The Bank of Lithuania, after starting the procedure of assessment of the application and the submitted documents, transmits all data to the European Central Bank. The Bank of Lithuania and the European Central Bank assess the data in parallel. If the authorities examining the application find that the documents are not deficient, the bank should be granted a license to operate within a period of 6 months. However, practice shows that only in exceptional cases the documents submitted are not deficient in one way or another. In this case, the examination period is extended. Once the assessment of the documents submitted by the potential bank has been completed, the Bank of Lithuania submits its conclusions on the bank's ability to operate in Lithuania to the European Central Bank, which takes the final decision on the granting of the license. The critical elements that may determine the granting of a bank's license include the adequacy of the documents submitted, the satisfaction of the bank's minimum capital requirement, the adequacy of the company and its shareholders or holders of voting rights, the suitability of the company's management, the operational plan of the bank which must be consistent with the ability of the bank's founders (shareholders or holders of voting rights) to implement it.

2.3. Can a foreign bank operate in your jurisdiction on the basis of its domestic license?

If a bank is licensed in EU countries, it can operate in Lithuania on the basis of its national license. The EU-licensed bank shall have a right to operate whether by establishing a branch or providing financial services without establishing a branch. The right to provide financial services without establishing a branch does not entitle an EU bank to carry on the provision of financial services on a regular basis.

In cases where a bank registered in a non-EU country wishes to start operations in Lithuania, it must obtain a license to operate in Lithuania in accordance with the procedure set out in the Law on Banks.

2.4. What are the restrictions on ownership, including foreign ownership of banks?

It is established under the Law on Banks that the legal entities supported by the state or municipal budgets, persons who did not provide the supervisory authority with the data allowing to establish their identity, participants, activity, financial condition, managers of the legal entity, persons for whose benefit the shares are acquired, or the legality of the acquisition of the funds used to acquire the bank's shares, or have not proved the legality of the acquisition of the funds used to acquire the bank's shares; persons who do not consent to the processing by the supervisory authority of their data necessary for the performance of its functions cannot be the shareholder of the

bank.

Assessment of the bank's shareholders is carried on by the Bank of Lithuania.

The shareholder must comply with the requirements of impeccable reputation in order to be approved by the Bank of Lithuania.

2.5. What are the requirements for a proposed acquisition and acquirer of a qualified holding in a bank? Would the same requirements apply in the case of an increase of a qualifying holding?

An acquirer who has decided to acquire, directly or indirectly, a qualified share in the authorized capital and/or voting rights of the bank, or if the share in the authorized capital and/or voting rights of the bank is acquired or increased so that the proportion of the bank's authorized capital and/or voting rights held reaches or exceeds 20%, 30% or 50%, or to the extent that the bank becomes controlled, shall be obliged to submit a notification of the proposed acquisition to the Bank of Lithuania. The notification of the proposed acquisition shall be submitted by completing the special form Notification of Proposed Acquisition and attaching the specified documents. A person transferring a qualified share in the authorized capital and/or voting rights of a financial market participant who decides to transfer a share in the authorized capital and/or voting rights of the bank or to reduce it so that the bank's share of the authorized capital and/or voting rights is less than 20%, 30% or 50%, or to the extent that the bank ceases to be controlled by it shall immediately submit a notification to the Bank of Lithuania.

III. REGULATORY CAPITAL AND LIQUIDITY

3.1. How are banks typically funded in your jurisdiction?

Banks in Lithuania are funded by contributions from their shareholders (an increase of share capital or loans) and deposits from non-professional market participants.

3.2. What capital and own funds requirements apply to banks in your jurisdiction?

Banks must hold sufficient capital to cover unexpected losses and to have sufficient funds to mitigate the risk of insolvency in times of crisis. The sum of the bank's capital ratios set out in Article 26(1)(a) to (e) of *Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions* must be at least EUR 5 million. Meanwhile, the amount of the bank's own funds ratios laid down in Article 26(1)(a) to (e) of *Regulation (EU) No 575/2013* for a specialized bank shall not be less than EUR 1 million.

Banks operating in Lithuania are also subject to liquidity requirements. Banks are required to hold sufficient liquid assets to cover their net cash outflows within 30 days in the event of extremely adverse conditions. The liquidity coverage ratio must not be less than 100%, i.e., a credit institution's stock of liquid assets must be at least equal to the net cash outflow during the 30 calendar days of the stressed period. Banks must have sufficient stable funding to cover their funding needs for a period of one year, under both normal and stressed conditions.

3.3. Has your jurisdiction implemented the Basel III framework? Are there any major deviations?

The principles of effective banking supervision are enshrined in the *Basel III* framework, to which Lithuania has joined. Lithuania is supportive of the *Basel III* framework.

IV. REPORTING, ORGANISATIONAL REQUIREMENTS, INTERNAL GOVERNANCE, AND RISK MANAGEMENT

4.1. What key reporting and disclosure requirements apply to banks in your jurisdiction?

The banks are required to publish regularly consolidated and, where appropriate, individual information that is easily accessible and accurately reflects their financial position, financial performance, risk exposures, risk management strategies, and the bank's governance policies and processes.

The reports can be divided into several groups:

■ Financial and operational reports necessary for the supervisory authority to carry out supervisory functions, such as the report on changes in equity, the report on issued loans, the report on employees' numbers, the report on calculation of initial capital and equity, etc.

■ Reports to supervise the implementation of measures to prevent money laundering and/or terrorist financing.

■ Operational and security risk event reports, e.g., notification of a major operational or security risk event.

4.2. What are the organizational requirements for banks, including with respect to corporate governance? Please briefly describe the requirements and the procedure of assessment of the suitability of the members of the management body and key function holders.

Under the Law on Banks, the bank must establish a governance structure consisting of a Supervisory Board, the Management Board, and the Chief Executive Officer. The roles and responsibilities of the bank's organs shall be clearly regulated and enshrined in the bank's internal documents, specifying

which functions are assigned to which organs of the bank.

The Resolution of the Board of the Bank of Lithuania on the approval of the general requirements for the internal governance of banks defines the basic principles and requirements to ensure that the organizational structure and internal governance of banks are effective, based on a long-term business strategy, and in line with the nature of the bank's activities, the business risks assumed and their management, and the ability of the bank's governing bodies to adequately manage the bank's activities.

The members of the management bodies are only selected on the basis of an assessment of their experience, qualification, and reputation. The process for the appointment/election of members of the organs of the bank shall be transparent and non-discriminatory and shall provide equal conditions for the participation of all candidates who meet the conditions set out in the competition/selection process. The appointment/election of members of the Bank's organs shall be based on an assessment of their ability to devote sufficient time and effort to their functions, in particular in relation to risk assessment issues. Each member should undertake, in accordance with the procedures laid down by the organs of the bank, to limit his/her other professional commitments to such an extent that they do not interfere with the proper performance of the functions assigned to them.

The members of the management bodies should be of impeccable reputation.

4.3. What are the local rules for loans to the management body and their related parties?

Lending to the bank's managers, persons related to them, and legal entities in which the bank's managers, persons related to them, or persons related to them, or in which such persons are the managers, hold a qualifying share of the share capital and/or voting rights, may not exceed the amounts set by the bank's Supervisory Board. The conditions and procedures for such lending shall be determined by the bank's Supervisory Board.

The lending conditions for the related parties may not be more favorable than the lending conditions for other customers of the bank.

The conditions and procedures for lending to persons related to the Bank must be approved by the Bank's Supervisory Board. The documents confirming such transactions should *inter alia* provide the name of the person and his/her status (i.e. member of a banking body or related party); the type and amount of the transaction the name and composition of the person or body of the bank deciding on the approval of the transaction and the applicable conditions; whether the transaction is at arm's length (yes/no); whether the transaction is on terms and conditions available to all employees (yes/no); the sum of Tier 1 capital and Tier 2 capital; the bank's total Tier 1 capital; whether the transaction/loan is part of a large exposure; the relative weighting of the aggregate amount of all outstanding balances of all transactions with the same person, calculated as a percentage dividing the total outstanding amount by the total outstanding amount of transactions with members of the banking body and their related parties.

The bank must also have a procedure for the management of interest, which *inter alia* should include the approved principles for transactions with related parties that define the conduct of such transactions on an arm's length basis.

4.4. What are the main legal provisions governing risk management in the banking sector in your jurisdiction?

The Resolution of the Board of the Bank of Lithuania approving the Provisions on the organization of internal control and risk assessment/management of all banks establishes the guiding principles to be followed by the bank to ensure that the bank's system of internal control and risk assessment/management is well organized, effective and ensures the safe and sound operation of the bank.

The Resolution has been developed in line with the documents published by the Basel Committee on Banking Supervision: the framework for internal control systems in banking organizations, sound credit risk assessment and valuation for loans, the principles of credit risk management, principles for the management and supervision of interest rate risk, sound practices for managing liquidity in banking organizations, sound practices for the management and supervision of operational risk.

As announced by the Bank of Lithuania on its website, the Bank of Lithuania's financial market supervision is based on a risk-based supervision model. The underlying assumption of this model is that not all financial market participants or the services they provide pose the same threat to the stability of the financial system, consumers, and the economy. Financial market participants supervised by the Bank of Lithuania are assigned to one of four categories, in descending order of supervisory priority, i.e., the first category is assigned to financial market participants with the highest priority, and the fourth category to financial market participants with the lowest priority. A financial market participant shall be assigned to one of the categories on the basis of its size, systemic importance, uniqueness, and other quantitative and qualitative indicators. An econometric model based on these indicators is developed to rank the importance of financial market participants and assign them to a category. Based on this, the Supervisory Service of the Bank of Lithuania develops a priority and risk map,

which is regularly updated.

4.5. What are the legal requirements applicable to banks in combating money laundering and terrorist financing area?

The main legal requirements applicable to banks in the area of anti-money laundering and counter-terrorist financing are primarily established in the *Law on Prevention of Money Laundering and Terrorist Financing*.

The Resolution of the Board of the Bank of Lithuania on the approval of the instructions to financial market participants aimed at preventing money laundering and/or terrorist financing establishes instructions to Financial Market Participants, including the banks on the Prevention of Money Laundering and/or Terrorist Financing provides that the bank must ensure that the internal control system includes the identification, assessment, and management of money laundering and terrorist financing risks on a continuous and effective basis. The system of internal control for the prevention of money laundering and terrorist financing shall *inter alia* include an AML/CFT policy and the internal rules and procedures implementing it, and a system of communication to the management bodies to enable timely decisions to be taken on the management of money laundering and terrorist financing risks. The bank is responsible for establishing an organizational structure that clearly defines the rights, duties, and responsibilities of its staff in relation to the management of money laundering and terrorist financing risks and for ensuring that those duties are fulfilled.

4.6. Are there any legal provisions regulating banking secrecy in your jurisdiction?

Banking secrecy in the Republic of Lithuania is regulated by Article 55 of the Law on Banks. Banking secrecy containing information may only be disclosed to the customer of the bank to whom the banking secrecy information relates or to other persons at the customer's written request or with the customer's written consent, specifying to whom and to what the information may be provided. The bank shall have the right to provide information that constitutes a bank secret to a court, arbitration, or other persons if and only to the extent necessary for the protection of the bank's legitimate interests, as well as to public authorities for the purpose of preventing crime. The bank shall provide information constituting the banking secrecy to the authorities performing pre-trial investigation, criminal intelligence, intelligence, tax administration, supervision of the financial market functions, and also to authorities responsible for money laundering and/or prevention of financing of terrorism, etc. In other cases not established by applicable laws, banking secrecy containing information shall be provided only on the basis of a reasoned court order, if the court determines that such information is necessary for a legitimate interest pursued by the court or by the person requesting the banking secrecy information.

V. TRENDS

5.1. What are the main trends in the banking sector in your jurisdiction?

As announced by the Bank of Lithuania in its review of activities of the banking sector in III quarter of the year 2022 published on their website the banks operating in Lithuania continue to successfully withstand the war in Ukraine and other economic challenges, as well as continue to take a very responsible approach to the uncertainties of the current situation and to be adequately prepared for possible surprises. Banks were quite active in lending to businesses and individuals. Residential mortgages dominated, as usual. Deposits of the population with banks grew, although the annual growth rate slowed down. The Bank of Lithuania continues to promote competition in the banking sector.

The recent entrants in the banking sector (specialized banks) or bank start-up market have almost doubled in terms of assets over the year and are increasingly competing with longer-established banks. However, it is noteworthy that in the Lithuanian banking sector, the divergence between the larger, longer-established banks and the more recently launched specialized banks remains significant, despite the rapid growth in the latter's business volume.

The Bank of Lithuania established the specialized Centre for Financial Market Development in the year 2022. As announced by the Bank of Lithuania on its website the Centre for Financial Market Development will look for ways to strengthen the existing financial market participants and attract new ones, promote sustainable FinTech development, and implement capital market development measures.

5.2. What are the biggest challenges in the banking sector at the moment?

The biggest challenges in the banking sector are related to international sanctions against Russia and Belarus and their implementation of anti-money laundering measures. The Bank of Lithuania notices that commercial banks may face indirect challenges from Russia's war against Ukraine: credit risk for Lithuanian companies that have or have had business relations with the affected countries and cyber security threats.

5.3. What's new in fintech?

While Lithuania is still considered a fintech hub, the Bank of Lithuania emphasizes its goals to increase the operational maturity and improve the quality of services of fintech its

licenses. It should also be noted that electronic money/ payment institutions wish to move into the banking sector obtaining a specialized bank license, however, the requirements for acquiring the specialized bank license are considerably higher. This is why the number of specialized banks is still low in comparison with the number of issued electronic money/payment institutions licenses. Based on the statistic of the Bank of Lithuania announced on their website the total amount of payment transactions made by electronic money and payment institutions in 2022 are almost two times higher than during the year 2021.

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CEE LEGAL MATTERS COMPARATIVE LEGAL GUIDE: BANKING/FINANCE 2023

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I. LEGAL FRAMEWORK

1.1. Which main legislative and regulatory provisions govern the banking sector in your jurisdiction?

The legal framework of the Moldovan financial sector is comprised of legislation regulating the supervision and control of credit institutions, e-money institutions and payment institutions, non-banking financial institutions, insurance companies, and other companies in the financial sector.

The Moldovan legal framework in this area has undergone significant reform in the past years. The legislation is continuing the process of implementing the EU`s legislation. Nonetheless, the Moldovan banking system is already regarded as harmonized at a high level with the relevant *acquis communautaire*.

Thus, the legal framework in the banking sector is comprised of a series of laws issued by the Parliament, as well as secondary legislation comprised of regulations and decisions issued by the National Bank of Moldova (NBM).

The main pieces of legislation in the banking sector are the *Law on banking activity No 202 dated 6 October 2017* (Banking Law) and the *Law regarding the National Bank of Moldova No 548 dated 21 July 1995* (NBM Law).

The Moldovan legislation in the banking sector has been aligned with the main European legislation and standards in the area such as **(i)** *Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms*, and **(ii)** *Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms*.

The Banking Law mainly regulates the activity of the banks in Moldova, by establishing a number of specific requirements, that banks are required to comply with. These requirements are constantly improved in order to bring them in line with the legal provisions and generally accepted international principles and best practices, in particular the recommendations of the Basel Committee on Banking Supervision and the European Union Directives.

The NBM Law establishes the authority, responsibilities, competencies, and jurisdiction of the NBM. It mainly supervises and regulates the activity of Moldovan banks. To accomplish its responsibilities the NBM is entitled to issue regulations and decisions, so-called secondary legislation, which are mandatory for the banks.

Additionally, there is the *Law on Capital Market No. 171 of 11 July 2012* (Capital Market Law), which regulates among others the trade of securities and other financial instruments as well as collective investments undertakings. The Capital Market Law has been drafted by transposing 11 EU directives, including *MiFID*, the *Directive on Takeover Bids*, the *Investor Compensation Scheme Directive*, the *Market Abuse Directive*, the *Capital Adequacy Directive*, and the *UCITS Directive*. As of today, the National Commission for Financial Markets (NCFC) supervises the securities market, insurance sector, and non-banking financing in Moldova.

Starting on July 1, 2023, the NBM will become also the regulator for non-banking credit organizations. The operation of non-banking financial institutions is mainly regulated by the *Law on non–bank credit institutions No 86 dated 11 July 2020* (NBC Law), which sets the main requirements and legal framework for non-bank credit institutions.

1.2. Which bodies are responsible for enforcing the applicable laws and regulations? What are their main competencies?

The National Bank of Moldova (NBM) is the public institution that regulates and supervises the activity of credit institutions, e-money institutions and payment institutions, non-banking financial institutions, and insurance companies.

The NBM is the primary regulator in the industry, has the authority to issue and withdraw banking licenses and regulate and supervise the banking sector. One of the primary tasks of the NBM is to implement the best international standards in the banking sector.

The NBM is the competent resolution authority for the banks.

In this respect, Moldovan law requires that the NBM is operationally independent in the performance of its responsibilities both as a matter of law and in practice. Hence, the NBM shall ensure that the supervisory function is separate and independent of the resolution function and the latter has an explicit mandate and objectives tailored to resolution.

The NBM is the only authority competent to apply the resolution tools (i.e., the sale of business tool, the bridge institution tool, the asset separation tool, the bail-in tool) to the banks that meet the applicable conditions for resolution, and in this respect has the following legal powers:

a) General powers: may be exercised by the NBM individually or in any combination.

The main general powers are: to take control of a bank under resolution and exercise all the rights and powers conferred upon the shareholders; to transfer shares or other instruments of ownership issued by a bank under resolution; to reduce, including to reduce to zero, the principal amount of or outstanding amount in respect of bail-inable liabilities, of a bank under

resolution; to convert bail-inable liabilities of a bank under resolution into ordinary shares or other instruments of ownership; to cancel debt instruments issued by a bank under resolution; to require a bank under resolution to issue new shares or other instruments of ownership or other capital instruments; to replace the management body and senior management of a bank under resolution, etc.

b) Ancillary powers: may be exercised where it is considered by the NBM to be appropriate to help to ensure that resolution action is effective or to achieve one or more resolution objectives. The main ancillary powers are to restrict the procurement of further shares or other instruments of ownership; to require the NCFM or the relevant authority of another country to discontinue or suspend the admission to trading on a regulated market or the official listing of financial instruments; to cancel or modify the terms of a contract to which the bank under resolution is a party, etc.

c) Other powers: to require the provision of services and facilities; to suspend certain obligations; to restrict the enforcement of security interests; to temporarily suspend termination rights; to apply administrative penalties or other administrative measures, etc.

The above-mentioned prerogatives of the NBM are in line with the provisions of the Bank Recovery and Resolution Directive 2014/59/EU.

Besides the above, the NBM is also the only authority competent to apply early intervention measures.

1.3. What are the current priorities of regulators and how does the regulator engage with the banking sector?

The priorities are established on an annual basis by the NBM as a common strategy. The current priorities of the NBM are:

1. Credit risks. The NBM is focused on assessing the banks' lending practices to ensure compliance with applicable regulations and risk profiles, and that risks are identified and mitigated appropriately.

2. Internal governance, risk management, and internal risk and the internal process of capital adequacy assessment process (ICCAP). In the last two years, the NBM paid particular attention to the assessment of the adequacy of internal control functions in banks, namely risk management practices, especially with regard to the identification, anticipatory measurement, and mitigation of risks in a timely manner, the existence of a transparent organizational structure with clear reporting lines and an appropriate corporate culture, segregation of responsibilities and independence of control functions.

3. Internal liquidity adequacy assessment process (ILAAP). Another priority derives from the changes made in the regulations regarding the framework for the administration of banks' activity, namely, the introduction of the internal liquidity assessment and adequacy process (ILAAP) by checking the quality of the liquidity adequacy assessment. Thus, the NBM is assessing the solidity, effectiveness, and comprehensive nature of the framework for managing liquidity and financing risks related to banks, ensuring that the banks have a rigorous management framework designed to manage liquidity risk, including a process for identifying, managing and monitoring liquidity and funding risks.

4. Risks associated with information and communication technologies (ICT). In the context of increasingly persistent and complex cyber threats, cyber risk is becoming prominent within banks, can generate significant losses, and damage banks' reputations. The NBM is continuing to assess the situation in the field of ICT and emphasizesemphasis its effort on the: verification of the use of operating systems that have support from suppliers, performing complex continuity tests to ensure the continuity of the bank's activity in case of unforeseen situations, performing penetration tests to demonstrate the banks' ability to face cyber-attacks.

5. Combating money laundering and terrorist financing. NBM is focusing on the implementation of the risk rating methodology in the supervision process, which will lead to a significant improvement in its quality and efficiency. The aim will be to ensure an adequate framework for carrying out surveillance activities, mainly off-site, based on the specific risks of the significant transfer of activities to the online environment, the risks of evading international sanctions, but also from the perspective of the risks deriving from the activities which frequently involve large amounts of cash or high-risk foreign transfer operations.

6. Risks associated with the use of payment systems. The NBM is focusing on the analysis and evaluation of innovative services and products offered by payment service providers, as well as the measures taken by them in order to increase user confidence in services and payment instruments.

II. AUTHORISATION

2.1. What licenses are required to provide banking services in your jurisdiction? What activities do they cover?

The banking activity in Moldova is subject to licensing. The banking license is issued provided that the requirements established by the Banking Law and subsequent acts are duly observed. The NBM issues the license provided only it is fully convinced that the bank can ensure the safe conduct of banking activity and the compliance with the requirements of prudent and sound management guaranteeing the protection of interests of depositors and other creditors as well as good

functioning of the banking system, making sure that the provisions of the banking laws and regulations are observed.

The banking license covers the following activities:

a) receiving deposits and other repayable funds;

b) granting loans, including consumer loans, real estate loan agreements, factoring with or without recourse, funding of commercial transactions (including the lump-sum business);

c) providing financial leasing;

d) providing payment services in accordance with *Law No 114/2012 on Payment Services and Electronic Money*;

e) issuing and administering traveler's checks, bills, and other payment instruments insofar as such an activity does not fall under provisions of the letter (d);

f) issuing bank guarantees and undertaking commitments;

g) carrying out transactions on own account or on behalf of clients by using any of the following money market instruments (checks, negotiable instruments, certificates of deposit, etc.); foreign currency; futures and options contracts on financial instruments; instruments based on the exchange rate and interest rate; securities and other financial instruments;

h) issuing securities and other financial instruments, and providing services related thereto;

i) providing consultancy services to legal entities on social capital structure, business strategy, and other business-related issues, as well as consultancy and services related to mergers and acquisitions of legal entities;

j) providing money brokerage (intermediation on interbank markets);

k) managing portfolios and providing consultancy related thereto;

l) holding the custody and managing financial instruments;

m) providing information services regarding lending;

n) providing safety deposit box services;

o) providing electronic money in accordance with Payment Services Law;

p) carrying out any other activities or services permitted by the NBM insofar as they fall within the scope of financial activity and are in compliance with particular legal provisions governing such activities.

Activities that, according to special laws, are subject to obtaining specific authorization (licenses, approvals, or endorsements), may be carried out by banks only if the specific authorization has been obtained.

2.2. What is the procedure for obtaining a banking license? How long does this typically take?

The licensing activity is a complex procedure, established by the Banking Law and secondary legislation by which the applicant shall submit a set of documents to the NBM. The process for obtaining a license can last from a few months to a couple of years, depending on:

- the complexity of the proposed bank's business;
- the proposed activities of the bank; and
- the potential regulatory concerns that arise in connection with the application.

The documents shall be prepared in accordance with the requirements of the law and based on the template approved by the NBM. While examining a license application, the NBM may request any additional documents and information related to the licensing process in case the submitted documents prove to be insufficient to assess compliance with the licensing conditions.

The NBM has a certain degree of discretion in deciding whether to grant or not the license. Thus, the NBM would grant the license *only if it is convinced* that the Bank can ensure the conduct of a safe activity and the observance of the requirements of prudent and healthy administration, ensuring the interests of depositors and other creditors and good functioning of the banking system. Therefore, typically, the NBM, when deciding whether or not to grant the License, is extremely cautious and prudent.

The licensing procedure is structured in two steps:

- obtaining the prior approval of the NBM for the incorporation of the bank;
- obtaining the banking license.

The NBM shall decide upon granting or refusal of the prior approval for bank incorporation within 5 months since the application has been submitted. This term is counted only if the submitted dossier is complete and the NBM is satisfied with the quality thereof. Otherwise, the examination term is suspended.

If the prior approval for bank incorporation is granted, additional information certifying compliance with banking licensing conditions will have to be submitted. Such documents will be assessed by the NBM within two months. If all conditions are met the banking license is to be issued.

2.3. Can a foreign bank operate in your jurisdiction on the basis of its domestic license?

The Moldovan legal framework does not provide a "European passport" for both outgoing and incoming banking activities.

Foreign banks licensed in their country of origin may operate banking activities on the territory of the Republic of Moldova provided that the following cumulative conditions are met:

a) the activity is to be carried out through an established branch office in Moldova;

b) the branch was licensed by the NBM;

c) the competent authority in the country of origin of the bank does not oppose the establishment of the branch in Moldova, this fact being confirmed in a document issued by the regulating authority in the country of origin;

d) the legal framework of the state of origin and/or the manner of its application does not prevent the NBM from exercising its supervisory functions;

e) the foreign bank complies with the provisions of the law and the regulations issued for its application.

The activities, which are permitted to be carried out through a branch established in the Republic of Moldova, shall be stipulated in the license issued by the NBM and shall not exceed the scope of activities permitted to the bank under the license issued by the competent authority in the country of origin.

The activity of a foreign bank's branch established in the Republic of Moldova is subject to the same prudential supervision of the NBM, under the Banking Law. The NBM may waive the application of prudential requirements to a foreign bank's branch if the following conditions are cumulatively met: **(i)** following the assessment, it is found that a prudential regulatory framework of the bank's country of origin is equivalent to that established in the Banking Law and that the competent authority of that country of origin exercises adequate supervision of the bank, including of its branch's activity in the Republic of Moldova, and **(ii)** the NBM and the regulating authority from the country of origin has entered into a cooperation agreement on a reciprocal basis.

2.4. What are the restrictions on ownership, including foreign ownership of banks?

The Banking Law does not generally restrict foreign ownership or control of Moldovan banks. However, as discussed below, establishing, or acquiring a bank in Moldova, or establishing an office of a foreign bank, requires the approval of the NBM. The NBM will evaluate the foreign acquirer's home country's regulation in connection with such an approval.

Certain foreign investments in Moldovan banks may be subject to review and potentially rejection by the NBM.

The Banking Law has established specific criteria for assessing proposed acquirers concerning their reputation, experience, integrity, and financial soundness. These provisions are backed up by extensive disclosure requirements toward proposed acquirers, including ultimate beneficiary ownership disclosure, accompanied by the legal prohibition for offshore entities to acquire directly and/or indirectly equity interests in Moldovan banks. Moreover, during the acquirer assessment procedure, the NBM typically communicates and requests relevant information from relevant authorities of other states to verify the profile of the acquirer.

In addition to the above measures, any direct and/or indirect shareholder of a bank shall permanently ensure that it corresponds to Banking Law's fit & proper criteria. Otherwise, the NBM is entitled to impose against the direct/indirect shareholders, including the ultimate beneficial owners, sanctions, and measures for violating the qualitative criteria.

2.5. What are the requirements for a proposed acquisition and acquirer of a qualified holding in a bank? Would the same requirements apply in case of an increase of a qualifying holding?

The Banking Law and the *NBM Regulation No. 127/2013 on holdings in bank equity* establish the legal framework for the prudential assessment of acquisitions by natural or legal persons of a qualifying holding in a bank.

In this respect, any natural or legal person or such persons acting in concert (the "proposed acquirer"), who has taken a decision either:

a) to acquire, directly or indirectly, including as an ultimate beneficial owner, a qualifying holding in a bank or

b) to further increase, directly or indirectly, including as an ultimate beneficial owner, such a qualifying holding in a bank as a result of which the proportion of the voting rights or of the capital held would reach or exceed 5%, 10 %, 20%, 33%, or 50 % or

c) so that the bank would become its subsidiary (the "proposed acquisition"),

shall notify the NBM in writing in advance of the acquisition, indicating the size of the intended holding and the relevant information, and obtain the NBM's prior approval in this respect.

Compared to *Directive 2013/36/EU*, the Moldovan Law sets out a lower threshold for regulatory clearance.

Thus, as per the Banking Law, a qualifying holding is a direct or indirect holding in an undertaking which **(i)** represents 1%

or more of the capital or of the voting rights, or **(ii)** makes it possible to exercise significant influence over the management of that undertaking.

In assessing the notification and the provided information, the NBM shall, in order to ensure the sound and prudent management of the bank in which an acquisition is proposed, and having regard to the likely influence of the proposed acquirer on that bank, assess the suitability of the proposed acquirer and the financial soundness of the proposed acquisition in accordance with the following criteria:

1. The reputation of the proposed acquirer:

A proposed acquirer (up to the ultimate beneficial owner(s)) should be of good repute and professionally competent.

Besides an impeccable reputation, the proposed acquirer has to demonstrate relevant and due skill, care, diligence, and compliance with the applicable standards.

The assessment of professional competence takes into account the influence that the proposed acquirer will exercise over the target undertaking.

The integrity and professional requirements are applied regardless of the size of the qualifying holding that the proposed acquirer intends to acquire and of its involvement in the management or the influence that it is planning to exercise on the target undertaking.

2. Financial soundness of the proposed acquirer:

The proposed acquirer should be sufficiently sound from a financial point of view to ensure the sound and prudent management of the target undertaking for the foreseeable future (usually three years).

3. The capacity of compliance with prudential requirements of the target undertaking:

The NBM assesses the ability of the target undertaking to comply at the time of the proposed acquisition and to continue to comply after the acquisition, with all prudential requirements, including capital requirements, liquidity requirements, and large exposures limits, as well as with requirements related to governance arrangements, internal control, risk management, and compliance.

Also, if the target undertaking will be part of a group as a result of the proposed acquisition, the NBM shall not be prevented from exercising effective supervision or from effectively exchanging information with the competent authorities.

4. Suspicion of money laundering or terrorist financing by the proposed acquirer:

The anti-money laundering and terrorist financing assessment complements the integrity assessment and is carried out regardless of the value and other characteristics of the proposed acquisition. The assessment also covers the persons with close personal or business links to the proposed acquirer, including the legal and beneficial owners of the proposed acquirer.

The same assessment criteria are used by the NBM when increasing the qualifying holding as well, but with respecting the principle of proportionality. This is envisaged in respect of **(i)** the intensity of the assessment, which should take into account the likely influence the proposed acquirer may exercise on the target undertaking, and **(ii)** the composition of the required information, which should be proportionate to the nature of the proposed acquirer and of the proposed acquisition.

Generally, the NBM calibrates the type and breadth of information required from the proposed acquirer, taking into account, amongst other matters, the nature of the proposed acquirer (legal or natural person, supervised financial institution or other entity, whether or not the financial institution is supervised in the EU or in a third country considered equivalent, etc.), the specifics of the proposed transaction (intra-group transaction or transaction between persons which are not part of the same group, etc.), the degree of involvement of the proposed acquirer in the management of the target undertaking and the size of the holding to be acquired.

III. REGULATORY CAPITAL AND LIQUIDITY

3.1. How are banks typically funded in your jurisdiction?

Banks are typically initially capitalized and funded by investors and organizers. Once operational, a bank is typically funded by equity investments along with deposits, loans, and debt securities. In addition, banks (particularly large banks) may obtain short-term funding through overnight loans and repurchase agreements.

The share capital of a Moldovan bank shall not be less than MDL 100 million (about EUR 5 million). When establishing a bank, the initial capital shall be made up of the share capital exclusive of the bank's establishment costs.

3.2. What capital and own funds requirements apply to banks in your jurisdiction?

The Moldovan laws establish requirements for the initial capital and for separate own funds of the banks.

(a) Initial capital requirement:

Whenever a bank to-be applies for a license, the NBM shall refuse to license the bank where its initial capital is less than MDL 100 million (about EUR 5 million).

(b) Own funds requirements:

In order to ensure the stability and the safety of the performed activity and/or the fulfillment of its commitments, each bank shall maintain an adequate level of its own funds. A bank's own funds may not fall below the initial capital level set for the license applicants.

Additionally, at any time, a bank shall:

(i) have the own funds' level equal to or higher than the level required to cover the credit risk, the dilution risk, the counter-party credit risk, the position risk, the settlement/delivery risk, the foreign exchange risk, the commodity risk, the credit adjustment risk and the operational risk, whichever appropriate;

(ii) comply with the minimum levels set for the own fund's adequacy ratios, calculated as a ratio between the own fund's categories and the total exposure amount;

(iii) have adequate own funds to maintain capital buffers. Capital buffers shall be maintained above the required own funds minimum set by the NBM. For this purpose, banks shall have adequate own funds for keeping the capital buffer, the capital countercyclical buffer, the buffer for systemically important financial institutions, and the systemic risk buffer, to the extent and under the conditions laid down by the regulations issued by the NBM.

(c) Requirements for liquidity:

The banks shall meet the liquidity requirements as set out by the NBM regulations. In this respect, the banks shall maintain the liquidity provisions that are adequate for allowing them to tackle eventual imbalances between liquidity inflows and outflows in case of crisis for a 30-day period.

The Moldovan laws also provide a mandatory administrative procedure for any recognition, value decreasing, reduction, distribution, and exemption from deduction of the own funds of the banks, as well as for the distribution by the banks of the profit to the shareholders and/or for the payment of interest to the holders. In each of these cases, the banks shall obtain the NBM prior approval, granted in accordance with its regulations.

3.3. Has your jurisdiction implemented the Basel III framework? Are there any major deviations?

Taking into account Moldova's commitments assumed under the Association Agreement with the European Union, the Moldovan legislation has been hurriedly moved into aligning with *Basel III* regulations, leapfrogging *Basel II* after having put Basel I in place. The Banking Law is transposing the *Basel III* regulations (based on the European CRD IV/ CRR framework) aligning with the international principles and standards, setting up the seize of capital buffers, which, if necessary, will diminish the impact of systemic crises on banks` capital. In 2016, the National Bank of Moldova approved the Strategy on *Basel III* standards implementation in the context of fulfilling the commitments assumed within the Association Agreement between the Republic of Moldova and the European Union.

Thus, several NBM regulations have been approved, which refer to bank's own funds and capital requirements, bank's capital buffers, credit risks treatment for banks according to a standardized approach, credit risk mitigation techniques used by banks, treatment of operational risk for banks according to the core approach and standardized approach, market risk treatment according to the standardized approach, settlement/delivery risk treatment for banks, banks' specific calculation of credit adjustments and of general credit risk adjustments, as well as the Regulation on banks,, external audit. Also, the Instruction on the presentation by banks of COREP reports for supervisory purposes has been approved and the Instruction on the method of preparing and submitting by banks of reports for prudential purposes has been modified. The new documents put an increased emphasis on the availability of capital to cover the risks of banks' activity and introduce new requirements to its structure. In addition, the requirements are also established for minimum capital thresholds by levels based on quality. The risk-weighted assets' structure has also been revised for better risk capture. Thus, a lower capital allocation is attributed to safer assets, while higher-risk assets receive a higher share and respectively, imply a higher capital requirement. Also, the Moldovan law requires coverage of more types of risks compared to those previously covered under Basel I, such as the market and operational risks. Consequently, under updated banking regulations the banks shall maintain a risk management framework, which includes policies and procedures for management, identification, assessment, timely monitoring, and control of risks. In parallel, under *Basel III* implementation new rules aimed to increase the effectiveness of risk supervision by the bank's management body, as well as of the NBM have been introduced.

IV. REPORTING, ORGANISATIONAL REQUIREMENTS, INTERNAL GOVERNANCE, AND RISK MANAGEMENT

4.1. What key reporting and disclosure requirements apply to banks in your jurisdiction?

The Moldovan banks are subject to extensive reporting and disclosure requirements. Among other things, such financial institutions must periodically disclose balance sheets, organizational structure, business management framework, internal policies, liquidity, and regulatory capital ratios. Disclosing requirements are established in a way to improve market discipline and identify risks in financial institutions and act in a way that mitigates those risks.

In addition, NBM in the course of conducting supervisory examinations and reviews may require banks to disclose additional information that the supervisor believes may be relevant to its examination. Among other things, this could include a review of loan files, trading records, personnel files, and commercial agreements.

The NBM may intervene and impose additional reporting requirements, such as in relation to disclosure frequency and forms and modalities of disclosure. Also, the NBM may impose the requirement to publish annually in full or by way of references to equivalent information, a description of the bank's legal structure and governance, the organizational structure of the group of banks and/or investment companies, by including information related to the entities with close links, as well as with regard to the governance arrangements.

4.2. What are the organizational requirements for banks, including with respect to corporate governance? Please briefly describe the requirements and the procedure of assessment of the suitability of the members of the management body and key function holders.

The legal basis is provided under the Banking Law and *NBM Regulation No. 292/2018* regarding the requirements towards the members of the management body of the bank, of the financial holding or mixed holding company, the managers of the branch of a bank from another state, the key function holders and towards the liquidator of the bank in the process of liquidation.

These pieces of law set out the criteria and processes that the banks and the NBM should follow when assessing the suitability of proposed and appointed members of the management body of a bank.

The banks shall establish adequate policies and procedures to ensure compliance of banks including their managers and employees with their obligations under the law. In this respect, the law requires that the management body of a bank defines, oversees, and is accountable for the implementation of governance arrangements that ensure effective and prudent management of the bank including the segregation of duties in the bank and the prevention of conflicts of interest, and in a manner that promotes the integrity of the market and the interest of clients.

The bank shall have a policy for selecting and assessing members of the management body which takes into account the nature, scale, and complexity of the business of the bank. The assessment of the suitability of key function holders is the best practice expected from all banks to ensure robust governance arrangements.

Assessing the initial and ongoing suitability of members of the management body and key function holders is primarily the responsibility of the bank. The bank bears responsibility for ensuring that members of the management body shall at all times be of good repute and possess sufficient knowledge, skills, and experience to perform their duties and that they meet the requirements. Events with the potential to affect a person's reputation or required experience can lead to the need to re-assess the suitability of that person.

The bank shall assess the suitability of members of the management body in the following situations:

a. when applying to be authorized as a bank;

b. when new members of the management body have to be notified to the NBM; and

c. whenever appropriate, in relation to appointed members of the management body.

When assessing the suitability of members of the management body, the bank shall also assess whether the management body is suitable collectively.

Where members of the management body do not fulfill the requirements set out in the law, or if the NBM is not satisfied that the members of the management body of the investment firm are of good repute, possess sufficient knowledge, skills, and experience, and commit sufficient time to perform their functions in the investment firm, or if there are objective and demonstrable grounds for believing that the management body of the firm may pose a threat to its effective, sound and prudent management and to the adequate consideration of the interest of its clients and the integrity of the market, the NBM has the power to remove such members from the management body.

These might be also ground for the NBM to refuse authorization as a bank.

(a) Requirements

Fit and proper requirements under the above-mentioned legal provisions for members of the management body play an important role as the management body bears the overall responsibility for the bank. The NBM assesses their suitability in accordance with the following criteria:

1. Reputation:

A member of the management body shall have an impeccable reputation. It is considered to be of good repute if there is no evidence to suggest otherwise and no reason to have reasonable doubt about his or her good repute.

All members of the management body need to be of good repute, regardless of the nature, scale, and complexity of the

bank or the position of the member within it.

2. Experience:

A member of the management body shall prove both theoretical experiences attained through education and training, and practical experience gained in previous occupations. The experience requirements differ depending on the bank's nature, scale, and complexity of its activities and the position concerned.

3. Independence of mind:

(a) A member of the management body shall prove relevant behavioral skills, past and ongoing behavior, in particular within a bank, and absence of conflicts of interest to an extent that would impede their ability to perform their duties independently and objectively, such as personal, professional or other economic relationships with the members of the management body or personal, professional or other economic relationships with the controlling shareholders of the same bank, subsidiary, etc.

4. Time commitment:

A member of the management body shall have sufficient time to carry out their responsibilities appropriately, to cover all the necessary subjects in depth, and in particular the management of the main risks. Also, they shall be able to commit sufficient time to understand the business of the bank, its main risks, and the implications of the business and the risk strategy.

(b) Procedure

An application or notification procedure applicable to appointments and re-appointments of a member of the management body is to be observed. The time period of the assessment by the NBM is 45 days and it starts on receipt of the complete application or notification.

4.2. What are the local rules for loans to the management body and their related parties?

Typically, the transactions with related parties (RP) shall reflect the bank's interests, shall not be carried out on more advantageous conditions than those with non-RP, and shall not be performed by violating the limits and the provisions established in the NBM regulatory acts.

The banks shall have a strong framework to manage conflicts of interest and ensure prudent decision-making in the context of loans to RP.

The bank shall determine the transactions with their RP, including the bank's exposures to these individuals and the total amount of these exposures, as well as monitor and report about them through an independent exposure management process.

Any transaction with a bank's RP, in an amount that exceeds the equivalent of MDL 1 million (about EUR 50,000), shall be approved prior to its conclusion/amendment of contractual conditions, by the majority of members of the bank's board. Upon its decision, the bank board may also approve such transactions in an amount not exceeding the equivalent of MDL 1 million.

Generally, in cases when the equivalent of MDL 1 million is not exceeded, the transaction is approved by the executive body of the bank.

The bank shall ensure that transactions with RP are reviewed and that the risks they pose for the institution are identified and adequately assessed.

When deciding on a loan or other transaction with a member of the management body or their RP, before taking a decision, the bank shall assess the risk to which the institution might be exposed due to the transaction.

In this respect, the bank's transactions with RP shall be made under certain conditions, limitations, and restrictions set by the NBM, which might include the requirement to make additional provisions for losses on loans and other assets related to the transactions with RP.

Thus:

(i) the value of the exposure, after taking into account the effect of credit risk mitigation, to a bank's RP and/or a group of parties related to the bank's related party shall not exceed 10% of the bank's eligible capital, and

(ii) the aggregate amount of the bank's total exposures to RP and/or groups of parties related to the bank's RP, after taking into account the effect of credit risk mitigation shall not exceed 20% of the eligible capital of the bank.

4.3. What are the main legal provisions governing risk management in the banking sector in your jurisdiction?

The main provisions in relation to the management activity within the banks are established in the *Regulation on Banking Activity Management Framework* approved by the Decision of the Executive Board of the NBM No 322 dated December 20, 2018 (Regulation 322/2018). Regulation 322/2018 transposes *Directive 2013/36/EU of the European Parliament and of the Council of 23 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms*. Regulation 322/2018 aims at ensuring effective and prudent risk management in a bank.

In general, the bank is required to develop a risk culture integrated at the general bank level based on a full understanding of the risks faced by the bank and the way they are managed

considering the bank's risk tolerance/ appetite. The bank shall have a comprehensive risk management framework covering all subdivisions, including support and control functions, identifying the economic substance of exposures and covering all risks relevant to the bank, ensuring that the risk management policies of the bank's business model are consistent with its capital and risk management experience and the level of risks are appropriately observed.

The risk management policies of the bank transposed into internal regulations of the banks need to establish, at least, the following:

1. risk management procedures tailored to the size and nature of bank activity, which shall include the permanent identification and assessment of risk positions, risk monitoring, and control, including outsourced activities and off-balance-sheet transactions;
2. process of adjusting risk management procedures to changing risk profiles and market developments;
3. risk exposure limits set for all activities and for each significant activity and/or branch reflecting the chosen risk profile in terms of the ratio between accumulated risks and the profit obtained, which the bank considers acceptable under effective and prudent business continuity conditions;
4. procedures for authorizing operations that may be affected by risks, considering the responsibilities of the management body and the bank's risk management staff;
5. measures required to minimize and limit the exposure to risks affecting the achievement of the bank's objectives and/or its stability;
6. sufficient bank resources (including technical and human resources) to manage risks.

4.4. What are the legal requirements applicable to banks in combating money laundering and terrorist financing area?

Law No. 308/2017 on the prevention and combating of money laundering and terrorism financing (AML Law), which aims to transpose *EU Directive 2015/849/EC* and implement the FATF Recommendations (of February 2012) requires that banks, as reporting entities, shall apply a risk-based approach to AML/CFT.

The NBM is the supervisory authority in the prevention and combating of money laundering and terrorism financing by the banks.

(a) The Risk-Based Approach (RBA):

Banks' identification and assessment of their own ML/TF risk should consider national risk assessments and take account of the national legal and regulatory framework, including any areas of prescribed significant risk and any mitigation measures defined at the legal or regulatory level.

Where ML/TF risks are higher, banks should always apply enhanced due diligence.

The RBA to AML/CFT aims to support the development of prevention and mitigation measures that are commensurate to the ML/TF risks identified. In this respect, the banks shall allocate their compliance resources, organize their internal controls and internal structures, and implement policies and procedures to deter and detect ML/TF.

(i) Risk assessment

While assessing the risk, the bank shall understand how, and to what extent, it is vulnerable to ML/TF. This shall help the bank determine the level of AML/CFT resources necessary to mitigate that risk.

(ii) Risk mitigation identification, verification, and the purpose and intended nature of the business relationship

Banks shall develop and implement policies and procedures to mitigate the ML/TF risks they have identified through their individual risk assessment. Customer due diligence (CDD) processes should be designed to help banks understand who are their customers by requiring them to gather information on what they do and why they require banking services.

Based on a holistic view of the information obtained in the context of their application of CDD measures, banks should be able to prepare a customer risk profile. This will determine the level and type of ongoing monitoring and support the bank's decision on whether to enter into, continue, or terminate, the business relationship.

(b) Initial CDD:

Under the law, the banks are required to apply extensive know-your-customer procedures.

The initial CDD typically comprises:

- Identification of the customer and, where applicable, the customer's beneficial owner;
- Verification of the customer's identity on the basis of reliable and independent information, data, or documentation; and
- Understanding the purpose and intended nature of the business relationship and, in higher-risk situations, obtaining further information.

In addition, banks should take measures to comply with national and international sanctions legislation by screening the customer's and beneficial owner's names against the UN and other relevant sanctions lists.

As a general rule, CDD measures have to apply in all cases.

The amount and type of information obtained, and the extent to which this information is verified must be increased where the risk associated with the business relationship is higher. For instance, the banks shall apply additional (enhanced) measures in specific cases, which include non-face-to-face operations, transactions of politically exposed persons, cross-border interbank transfers, or electronic transfers when the parties cannot be fully identified.

CDD may be simplified where the risk associated with the business relationship is lower.

Banks, therefore, have to draw up, and periodically update, customer risk profiles, which serve to help them apply the appropriate level of CDD.

Where banks cannot apply the appropriate level of CDD, the AML Law requires that banks do not enter into the business relationship or terminate the business relationship.

(c) Ongoing CDD/Monitoring:

Monitoring transactions is an essential component in identifying transactions that are potentially suspicious.

The AML Law requires that the banks ensure the scrutiny of transactions to determine whether those transactions are consistent with the bank's knowledge of the customer and the nature and purpose of the banking product and the business relationship.

Monitoring also involves identifying changes to the customer profile (for example, their behavior, use of products, and the amount of money involved), and keeping it up to date, which may require the application of new, or additional, CDD measures.

At present, local legal initiatives are promoted aiming to make possible the implementation of customer onboarding identification. The draft law also aims at the pre-implementation assessment when onboarding the customers remotely, third parties, and outsourcing, remote CDD.

(d) Reporting:

If a bank suspects or has reasonable grounds to suspect, that funds are the proceeds of a crime or are related to terrorist financing, it shall report its suspicions promptly to the Moldovan FIU.

Banks should have appropriate case management systems so that such funds or transactions are scrutinized in a timely manner and a determination made as to whether the funds or transactions are suspicious.

Any transaction which is deemed suspicious, irrespective of the amount of the transaction, should be reported within 24 hours.

(e) Tipping off:

Under the AML Law, the banks and their employees are bound not to inform the subject of a report that a report has been made to the Moldovan FIU. The tipping off, as wrongdoing, shall be examined under the general rules of the law, while the AML Law states that infringing the provisions of said law shall bring liability in compliance with civil, administrative, and criminal laws.

(f) Whistleblowing:

Under the AML Law, the banks, their employees, the responsible persons, and their representatives are bound not to inform the clients or the third parties that a report has been made to the monitoring authority until the legal terms of recordkeeping have expired. Such disclosure of data may interfere with rules on keeping banking secrets, and commercial secrets if done too early when a criminal investigation was not yet finalized and a final court decision was not issued.

(g) Recordkeeping:

Under the AML Law, the banks shall keep, on paper, all data related to national and international activities and transactions of the client, for a minimum of five years after the business contract has ended (or after the termination of the occasional transaction) and up to five years – on electronic support.

(h) Internal controls, governance, and monitoring:

(i) Internal controls:

Under the AML Law, as a prerequisite for the effective implementation of policies and processes to mitigate ML/TF risk, the banks shall have adequate internal controls.

Internal controls include appropriate governance arrangements where responsibility for AML/CFT is clearly allocated, controls to monitor the integrity of staff, in accordance with the AML Law, especially in cross-border situations, and the national risk assessment, compliance, and controls to test the overall effectiveness of the bank's policies and processes to identify, assess and monitor risk.

(ii) Governance:

The successful implementation and effective operation of an RBA to AML/CFT depends on strong senior management leadership and oversight of the development and implementation of the RBA across the bank.

As per the AML Law, senior management should consider various ways to support AML/CFT initiatives:

■ promote compliance as a core value of the bank by sending a clear message that the bank will not enter into, or maintain, business relationships that are associated with excessive ML/TF risks which cannot be mitigated effectively. Senior management, together with the board, is responsible for setting up robust risk management and controls adapted to the bank's stated, sound risk-taking policy;

■ implement adequate mechanisms of internal communication related to the actual or potential ML/TF risks faced by the bank. These mechanisms should link the board of directors, the AML/CFT chief officer, any relevant or specialized committee within the bank (e.g., the risks or the ethics/compliance committee), the IT division, and each of the business areas;

■ decide on the measures needed to mitigate the ML/TF risks identified and on the extent of residual risk the bank is prepared to accept, and

■ adequately resource the bank's AML/CFT unit.

This implies that senior management should not only know about the ML/TF risks to which the bank is exposed but also understand how its AML/CFT control framework operates to mitigate those risks.

(iii) Ensuring and monitoring compliance:

According to the AML Law, the bank's internal control environment should be conducive to assuring the integrity, competence, and compliance of staff with relevant policies and procedures. The measures relevant to AML/CFT controls should be consistent with the broader set of controls in place to address business, financial, and operating risks generally.

(j) Internal procedures:

The Moldovan banks should have internal AML programs and procedures in place to ensure collection of the information on the identity of the client, the ultimate beneficiary, politically exposed persons, the trust relations, the holder of the corresponding bank account, etc.

The banks shall adopt internal policies and adequate methods of working with clients, data storage, internal control, evaluation and management of risks, management of conformity, and communication to impede the activities and transactions related to money laundering or terrorism financing. The banks shall appoint the persons responsible for enforcement of the legal provisions, the names and responsibilities of which shall be reported to FIU.

(k) Training and awareness:

According to the AML Law, the competent bank staff shall receive AML/CFT training.

Within the training, the bank staff shall understand not only the processes they are required to follow but also the risks these processes are designed to mitigate, as well as the possible consequences of those risks.

The sanctions for the violation of AML local provisions are provided in the *Law on the Procedure for Establishing Violations of Prevention of Money Laundering and Terrorist Financing and Imposition of Sanctions* are established on an individualization criterion and are pecuniary (up to EUR 5 million) or non-pecuniary (public declaration in the mass-media, prescription on ceasing the illegal activity, suspension of the activity, license withdrawal, temporary ban on holding management positions in reporting entities).

4.5. Are there any legal provisions regulating banking secrecy in your jurisdiction?

In 2018, the European Banking Authority performed its equivalence assessment evaluating the professional secrecy and confidentiality regimes applicable to the NBM and assessed the Moldovan regime as being equivalent to the EU confidentiality regime.

In this respect, the notion of confidential information, the obligation of professional secrecy, the use of confidential information, and restrictions on disclosure of confidential information are provided in the Banking Law.

Any failure to observe the provisions of banking secrecy will result in the application of civil/administrative/criminal sanctions.

V. TRENDS

5.1. What are the main trends in the banking sector in your jurisdiction?

There have been several trends in the banking sector in recent years. Most of them are linked directly or indirectly to the implementation of the strategic objectives of the NBM or are driven by technological advances and changes in consumer behavior.

Some of the most significant trends include:

1. Digitalization. All the Moldovan banks are now offering a range of digital banking services, including mobile banking apps, online banking portals, and virtual assistance, which allow customers to access their accounts and conduct transactions remotely.

The Moldovan banks have been investing in digital technologies to improve customer experience and operational efficiency, by developing mobile banking apps and implementing digital payment solutions.

2. Open banking. In July 2022, a draft law amending the Payment Services Law has been approved. By the amending law, the provisions of *Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC* (PSD2 Directive) are transposed into national legislation. Following the implementation of the PSD2 Directive the open banking concept has been introduced.

3. Improved regulations. Following the Association Agreement between the European Union and the Republic of Moldova signed on June 27, 2014, and the implementation of the action plan, the Moldovan legislation has been subject to certain legislative amendments by implementing major European legislation.

4. Accession to SEPA. In 2021, the NBM has initiated the dialogue on Moldova`s accession to the SEPA area. In 2023 the process of adjusting to SEPA criteria shall progress.

5. E(-commerce)-Know-Your-Customer. Following the implementation of the PSD2 Directive, the amendment of the legislation governing the bank KYC has been initiated.

6. Social and environmental responsibility. Banks started prioritizing social and environmental responsibility.

5.2. What are the biggest challenges in the banking sector at the moment?

The biggest challenges the banking sector is facing are related to prudential requirements that the banks shall comply with and the possible system risks such as the currency rate risk.

Based on the latest report of the NBM, not only is the risk and credibility of banks at issue with the population, but the dramatic decrease in lending has also added to the frustration people have when dealing with banks.

Not only is their reserve requirement high relative to most banking sectors around the world, but commercial banks are also hurriedly working toward complying with Basel III requirements. Basel imposes a high level of Know Your Customer (KYC) processes. This, along with a focus on risk-based lending protocol over asset-based lending, has put banks on the defensive and has significantly reduced banks' willingness to lend. In addition, banks face more amorphous risks such as the ever-changing political environment which can dramatically swing financial system requirements at any given moment.

5.3. What's new in fintech?

The ecosystem of fintech in Moldova is starting to develop starting with the implementation of PSD2 for the evolution of the market trends to meet customer needs and regulatory demands.

Open Banking is facilitating the evolution of fintech in Moldova.

A draft law has been prepared to regulate the "virtual currency" and "virtual currency service provider". The draft law was developed based on the recommendations of the MONEYVAL Committee of the Council of Europe and transposes a series of European directives in the field.

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I. LEGAL FRAMEWORK

1.1. Which main legislative and regulatory provisions govern the banking sector in your jurisdiction?

As a member state of the European Union, Romania's regulatory framework is based on EU directives and regulations. The most important is *Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms* (Directive 2013/36/EU), whose provisions are to be read together with *Regulation No. 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms* (Regulation (EU) 575/2013).

The provisions of these enactments are implemented into Romanian banking legislation, including in the *Government Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy*, this being the main element of Romanian banking activity regulation, as approved and amended by *Law Number 227/2007*. This act provides which conditions need to be fulfilled by credit institutions in order to be granted access to the banking activity in Romania, along with prudential supervision of the credit institutions, the financial investment services companies, payment systems, and of settlement for the operations performed with financial instruments.

In 2015, a new law has been adopted in order to transpose into national law the provisions of *Directive 2014/59/EU – Law Number 312/2015 on the recovery and resolution of credit institutions and investment companies*, as amended by *Law Number 320/2021*, setting certain rules and procedures in this matter.

The legislative system in the banking sector is completed by a series of laws issued by the Parliament, ordinances, and decisions issued by the Romanian Government, as well as by the special regulations issued by the National Bank of Romania (NBR), such as *NBR Regulation no. 5/2013 on prudential requirements for credit institutions* and *NBR Regulation no. 12/2020 on the authorization of credit institutions*. In addition, NBR's activity is regulated by *Law Number 312/2004 regarding the Statute of the National Bank of Romania* (The Statute of NBR).

The regulatory framework is complemented by various regulations setting out more detailed rules for specific areas of banking regulations.

Payment services are mainly regulated by *Law Number 209/2019 on payment services*, completed by the provisions of NBR Regulations, such as *NBR Regulation no. 4/2019 regarding the payment institutions*. Another important normative act in this field is *Law Number 129/2019 for the prevention and combating of money laundering and terrorist financing*, whose provisions are to be analyzed together with *NBR Regulation no. 2/2019* on the same matter.

The activity of non-banking financial institutions acting in the field granting credits is mainly regulated by *Law Number 93/2009* regarding non-banking financial institutions, which sets the main characteristics of those institutions: legal form, the scope of the business, share capital requirements, and NBR supervision. Certain aspects are further detailed and clarified by NBR norms.

The electronic money issuing institutions sector is regulated by *Law Number 210/2019 on electronic money activity*, completed by the provisions of *NBR Regulation no. 5/2019 regarding electronic money institutions*.

1.2. Which bodies are responsible for enforcing the applicable laws and regulations? What are their main competencies?

The National Bank of Romania is the public institution that has control and supervision attributions over credit institutions, electronic money institutions, non-banking financial institutions, and payment institutions, being the main authority responsible for enforcing the applicable laws and regulations.

According to the Statute of the National Bank of Romania, the NBR is an independent public institution with legal status. In its capacity as a central bank, the NBR aims at ensuring and maintaining the stability of the prices on the Romanian market. For this purpose, the NBR has the following main statutory powers:

i. to issue and implement monetary and exchange rate policy;

ii. to authorize, regulate and supervise credit institutions from a prudential perspective, as well as to promote and monitor the good functioning of payment systems in order to ensure financial stability;

iii. to issue currency as a legal means of payment in Romania, being the sole Romanian institution authorized to issue banknotes and coins;

iv. to establish the currency regime and to oversee its observance;

v. to manage the international reserves of Romania.

NBR also has international duties, such as:

vi. to participate, on behalf of the state, in international negotiations on financial, monetary, foreign currency, loan, and payment issues;

vii. to propose regulations on the supervision and control of foreign currency transactions in Romania and the issue needed

authorizations in order for international transfers and other specific operations to take place.

Apart from being the central bank of Romania, *Law no. 312/2015* designates the National Bank of Romania as the resolution authority for the banking sector. Being given this role, the NBR retains wide regulatory powers in the banking sector, sustaining the State's general economic policies and the maintenance of macroeconomic stability.

Moreover, according to *Law Number 128/2018 on financial instruments markets*, the NBR is the competent authority that supervises compliance with the provisions of this law and with other European regulations, by exercising regulatory, authorization, supervision, and control powers over credit institutions.

Thus, in every field where it holds responsibility, the NBR provides norms and principles that must be respected by all credit institutions, non-banking financial institutions, and payment institutions which are performing their activity on Romanian territory, being able to apply sanctions and enforce remedy measures in case of non-compliance.

1.3. What are the current priorities of regulators and how does the regulator engage with the banking sector?

The National Bank of Romania, as resolution authority, prepares plans for credit institutions and other entities covered by the specific provisions of *Law no. 312/2915* in order to ensure the efficiency of potential resolution actions.

The National Bank of Romania has responsibilities regarding planning and carrying out resolution actions, being the main responsible for the process of restructuring a credit institution, using the tools and the resolution powers to ensure the continuity of the critical function of the said institution, to restore its viability, wholly or partially, and to liquidate the residual part of the credit institution under normal insolvency proceedings.

Given the current state of the banking and finance sector, the main priorities of the National Bank of Romania are:

■ to ensure the continuity of critical functions;

■ to maintain financial stability;

■ to protect public funds;

■ to protect depositors and investors covered by the relevant legislation;

■ to protect client funds and client assets.

The banking industry has, due to the specifics of its activity, a key role in the functioning of economic and financial mechanisms, with an impact on macroeconomic developments, the business environment dynamics, and the improvement of economic welfare.

We must take into consideration that the banking system in Romania is composed of two main structures: on one side, the National Bank of Romania, and on the other, the commercial banks and financial institutions.

In order to accomplish its objectives, the NBR must engage actively with other institutions of the banking sector. At a general level, NBR does this by using its supervisory and control functions. For this purpose, the NBR performs supervision of credit institutions, non-banking financial institutions, and payment institutions on an individual and, where needed, consolidated basis. For the exercise of this function, NBR has the possibility to request from those institutions any information that is necessary.

At a more specific level, the NBR engages with the banking sector by performing different types of operations, depending on the institutions it interacts with:

i. Operations with credit institutions:

■ granting loans for credit institutions with maturities no longer than 90 days;

■ opening and operating current accounts for credit institutions, the State Treasury, settlement houses, and other resident or non-resident legal entities, as per NBR's regulations;

■ setting the official discount tax and refinancing rate;

■ establishing credit conditions and the regime of the minimum compulsory reserves that credit institutions need to maintain with the NBR;

■ offering clearing, depository, settlement, and payment services;

■ regulating, monitoring, authorizing, and supervising payment systems;

■ supervising credit institutions.

ii. Operations with the State Treasury

The National Bank of Romania's operations on the State's account is essential to keep operating the State treasury's current account on behalf of the Ministry of Public Finance.

iii. Monetary Market operations:

Open market operations are the most important monetary policy instrument of the NBR. They are conducted at the central bank's initiative and play a role in steering interest rates,

managing liquidity conditions in the money market, and signaling the monetary policy stance.

There is a prohibition from acquiring from the primary market receivables of the state, central or local public authorities, national companies, and other majority state-owned companies. However, according to the regulations in force, the NBR may conduct the secondary market different operations, such as repo operations/ reversible operations, direct purchases/ sales, or may conduct foreign exchange swaps or issue deposit certificates, or attract deposits from the credit institutions. These open market operations will be conducted under such terms it may deem necessary in order to fulfill the monetary policy objectives.

iv. Gold and foreign assets operations:

- establishing and maintaining the State's international reserves;
- entering transactions with gold bars, coins, and other precious metals, as well as with foreign currencies;
- open and maintain accounts with central banks and monetary authorities, banking companies, and international financial institutions;
- open and maintain accounts and perform corresponding operations with foreign central banks and monetary authorities, credit institutions or international financial institutions, foreign governments, and their agencies.

II. AUTHORIZATION

2.1. What licenses are required to provide banking services in your jurisdiction? What activities do they cover?

Credit institutions, Romanian legal entities, and branches of third-country credit institutions may be set up and operate in Romania only according to an authorization, issued by the National Bank of Romania.

The authorization process of the credit institutions implies three stages:

- the approval of the credit institution's establishment by the National Bank of Romania;
- the registration of the credit institution at the Trade Register, according to the provisions of *Law no. 31/1990 on companies*;
- the authorization of the credit institution's functioning.

Credit institutions may perform, according to their authorization, the following activities:

- accepting deposits and other repayable funds;
- lending, including consumer credit, mortgage credit, factoring with or without recourse, financing of commercial transactions, including forfeiting;
- financial leasing;
- payment services;
- issuing and administering other means of payment such as traveler's cheques and bankers' drafts insofar as this activity is not covered by payment services;
- issuing guarantees and payment commitments;
- trading for own account or for the account of customers, according to the law;
- participation in securities issues and other financial instruments by underwriting and selling them or by selling them and providing ancillary services;
- advice on capital structure, business strategy, and other related issues, advice and other services relating to mergers and purchase of undertakings, as well as other advice services;
- portfolio management and advice;
- safekeeping and administration of financial instruments;
- intermediation on the inter-bank market;
- credit reference services related to the provision of data and other credit references;
- safe custody services;
- issuance of electronic money;
- operations with precious metals and gems;
- acquiring participation in the capital of other entities;
- any other activities or services in the financial field, abiding by the special laws regulating those activities if required.

2.2. What is the procedure for obtaining a banking license? How long does this typically take?

The National Bank of Romania shall decide regarding a credit institution's application for authorization, either by granting approval for the credit institution's establishment or by rejecting the application, within four months from the receipt of the application and of the documents provided by the National Bank of Romania.

The National Bank of Romania may request in writing, in four

months, but not later than three months from the moment when the application for authorization was received, any additional information or documents, if those submitted are not sufficient or relevant in carrying out the assessment.

In order to remedy the deficiencies, within one month of the aforementioned request of the National Bank of Romania, the credit institution must submit the required information and/or requested documents. During this period, the four months term shall be suspended.

If the National Bank of Romania decides to grant approval for the establishment, in order to obtain the authorization to start the business and no later than two months after receiving the National Bank of Romania's notification on its decision, the credit institution shall submit to the National Bank of Romania the documents certifying its legal establishment, according to the legal provisions applicable and to the conditions provided by the project.

The National Bank of Romania shall make a decision regarding the authorization to start the business of the credit institution within up to four months from the moment the documents that certify the legal establishment of the credit institution were received.

The National Bank of Romania shall notify the European Banking Authority about any authorization granted so that the name of the credit institution will be entered in the list of credit institutions drawn up and updated by the European Banking Authority, which is published on its website.

The authorization granted shall be valid for an indefinite period of time and cannot be transferred to another undertaking.

2.3. Can a foreign bank operate in your jurisdiction on the basis of its domestic license?

The credit institutions which are authorized and supervised by the competent authority of another Member State may carry on activities in Romania, either by the establishment of a branch or by directly providing their services, under the condition that such activities are covered by the authorization granted by the competent authority of the Member State and, at the same time, to ensure that the Romanian legislation which protects the public interest is observed.

Additionally, for the establishment of a branch by a credit institution from another Member State, it is not necessary to obtain authorization from the National Bank of Romania or an endowment capital for the branch.

A credit institution, authorized and supervised in another Member State, may establish a branch in Romania based on the notification sent to the National Bank of Romania by the competent authority of the Member State. Before the commencement of the activity, within two months from the moment the notification was received, the National Bank of Romania shall communicate to the credit institution concerned, if the case may be, the list of Romanian legal acts which concern the protection of the public interest, stipulating the particular conditions under which certain activities may be carried on.

Credit institutions that have their registered office in third countries may perform an activity in Romania only if all the following requirements are met:

- the activity is carried on by establishing a branch;
- the branch has been authorized by the National Bank of Romania;
- the competent authority from the country of origin does not oppose the establishment of a branch in Romania;
- the provisions of *Government Emergency Ordinance no. 99/2006* and the regulations issued for its application are observed.

Activities that may be performed by the branch in Romania shall be included in the authorization granted by the National Bank of Romania and may not exceed the purpose of the activity for which the competent authority of the third country of origin has authorized the concerned credit institution.

The National Bank of Romania shall grant authorization to the branch of a credit institution from a third country only if it is satisfied that the credit institution is able to ensure the safe performance of the activity within Romania's territory and by preserving the requirements of prudent and sound management, as well as by securing that there are adequate conditions for supervision to be exercised.

2.4. What are the restrictions on ownership, including foreign ownership of banks?

The National Bank of Romania evaluates the suitability of the proposed acquirer and its financial soundness in relation to its proposed acquisition, on the basis of the following cumulative criteria:

- the reputation of the potential acquirer, respectively its integrity and professional competence;
- the reputation and experience of any person exercising managerial and/or administrative responsibilities at the credit institution as a result of the proposed acquisition;
- running responsibilities of the credit institution, as a result of the proposed acquisition;
- the financial soundness of the potential acquirer, in par-

ticular with regard to the type of business conducted and envisaged within the credit institution where the acquisition is proposed;

- whether the credit institution will be able to comply with the prudential requirements based on *Government Emergency Ordinance no. 99/2006*, as well with all other legal provisions applicable, in particular, whether the group of which it will become a part of has a structure which makes possible to exercise effective supervision, to effectively exchange information among the competent authorities and to determine the responsibility allocation among the competent authorities;

- whether there are reasonable grounds to suspect that, in connection with the proposed acquisition, there has been committed an offense or an attempt of offense on money laundering or terrorist financing or that the proposed acquisition could increase the risk thereof.

The National Bank of Romania shall work in full consultation with the other supervisory local competent authorities or from other Member States involved if the proposed acquirer is one of the following:

- a credit institution, assurance undertaking, insurance undertaking, reinsurance undertaking, investment firm, or management company authorized in another Member State or in another sector of the financial system;

- the parent undertaking of an entity referred to above which is authorized in another Member State or in another sector of the financial system;

- a natural or legal person controlling an entity referred to above which is authorized in another Member State or in another sector of the financial system.

If the potential acquirer is a regulated entity situated in a third country, the National Bank of Romania shall cooperate with the involved supervisory authority, if the following conditions are simultaneously fulfilled:

- the supervisory framework of the third country can be considered equivalent by the National Bank of Romania;

- in the third country there are no laws, regulations, or administrative measures in order to preclude the exchange of information;

- the competent authority of the third country expressed its availability for concluding a cooperation agreement with the National Bank of Romania in information exchange.

2.5. What are the requirements for a proposed acquisition and acquirer of a qualified holding in a bank? Would the same requirements apply in the case of an increase of a qualifying holding?

Any natural or legal person who has made a decision to acquire qualifying holdings in a credit institution, directly or indirectly, shall notify in writing the National Bank of Romania of this decision. The National Bank of Romania shall only grant authorization if, taking into account the need to ensure the sound and prudent management of the credit institution, it is satisfied by the suitability of the persons concerned.

Any natural or legal person who has made a decision to increase qualifying holdings to the extent the proportion of the voting rights or of the capital held would exceed 20%, 30%, or 50% or to the extent that the credit institution would become a subsidiary shall notify in writing the National Bank of Romania on this decision. In this situation, the natural or legal person shall communicate to the National Bank of Romania the documents for authorization.

The legal person or the entities without legal personality that own qualifying holdings shall communicate to the National Bank of Romania the following documents:

- the registration certificate issued by the Trade Registry Office;

- the company's articles of association;

- the criminal record and the fiscal record;

- the list of entities managed or controlled by the person who owns qualifying holdings;

- the list of the persons who manage the activity;

- the shareholding;

- the description of the group, in case the person who owns qualifying holdings is part of a financial group, subject to supervision on a consolidated basis;

- the individual annual financial statements and the consolidated financial statements;

- the description of the legal and institutional framework applicable in a third state, in case the person who owns qualifying holdings is established in a third country;

- the identity of the person who manages the activity of an entity without legal personality, which owns qualifying holdings on his own behalf;

- the survey for the persons who own qualifying holdings.

The natural persons who own qualifying holdings shall communicate to the National Bank of Romania the following documents:

- the copy of their identity document;
- a *curriculum vitae*, which should include information related to graduate studies and professional experience;
- the criminal record and the fiscal record;
- the survey for the persons who own qualifying holdings;
- the list of companies that the applicant has identified after rigorous analysis as being managed or controlled by the person who owns qualifying holdings.

III. REGULATORY CAPITAL AND LIQUIDITY

Summary

- Banks can request a Lombard loan from the NBR, in order to obtain very short-term liquidity;
- Banks can only lend if they meet the eligibility criteria provided by law, being required to make a written request, which will be resolved by the NBR;
- The bank receives authorization from the NBR if it has separate funds or a level of initial capital at least equal to the minimum level established by regulations, which cannot be lower than the equivalent in RON of EUR 5 million;
- Banks must have their share capital paid in full and in cash, on subscription, contributions in kind not being allowed;
- Credit institutions must have a level of own funds that is permanently at least at the level of the own funds' requirements provided in art. 92 of *Regulation (EU) no. 575/2013*;
- Credit institutions must have their own funds to cover, in addition to the minimum own funds' requirements, the capital buffers imposed by the NBR, upon the recommendation of the inter-institutional coordination structure in the field of macroprudential supervision of the national financial system;
- The *Basel III* framework is implemented in the European Union by *Regulation no. 575/2013* and by *Directive 2013/36/EU*;
- In Romania, EU regulations are transposed by *Government Emergency Ordinance no. 99/2006*.

3.1. How are banks typically funded in your jurisdiction?

Regulation no. 1/2000 on money market operations conducted by the National Bank of Romania and standing facilities granted by it to eligible participants provides that the National Bank of Romania shall grant standing facilities to banks, mortgage banks, central offices of credit cooperatives, savings, and loan banks in the housing sector, Romanian legal entities, and branches in Romania of credit institutions from Member States of the European Union (EU), respectively from third countries, with the exception of branches in Romania of credit institutions issuing electronic money, which fulfill the following eligibility criteria:

(i) are subject to the mandatory minimum reserves regime, according to the NBR regulations;

(ii) comply with the NBR regulations on solvency indicators, in the case of banks, mortgage banks, central offices of credit cooperatives, savings, and loan banks in the housing sector, and Romanian legal entities;

(iii) comply with the provisions of the banking prudential regulations in force issued by the banking supervisory authority of the home country, in case of branches in Romania of credit institutions from Member States and respectively from third countries, except for branches in Romania of credit institutions issuing electronic money. The home country banking supervisory authorities shall certify, at least annually, that the foreign credit institution to which the Romanian branches belong complies with the prudential banking regulations in force in that country.

In order to participate in the money market operations and credit facilities of the NBR involving transactions with government securities and/or certificates of deposit, they must also be a participant in the SaFIR depository and settlement system.

Thus, banks can resort to the credit facility, called Lombard credit, to obtain very short-term liquidity from the NBR. To this end, banks make a written request to the NBR - Market Operations Directorate, which will be resolved by the end of the banking day. The Lombard lending period is overnight.

The granting of the Lombard credit is conditioned by its collateralization with eligible assets. The guarantees must be established by the time the loan is granted, and their value must cover 100% of the loan and related interest.

3.2. What capital and own funds requirements apply to banks in your jurisdiction?

According to *Government Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy* (*Government Emergency Ordinance no. 99/2006*), the NBR can grant authorization to a bank only if it has separate funds or a level of initial capital at least equal to the minimum level set by regulations, which cannot be less than the RON equivalent of EUR 5 million.

Banks must have their share capital paid up in full and in cash on subscription, including in case of an increase, and contributions in kind are not allowed. At incorporation, contributions to the share capital must be paid into an account opened with a credit institution. This account is blocked until the credit institution, a Romanian legal entity is registered with the Trade Registry.

The establishment of a branch by a credit institution from a Member State does not require authorization from the NBR or the provision of endowment capital at the branch level.

The credit institution from a third country shall provide the branch with endowment capital, in monetary form, in order to ensure the initial capital of the branch, at the level prescribed by the regulations of the NBR, which may not be less than the equivalent in RON of EUR 5 million.

Credit institutions must have a level of their own funds that are permanently at least at the level of the own funds' requirements provided in art. 92 of *Regulation (EU) no. 575/2013 of the European Parliament and of the Council of June 26, 2013, on prudential requirements for credit institutions and amending Regulation (EU) no. 648/2012* (*Regulation (EU) no. 575/2013*).

The own funds' requirements provided in art. 92 of *Regulation (EU) no. 575/2013* are the following: **(i)** a core Tier 1 own funds ratio of 4.5%; **(ii)** a Tier 1 own funds ratio of 6%; **(iii)** a total own funds ratio of 8%; **(iv)** a leverage ratio of 3%. An institution's Tier 1 own funds shall consist of the sum of the institution's core Tier 1 own funds and additional Tier 1 own funds.

An institution's core Tier 1 own funds shall consist of the core Tier 1 own funds items after the application of the adjustments, the deductions, and the derogations and alternatives provided in the provisions of the Regulation.

Institutions' core Tier 1 own funds shall consist of: **(a)** capital instruments, subject to the fulfillment of the conditions stipulated in the Regulation above; **(b)** issue premium accounts related to the instruments mentioned in the letter **(a)**; **(c)** retained earnings; **(d)** other elements of the accumulated comprehensive income; **(e)** other reserves; **(f)** funds for general banking risks. The elements referred to in letters **(c)**-**(f)** are considered elements of core Tier 1 own funds only if they are available to the institution for unrestricted and immediate use in order to cover risks or losses as soon as they arise.

Credit institutions must have own funds that cover, in addition to the minimum own funds' requirements mentioned in the provisions of the Regulation, the capital buffers imposed by the NBR, upon the recommendation of the inter-institutional coordination structure in the field of macroprudential supervision of the national financial system.

3.3. Has your jurisdiction implemented the Basel III framework? Are there any major deviations?

Basel III is implemented in the EU through the legislative package on capital requirements. The capital requirements package transposes the *Basel III* standards into EU legislation through *Regulation no. 575/2013 and by Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC* (Directive 2013/36/EU).

The package mentioned above entered into force on January 1, 2014.

EU regulations are directly applicable in Romania and transposition through an internal normative act is not necessary. *Regulation (EU) no. 575/2013* establishes a single set of harmonized prudential rules that banks across the EU must comply with. This single regulatory framework aims to ensure the uniform application of global standards (*Basel III*) in all EU Member States.

Government Emergency Ordinance no. 99/2006 transposed *Directive no. 2006/48/CE of the European Parliament and of the Council of June 14, 2006, on access to the activity and the performance of the activity by credit institutions* and *Directive no. 2006/49/EC of the European Parliament and of the Council of June 14, 2006, on the capital adequacy of investment firms and credit institutions*. The aforementioned directives were repealed by *Directive 2013/36/EU*.

Government Emergency Ordinance no. 99/2006 refers both to the regulations contained in *Regulation no. 575/2013*, as well as *Directive 2013/36/EU*.

IV. REPORTING, ORGANISATIONAL REQUIREMENTS, INTERNAL GOVERNANCE, AND RISK MANAGEMENT

4.1. What key reporting and disclosure requirements apply to banks in your jurisdiction?

According to national jurisdiction, the aspects regarding the reporting and disclosure requirements applying to the banks are instituted by *Regulation of the National Bank of Romania no. 2/2020 on the security measures regarding the operational and security risks* and the requirements of *Regulation of National Bank of Romania no. 2/2020 on the security measures regarding the operational and security risks and the requirements of the of reporting related to payment services* (*Regulation No. 2/2020*).

Thus, according to *Regulation No. 2/2020*, we identify the obligation of payment service providers to submit within four

hours an initial report to the National Bank of Romania, after an operational and/or security incident has been classified as major.

Subsequently, the payment service providers must submit an interim report, when the activities usually carried out have returned to normal, while informing the National Bank of Romania on this situation.

Finally, payment service providers must submit a final report when the root cause analysis has been carried out, regardless of whether the mitigation measures have already been implemented or whether the final root cause has been identified. In this respect, according to the provisions of *Regulation no. 2/2020*, the final report will have to be submitted within a maximum of 20 working days from the date on which the payment service providers can demonstrate that the activity has returned to normal.

4.2. What are the organizational requirements for banks, including with respect to corporate governance?

In line with the provisions of *Government Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy* (GEO no. 99/2006), each credit institution shall have at its disposal a rigorously designed formal framework for business administration, including a clear organizational structure with well-defined, transparent and consistent lines of responsibility, effective processes for identifying, managing, monitoring and reporting the risks to which it is or could be exposed.

At the same time, according to national legislation, we find in place adequate internal control mechanisms, including rigorous administrative and accounting procedures, as well as remuneration policies and practices that promote and are consistent with sound and effective risk management.

In this context, the board of directors or, as the case may be, the supervisory board shall be responsible for ensuring effective supervision of the activities of the directors or of the members of the management of the credit institution.

Considering the provisions of *Regulation of the National Bank of Romania no. 5/2013 regarding prudential requirements for credit institutions* (*Regulation no. 5/2013*), each of the members of the management board and the directors or, where appropriate, the members of the supervisory board and of the management of a credit institution shall at all times have a good reputation, honesty, integrity, and independent thinking skills and experience appropriate to the nature, extent, and complexity of the business of the credit institution and to the responsibilities entrusted to it and must carry on its business in accordance with the rules of prudent banking practice.

Moreover, the members of the management body must have the ability to allocate sufficient time for the performance of their duties.

4.3. What are the local rules for loans to the management body and their related parties?

According to *Regulation of the Financial Supervisory Authority no. 3/2014 on aspects related to the application of the GEO no. 99/2006*, financial investment services companies must properly document and put to the order of the Financial Supervisory Authority, upon request, the data on the loans granted to the management body and related parties, in accordance with the provisions of *Law no. 31/1990 on companies*.

In this sense, an "affiliated party" shall be interpreted as:

- the spouse, child, or parent of a member of the management body;
- a commercial entity in which a member of the management body or its member of the family, within the meaning of the foregoing: **(i)** has a qualifying holding of at least 10% of the capital or of the voting rights; **(ii)** or may exercise significant influence; **(iii)** or hold positions relating to the senior management or are members of the management body.

Furthermore, the exposures to the parties affiliated with the credit institution are established by the provisions of *Order of the National Bank of Romania no. 2/2014 regarding some reports related to Regulation no. 5/2013*.

Thus, we find the obligation to complete a form that contains a series of information regarding in particular **(i)** the type of affiliation, **(ii)** the type of risk, **(iii)** the value of the guarantees, **(iv)** the granting period, **(v)** the behavior of the credit.

4.4. What are the main legal provisions governing risk management in the banking sector in your jurisdiction?

On a general basis, according to the provisions of *Law no. 209/2019 on payment services*, payment service providers establish a framework of mitigation measures and adequate control mechanisms to manage operational and security risks related to the payment services they offer.

This framework of measures requires payment service providers to establish, update and apply effective incident management procedures, including for the identification and classification of major operational and security incidents.

In order to prevent and mitigate the operational and security risks associated with the payment services provided by payment institutions, the National Bank of Romania may cooperate and participate in the exchange of information with

other competent authorities, the European Central Bank and the European Banking Authority and, where appropriate, with the European Union Agency for Network and Information Security.

At the same time, according to the provisions of *Regulation no. 5/2013*, when implementing the internal control framework, credit institutions must establish:

- adequate separation of duties, such as entrusting to different persons the activities likely to generate conflicts of interest within the chain of operations related to the processing of transactions or in the provision of services, or entrusting to different persons the responsibilities of supervision and reporting of activities likely to generate conflicts of interest;

- barriers in the circulation of information, such as, for example, through the physical separation of certain departments.

Moreover, the internal control functions must verify that the internal control policies, mechanisms, and procedures are correctly implemented in their areas of competence. The internal control functions must periodically submit to the management body, according to internal procedures, written reports on the identified major deficiencies. These reports must include, for any new major deficiency identified, the relevant risks involved, an impact assessment, recommendations, and remedial measures to be taken. The management body must, based on a formal monitoring procedure, act promptly and effectively on the findings of the internal control functions and request the taking of appropriate remedial measures.

4.5. What are the legal requirements applicable to banks in combating money laundering and terrorist financing area?

Credit institutions and financial institutions have the obligation to appoint a compliance officer at the management level, who coordinates the implementation of internal policies and procedures for the application of *Law no. 129/2019 for the prevention and combating of money laundering and terrorist financing* (*Law no. 129/2019*).

At the same time, the reporting entities have the obligation to submit to the National Office for Prevention and Combating Money Laundering a report for suspicious transactions if they know, suspect, or have reasonable grounds to suspect that some goods derive from the commission of crimes or are related to the financing of terrorism, or the information that the reporting entity holds could be used to impose the provisions of *Law no. 129/2019*.

In addition, reporting entities are required to identify and assess the risks of their work relating to exposure to money laundering and terrorist financing, considering risk factors, including those relating to customers, countries or geographical areas, products, services, transactions, or distribution channels.

Evaluations drawn up for this purpose shall be documented, and updated including on the basis of national and sectoral assessment and regulations or instructions issued by the authorities, and shall be made available to the authorities responsible for supervision and control and to self-regulatory bodies upon request.

Additionally, conforming to *Regulation of the National Bank of Romania no. 2/2019 regarding the prevention and combating of money laundering and terrorist financing*, in accordance with the provisions of *Law no. 129/2019*, the institutions ensure the continuous training of the persons with responsibilities in the application of the measures provided for in the customer due diligence rules, so as to ensure that they know the legal requirements, their responsibilities according to the internal customer due diligence rules, the risks to which the institution is exposed according to their own risk assessment, the consequences of not fulfilling their respective responsibilities and the implications for the institution and the respective persons, in the event of risks, and that they have sufficient information to allow them to recognize operations that may be related to money laundering or the financing of terrorism.

4.6. Are there any legal provisions regulating banking secrecy in your jurisdiction?

Regarding professional secrecy in the banking field, we find it in close relationship with the clientele, aspects that are regulated according to *GEO no. 99/2006*.

Thus, according to Article 111 of *GEO no. 99/2006*, the credit institution shall maintain confidentiality over all facts, data, and information related to the activity carried out, as well as any fact, date, or information, at its disposal, which concerns the person, property, activity, business, personal or business relations of the clients or information regarding the clients' accounts, respectively: balances, turnovers, operations carried out regarding the services provided or the contracts concluded with customers.

However, the obligation of professional secrecy in banking matters may not be invoked against a competent authority in the exercise of its supervisory powers at individual or, where appropriate, consolidated or sub-consolidated level.

On the other hand, information on the nature of bank secrecy can be provided, to the extent that it is justified by the purpose for which it is requested or provided, in the following situations:

■ at the request of the account holder or his heirs, including legal representatives and/or statutory, or with their express consent;

■ in cases where the credit institution justifies a legitimate interest;

■ at the written request of other authorities or institutions or ex officio, if by special law these authorities or institutions are entitled, for the purpose of fulfilling their specific attributions, to request and/or receive such information and the information that can be clearly identified provided by credit institutions for this purpose;

■ at the written request of the account holder's spouse, when he proves that he submitted a request to the court for the division of common assets, or at the request of the court;

■ at the request of the court, for the purpose of resolving various cases brought before the court;

■ at the request of the bailiff, for the purpose of enforcement, for the existence of the accounts of the pursued debtors;

■ at the public notary's request, within the notarial succession procedure.

V. TRENDS

5.1. What are the main trends in the banking sector in your jurisdiction?

We are going through an intense period, with various predictions for the future. The war on the country's borders and the energy crisis have caused uncertainty and a high degree of concern over the future, both at the level of companies and at the individual level. Rising inflation and prices have led to the permanent revision and modification, more precisely the adaptation to the context, of the initial plans.

In these circumstances, it is quite difficult to anticipate trends, in the banking sector and not only, for the next period. However, our analyses make us hope for economic recovery and a year 2023 that will bring growth. Therefore, the beach is wide, there is room for investment and for optimizing flows, in line with the evolution of the market, and the economic factors are not pessimistic, at least at the beginning of the year.

Currently, the economic players in the market have to manage a series of challenges, but also opportunities, trying to find the most appropriate solutions for all the situations they face, to show flexibility, and to adapt, quickly and as well as possible, to all changes. We are constantly nearby our clients to provide them with the necessary advice and all the support from the legal point of view, trying each time to anticipate both opportunities and risks, so that the proposed solutions be the best, taking into account a number of factors: economic context, industry, market forecasts, purchasing power of consumers, etc.

From our point of view, can be considered as main trends in the banking sector are the following: analyzing the collected data, in accordance with all legal regulations and GDPR, and using all the available data for more efficient communication, classified on the target audiences. Then, the permanent investment in Data Security and customers' experience as consumers are expecting safety and personalized offers. As the competition continues to be at a high level this implies a better and constant harmonization between technology and attracting and maintaining the best specialists within the teams. Talking about AI, probably significant budgets will continue to be allocated to the improvement of chatbots to integrate automation as efficiently as possible, but at the same time, human involvement must remain active.

Last, but not least we consider that also ESG and cybersecurity represent important subjects in the banking sector (and not only) because the dynamics of both cyber-risks and global warming continue to evolve and these are topics that occupy an essential place on the agenda of large companies.

5.2. What are the biggest challenges in the banking sector at the moment?

Although the market may know a number of challenges and there are rumors about the possibility of a *new* crisis, however, up to the present, we have not noticed a decrease in investor interest. Also, we can observe a maturation of the business environment, which determines a moderate growth of the economy, even with clear opportunities in some of the areas of interest.

On the agenda of large companies, but not only, remain the major concern for the environment, and this concern means medium and long-term investments in green energy projects, in sustainable investments involving various resources: financial, human, business, and collaboration opportunities, etc.

Other challenges can be: the permanent fight against cyberattacks within the banking industry, prevention and mitigation of frauds, a permanent digital transformation which means remaining in trend with all the changes and keeping up with the competition and customer expectations, being up to date with everything related to Privacy, Security, and Compliance, efficient omnichannel integration, digital Engaging of clients and potential clients and last, but not least, the challenge of always being agile to respond to new regulations and creating added value to differentiate yourself, as a brand, in a market where expectations are increasing from one year to the next.

5.3. What's new in fintech?

The pandemic has accelerated the digitalization process in many sectors of activity, and in the financial sector, this means innovation, but also high-level security at the same time.

In order to ensure the necessary security, it is necessary to work with the best, to allocate appropriate budgets. At the same time, within the technology industry, we are talking about high competition which leads to more and more diverse tools created to improve the lives of consumers, to have everything at a click touch.

In fintech, some trends are no longer so new, but the fact that they are constantly improving makes them look new. Also, surely consumer behaviors are the ones that dictate the changes in all industries and implicitly the changes in the market, whether we are talking at the national level or at the regional/global level.

So, what is new or rather *current*, can be probably the following: buy now, pay later may become the method of payment of the year, depending on how things will evolve on an economical level; innovations regarding payment as there are a lot of ways to make the payments nowadays and for sure the new generations will be an important engine for faster implementation of all the innovative solutions within the companies that are not yet so digital; Environmental, Social, and Governance (ESG) initiatives will remain in the top strategic objectives of all companies; the fintech will probably continue to improve chatbot and AI integration in the banking sector and not only and for efficient integration of all the fintech tools and services it is necessary a perfect synchronization between internal business processes, mobile apps, and institutions' websites.

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CEE LEGAL MATTERS COMPARATIVE LEGAL GUIDE: BANKING/FINANCE 2023

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I. LEGAL FRAMEWORK

1.1. Which main legislative and regulatory provisions govern the banking sector in your jurisdiction?

The primary law governing the banking sector is the *Banks Act*. It addresses core issues such as incorporation, corporate structure, bank operations, restructuring, and termination. Additionally, the *Banks Act* sets forth the competencies of the National Bank of Serbia in exercising its control function.

Legislation concerning bank operations is comprehensive, but the emphasis should be on the following acts: the *Act on National Bank of Serbia*, *Act on Payment Services*, *Act on Payment Transactions*, *Act on Foreign Exchange Operations*, *Act on the Protection of Financial Service Consumers*, *Capital Market Act*, *Act on the Prevention of Money Laundering and the Financing of Terrorism*, *Digital Assets Act*, and *Act on Bankruptcy and Liquidation of Banks and Insurance Companies*.

In addition to the legislative acts, banks comply with the Regulator's decisions, recommendations, and mitigating measures, which tackle a series of critical matters: risk management in bank operations, capital adequacy, reporting, accounting, disclosure of data and information by banks, and many more.

1.2. Which bodies are responsible for enforcing the applicable laws and regulations? What are their main competencies?

The lead authority for the banking sector is the National Bank of Serbia (Regulator), which exercises the competencies stipulated by the *Act on the National Bank of Serbia* and the *Banks Act* and serves as a bank resolution authority. The Regulator is established as an independent and autonomous authority, subject to the oversight of the National Assembly of Serbia. The scope of the Regulator's competencies includes but is not limited to monitoring the achievement and maintenance of price stability along with overall financial strength, controlling the stability of foreign exchange operations, implementing monetary and foreign exchange policies measures, and issuing fiat and digital currency.

Concerning banking operations, the Regulator, among other things, decides on issuing and revoking the operating licenses, controls bank creditworthiness and supervises the operational legality, and is involved in protecting consumers' rights and interests, as well as in the restructuring process. The Regulator gives consent for the acquisition of direct or indirect ownership in the bank and provides approval on the appointment of the members of the bank's management bodies.

Aside from the Regulator, other critical authorities in the banking sector are the Securities Commission (in charge of the prudential functioning of capital markets), the Administration for the Prevention of Money Laundering (responsible for the application of the Act on the Prevention of Money Laundering and the Financing of Terrorism) and Association of Serbian Banks (in charge of developing and harmonizing the activities of the banks and represent their common interest).

1.3. What are the current priorities of regulators, and how does the Regulator engage with the banking sector?

Current priorities of the Regulator include monitoring the overall financial stability by preserving the value of the domestic currency (dinar/RSD), implementation of measures of macroeconomic (monetary, fiscal, and monetary policy to mitigate inflation risks), promotion of long-term domestic savings, as well as motoring of banks' exposure to non-performing loans.

Moreover, as Serbia is a candidate for European Union accession, the priority for the Regulator remains to be the harmonization of legislation governing the banking sector in Serbia with the EU. Serbia follows the EU recommendations and continues the implementation of *Basel III* standards in line with their finalization and introduction at the EU level (see Section 3.3.) as well as to work towards complete alignment with the Solvency II directive in the area of insurance.

II. AUTHORISATION

2.1. What licenses are required to provide banking services in your jurisdiction? What activities do they cover?

Generally, there are following three types of licenses for providing banking services, all issued by the Regulator:

(i) In case of establishing a new bank, the Regulator issues a preliminary founding permit, bank operating license, and consent to the incorporation acts.

(ii) In case of an acquisition of an existing and operating bank, the Regulator issues prior consent ("purchase" license).

(iii) In both cases, the Regulator issues prior consent to appoint management body members (supervisory and executive boards).

Once acquired, the operating license entitles the bank to provide the following services:

1) depositing operations;

2) lending operations;

3) foreign exchange operations;

4) payment transactions;

5) issuance of payment cards;

6) activities regarding the securities;

7) brokerage-dealership services;

8) guarantee operations;

9) purchase, sale, and collection of receivables (including factoring and forfeiting);

10) insurance agency activities;

11) other activities banks are entitled to per the applicable legislation or related activities.

2.2. What is the procedure for obtaining a banking license? How long does this typically take?

The process of obtaining a banking license comprises two steps: obtaining the preliminary approval to establish the bank (Preliminary Permit) and ii) obtaining the right to operate (Operating License), both issued by the Regulator.

i) Preliminary Permit

To obtain the Preliminary Permit, the bank founders shall submit to the Regulator **(i)** a request for Preliminary approval, **(ii)** all necessary documentation (*which includes: information on the bank founders, their contributions, and information of the shares they acquire; memorandum of association; bank's articles of association; a statement that the founder will pay the monetary portion of the initial capital to the temporary bank account of the Regulator; a statement that will transfer non-monetary assets to the bank's initial capital; information on all persons who will obtain the bank's shares and the legal grounds for such; list and information of proposed members of the bank's management and executive board; a three-year business policy and strategy and program of activities for the initial business year; risk management and proposed capital management strategy*).

The Regulator decides upon the duly submitted request within 90 days of request submission.

ii) Operating License

Once they obtain the Preliminary Permit, the bank founders are obliged to apply for the issuance of the Operating license within 60 days from the date of granting the Preliminary Permit. Along with the request for issuing the Operating license, the founders will submit the following documents: **(i)** proof of payment of initial capital; **(ii)** evidence of ensuring the adequate premises and other technical and operational requirements for bank establishment; **(iii)** evidence on the engagement of external auditor; **(iv)** information on the organizational structure and HR capacities.

The Regulator decides upon the duly submitted request within 30 days of the request submission. The completed process of obtaining the Operational license ends with publication in the Official Gazette of the Republic of Serbia.

iii) Founding Assembly and Registration

The Founding Assembly must take place within 30 days from receipt of the Operational license, and the acts passed at the Assembly are subject to the Regulator's approval (60 days from the receipt of the acts).

The last step in the process is registering a bank in the business register, which the founders should undertake within 30 days of receipt of the Regulator's consent to the incorporation acts.

2.3. Can a foreign bank operate in your jurisdiction on the basis of its domestic license?

Foreign banks can operate in Serbia based on a domestic license issued to a subsidiary in Serbia, which is the case with most currently active banks in the Serbian market. The procedure to establish a subsidiary of a foreign bank is the same as for domestic founders, except for the additional two requirements.

When submitting a request for a Preliminary Permit, the foreign entity is obliged to provide the Regulator with: **(i)** proof of approval to the foreign entity by a regulator in its country of origin that it may participate in the establishment of a bank in the Republic of Serbia or confirmation that no such approval is required, and **(ii)** the regulatory authority of founder performs supervision on a consolidated basis which meets the Regulator's requirements, and there is adequate cooperation between the Regulator and of founder's regulatory authority, and potentially other requirement set forth by the Regulator.

Furthermore, the foreign bank can register its representative office in Serbia. Establishing and operating a representative office of a foreign bank in Serbia also requires Regulator's approval. Its activities are limited to market research and representation.

2.4. What are the restrictions on ownership, including foreign ownership of banks?

There are no limitations when acquiring ownership in the bank's capital, with the ability to exercise up to 5% of voting rights, which is the first threshold for qualified ownership. Obtaining qualified ownership, as described below, is conditioned by obtaining prior approval from the Regulator.

Regardless of whether the acquired ownership is qualified, there are no limitations to acquiring ownership by inheritance, legal succession, or another acquisition source independent of the acquirer's will. However, if such ownership should be considered qualified, the acquirer must obtain approval of the Regulator or otherwise disburse the acquired share. The acquirer may not influence the bank's management or business policies, nor can they exercise voting rights before the Regulator grants approval.

2.5. What are the requirements for a proposed acquisition and acquirer of a qualified holding in a bank? Would the same requirements apply in the case of an increase of a qualifying holding?

The *Banks Act* stipulates different categories of preferred ownership as follows:

(i) qualified ownership – direct or indirect ownership of 5% capital and voting rights, or ability to exercise the influence over the management or business policy;

(ii) significant ownership - direct or indirect ownership of 20% capital and voting rights, or ability to exercise significant influence over the management or business policy;

(iii) controlling ownership - direct or indirect ownership of 50% capital and voting rights, or ability to exercise the dominant influence over the management or business policy, or ability to elect at least half of the management body's members.

Acquiring each type of preferred ownership is conditioned by obtaining the approval of the Regulator. Such consent is required for the existing holder when acquiring the next level of preferred ownership.

The Regulator will reject the request for issuing the approval in cases prescribed by Article 96 of the *Act on Banks*. As part of its decision-making process, the Regulator considers a variety of factors, including the financial status of the prospective owner, the reputation of the business and the reputation of the beneficial owners and management, the completeness and verifiability of the provided data, a risk assessment based on the owner's current business activities, and transparency about financing sources.

The same rules apply to foreign banks acquiring ownership in the domestic bank, alongside additional conditions referred to in Section 2.3.

The Regulator also sets a deadline for the applicant to acquire ownership for which it issued the approval. Private individuals are entitled to execute the acquisition within one year of approval. Legal entities may complete the approved acquisition by the date of adoption of the first subsequent annual financial statements, i.e., audited financial statements of those legal entities.

Acquiring the qualified ownership in the bank without prior approval of the Regulator is sanctioned by the nullity of such acquisition and lack of authorization to exercise such ownership by voting rights and deciding upon the bank's management and policy designing.

III. REGULATORY CAPITAL AND LIQUIDITY

3.1. How are banks typically funded in your jurisdiction?

Banks' main sources of financing include financing from own or founder's funds, deposits from customers, issuing debt securities, borrowing from other financial institutions, and lending from the Regulator via repos. Banks may also generate financing from the sale of assets or by issuing shares of stock.

Additionally, the government may fund banks through various programs and initiatives, such as deposit insurance schemes or activities of the Deposit Insurance Agency, which aim to help the banks attract additional deposits.

3.2. What capital and own funds requirements apply to banks in your jurisdiction?

The bank's capital consists of Tier 1 capital comprising Common Equity Tier 1 capital, Additional Tier 1 capital, and Tier 2 capital, per the Regulator's Decision on the Capital Adequacy of Banks.

The initial share capital can consist of monetary and non-monetary contributions. The monetary contribution to the bank's capital may not be less than EUR 10 million in dinars calculated by Regulator's official middle exchange rate. Banks are obliged to maintain their capital above initial levels, in addition to the amount required for covering the risks that the bank may be exposed to in its operations, to maintain the ratio of foreign currency assets and liabilities (FX risk ratio), liquidity coverage ratio, and comply with other existing rules in terms of exposure.

The total amount of the capital the bank is obliged to maintain should be calculated per the *Decision on Capital Adequacy of Banks*, *Decision on Risk Management by Banks*, and *Decision on Liquidity Risk Management by Banks* and is subject to the Regulator's approval.

3.3. Has your jurisdiction implemented the Basel III framework? Are there any major deviations?

To harmonize the legal framework in Serbia with EU regulations, the Regulator has introduced six new decisions based on *Basel III* standards. Those decisions are:

- *Decision on Capital Adequacy of Banks*;
- *Decision on Disclosure of Data and Information by Banks*;
- *Decision on Reporting on Capital Adequacy of Banks*;
- *Decision Amending the Decision on Reporting Requirements for Banks*;

- *Decision on Liquidity Risk Management by Banks*;
- *Decision Amending the Decision on Risk Management by Banks*.

Desired effects of the decisions mentioned above refer to the banking sector in its entirety, especially on capital quality, monitoring and controlling of the bank's exposure to liquidity risk, setting up a new and more efficient reporting system, as well as straightening of market discipline and transparency of bank's operations.

As per deviations, the Regulator has detected discrepancies while implementing *Basel III*, mainly in the capital and capital requirements against market risks and liquidity ratios. Additionally, minor differences have been determined in capital requirements against credit and operational risks. Moreover, the Regulator stressed the need for further harmonization, securitization, leverage ratios, and capital buffers since such concepts were introduced with *Basel III*.

IV. REPORTING, ORGANISATIONAL REQUIREMENTS, INTERNAL GOVERNANCE, AND RISK MANAGEMENT

4.1. What key reporting and disclosure requirements apply to banks in your jurisdiction?

The main reporting obligations of the banks embody in reporting to the Regulator. To adequately assess and monitor the banks' operations regarding risk management and overall business activity, the Regulator collects a series of reports from the banks. The reports include information on the bank's management, organizational units' operations, planned business activities, profitability, liquidity, and solvency on an individual and consolidated basis.

Types of reports, forms, and timeframe for the delivery are stipulated in detail in the *Decision on Banks Reporting*. The decision determines daily, monthly, and annual reports, depending on the report type.

In addition to reporting to the Regulator, banks are obliged to publish information on their strategy and policies on risk management, the bank's capital, and its adequacy. However, banks are not obliged to publish data and information that are not materially significant, data and information that could negatively affect the competitive position of a bank on the market if published, or data and information that constitute a banking secret (see Section 4.6.).

4.2. What are the organizational requirements for banks, including concerning corporate governance?

Please briefly describe the requirements and the procedure for assessing the suitability of the members of the management body and key function holders.

In Serbia, banks may exclusively be established as joint stock companies. Corporate bodies of the banks are **(i)** Bank's Assembly, **(ii)** Managing Board, and **(iii)** Executive Board.

The Bank's Assembly consists of all its shareholders and is held via ordinary and extraordinary meetings. Its main competencies are adopting the bank's policies and strategies, drafting and amending the articles of association, and preparing financial reports. The Assembly appoints the Managing Board members, decides on their remuneration and termination, and appoints external auditors. Besides deciding on capital increases and investments, it also determines the appointment of the bank's Managing Board members.

The Managing Board consists of at least five members, including the chairpersons. The main competencies of the Managing Board include supervising the activities of the Executive Board, establishing an internal control system and monitoring its efficiency, adopting the bank's recovery plan, adopting business policies and strategy and its risk management and capital management strategies, determining general terms of business of the bank, and establishing the bank's internal organization.

The Executive Board consists of at least two members, including the chairperson. The principal competencies include implementing the Bank's Assembly and Managing Board's decisions, implementing the bank's business policies and strategies, ensuring the security of the bank's IT and treasury operation system, presenting the overview of business activities, informing the Managing Board of any actions non-compliant with regulations and other acts of the bank.

The *Act on Banks* prescribes the prohibition of conflict of interest for management members.

Aside from fundamental corporate bodies, the banks must establish an audit committee, credit committee, and assets and liabilities management committee. Although not mandatory, the banks may introduce other committees according to their internal governance or to improve specific segments of their business, such as a risk committee, nomination committee, and remuneration committee, modeled by the EU bank governance principles.

The *Act on Banks* prescribes the obligation for the bank to obtain prior consent to appoint members of the management body (Managing Board and Executive Board). Such a duty does not apply when selecting key position holders.

The Regulator has provided a list of documents that a bank should submit to enable it to assess the suitability of the appointment of a member of a management body (which resembles the EU's Fit & Proper procedure). The criteria for

selection include professional experience and background, criminal history, tax liabilities, reputation, integrity, political history, potential involvement in the management of other banks and conflict of interest, and overall personal skills and competencies.

4.3. What are the local rules for loans to the management body and their related parties?

As other pieces of legislation define them differently, it is essential to mention that the *Banks Act* stipulates its definition of related parties (Article 2). Banks may not offer loans to related parties or employees on terms more favorable than those generally provided in the market for persons not affiliated with or employed by a bank.

The conclusion of any legal transaction, including loans, with a related party or person related to a related party, is conditioned by prior approval of the Managing Board, except in cases of (i) deposit placement, (ii) granting loans collateralized by a linked deposit of related person, (iii) granting loans collateralized by debt securities of the Republic of Serbia or the Regulator, and debt securities of persons rated by recognized international credit rating agencies not lower than "A."

As for the members of the Executive Board, they are, as bank employees, subsumed under the rule of loans to related parties.

Additionally, the bank may only grant loans to its shareholders after the expiration of one year from the day it started operating.

4.4. What are the main legal provisions governing risk management in the banking sector in your jurisdiction?

The bank must identify, measure, assess, and manage its exposure to risks from its operations. Notably, it is also obliged to form a special organizational unit whose scope is risk management. Banks provide strategies and policies for risk management, capital management strategy, procedures for identifying, measuring, and assessing risks, adequate internal control systems, and appropriate information systems. The main risks that banks must identify and manage include: **(i)** liquidity risk, **(ii)** credit risk (including residual risk, dilution risk, settlement/delivery risk, and counterparty risk), **(iii)** interest rate, foreign exchange, and other market risks, **(iv)** risk exposure to a single person or group of related persons, **(v)** risks of an investment in other legal persons and fixed assets and investment property, **(vi)** risks related to the home country of a person the bank, (vii) operational risk including legal and IT risk. Additionally, there are additional risks to which the bank is exposed, including compliance risk, AML/CFT risk, and strategic risk.

The banks are obliged to report to the Regulator on the activities performed under risk management. Moreover, the banks are obliged to prepare and submit to the Regulator a document called "a recovery plan." It foresees the measures that the bank will apply in the event of a significant deterioration of its financial condition, especially when it is undercapitalized, to re-establish its sustainable operations and appropriate financial position. This plan is updated yearly.

4.5. What are the legal requirements applicable to banks in combating money laundering and terrorist financing area?

The *Money Laundering and Terrorist Financing Prevention Act*, as well as the *Strategy against Money Laundering and Terrorist Financing 2020-2024* and *AML/CFT Strategy Action Plan 2022-2024*, regulate AML/CFT risks. The act established the competent authority for supervision of the act within the Ministry of Finance - Administration for the Prevention of Money Laundering (APML).

The following actions and measures must be undertaken by banks before, during, and after a transaction or the establishment of a business relationship under the applicable legislation:

1) KYC and monitoring of their business transactions (customer due diligence);

2) sending information, data, and documentation to the APML;

3) designating persons responsible for applying the obligations laid down by the act;

4) regular professional education, training, and development of employees;

5) providing regular internal control of the implementation of the obligations, as well as an internal audit;

6) developing the list of indicators for identifying persons and transactions suspicious of ML/FT;

7) record-keeping, protection, and storing of data from such records;

8) implementing the measures by branches and subsidiaries located in foreign countries;

9) implementing other actions and measures based on the act.

Moreover, banks are also required to report and disclose any information it considers a possible threat to ML/FT before the execution of that transaction. Additionally, the bank must report to the APML all the transactions whose value exceeds EUR 15,000.

4.6. Are there any legal provisions regulating banking secrecy in your jurisdiction?

Yes. The applicable legislation defines a banking secret as a business secret and provides rules on information that should

be considered a banking secret, its treatment, and exempting disclosure. The following information is considered a banking secret:

- data are known to the bank related to personal data, financial status, and transactions, as well as ownership or business relations of clients with the banks;
- data on balance and transactions on individual deposit accounts;
- any other data obtained by the bank in operations with clients.

A bank and members of its bodies, shareholders, and employees, including a bank's external auditor and other persons who have access to the data above, may not communicate this data to third parties or use it contrary to the interest of the bank and its clients, nor may they allow third-party access to this data.

There are exemptions to this rule duly prescribed by the law and are most often related to disclosing the date to the public authorities in relevant procedures and to protect the bank's rights.

Otherwise, a bank may disclose a banking secret solely upon the written consent of the client to whom the data refers.

V. TRENDS

5.1. What are the main trends in the banking sector in your jurisdiction?

One of the trends that continues to shape the banking market is its consolidation. Serbia has a relatively high number of banks compared to its market size. The trend is likely to continue, although there are no public announcements of further acquisitions.

Another ongoing trend that improves customer experience is the further digitalization of banking services. The current focus of digitalization is the Regulator's introduction of QR code payments, online services of e-banking and m-banking (currently, there are three million users of m-banking), and the remote conclusion of agreements. Banks will likely continue to offer an even broader range of digital products.

As in other markets, the banking sector is at the forefront of applying ESG standards, encouraging further harmonization with EU legislation. With most of the banks in Serbia being EU-based, the banking market is naturally the most progressive in recognizing new EU standards. Application of these standards impacts both banks' internal operations and shaping the banking products due to different ESG factors. They must therefore include a new type of risk in the assessment process – ESG risk. The scale of application of ESG risk is yet to increase, reflected in the amendments proposed by the ECB to the European Commission's proposal for a directive on the energy performance of buildings on January 16, 2023.

5.2. What are the biggest challenges in the banking sector at the moment?

Being part of a global market, Serbian banks are experiencing the same effects. Their most significant challenge is the inflation hike and the waterfall of consequences that follow it.

The interest rate hike created two streams working in opposite directions in credit activity, both unfavorable for banks. One is that there has been a decline in the level of credit activity due to lower demand. The second is that banks must tighten credit conditions resulting in increased prices of the loans, further decreasing loan activity.

To secure liquidity, the banks are taking measures to increase the number of deposits. Challenged by a lack of customer savings habits, banks face a significant task and are slowly hiking the interest rates, mainly on dinar-denominated deposits.

Lastly, although the level of NPLs dropped to a historical minimum in 2022, the latest data shows that problematic loans are again growing. Although not unexpected in times of crisis, this trend serves as a red flag and may trigger additional state-imposed measures as such were imposed within the COVID-19 pandemic.

5.3. What's new in fintech?

Among the first countries in the region to pass an *Act on Digital Assets*, Serbia enabled the use of cryptocurrencies and NFTs as a source of financing. This segment is under the supervision and licensing of the Regulator for issuing cryptocurrency and the Securities Commission for NFTs. Banks are not permitted to issue NFTs.

The market is still developing, and the first licenses have been issued. For now, the Securities Commission has published only two "white papers" and two decisions on granting licenses for the provision of virtual currency services issued in December 2022 by the Regulator. The biggest obstacle to overcome in this area will be enabling cross-border NFTs purchase while the Regulator remains reserved towards foreign exchange loan activity.

With all the obstacles that the banks are currently facing, more extensive application of fintech solutions, especially NFTs, is beneficial for an additional increase of sources of financing to SMEs.

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CEE LEGAL MATTERS COMPARATIVE LEGAL GUIDE: BANKING/FINANCE 2023

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I. LEGAL FRAMEWORK

1.1. Which main legislative and regulatory provisions govern the banking sector in your jurisdiction?

The principal law governing the banking sector in Slovenia is the Banking Act (ZBan-3; *Official Gazette of Republic of Slovenia, no. 92/21, as amended*), whereas the prudential regulatory framework for banks comprises a range of different EU and national regulations, supplemented by regulations, implementing technical standards, guidelines and recommendations issued by the European Central Bank (ECB) and the European Banking Authority (EBA). As in other EU member states, the majority of the applicable banking regulations in Slovenia implement and/or are based on EU directives and regulations. The Bank of Slovenia as the competent national authority also issues guidelines for the general and more detailed uniform interpretation and application of the banking regulations and for the formulation of best practices.

An essential additional regulation applicable to all entities in the banking sector (as well as other financial institutions) is contained in the Prevention of Money Laundering and Terrorist Financing Act (ZPPDFT-2; *Official Gazette of Republic of Slovenia, no. 48/22, as amended*).

In addition to the above, there are other relevant legislative provisions that also affect the banking sector, such as:

- The Payment Services, Services for Issuing Electronic Money and Payment Systems Act (ZPlaSSIED; *Official Gazette of Republic of Slovenia, no. 7/18, as amended*);
- The Takeovers Act (ZPre-1; *Official Gazette of Republic of Slovenia, no. 79/06, as amended*);
- The Act Implementing the Regulation (EU) laying down a general framework for securitization and creating a specific framework for simple, transparent, and standardized securitization (ZIUDSOL; *Official Gazette of Republic of Slovenia, no. 22/19*);
- The Resolution and Compulsory Winding-Up of Banks Act (ZRPPB-1; *Official Gazette of Republic of Slovenia, no. 92/21*)

and other.

1.2. Which bodies are responsible for enforcing the applicable laws and regulations? What are their main competencies?

The Bank of Slovenia is the competent authority responsible for the supervision of banks in accordance with the Banking Act and *Regulation 1024/2013*, except with regard to the tasks and powers of prudential supervision for which the European Central Bank is responsible in accordance with *Regulation 1024/2013*.

- Bank of Slovenia (Banka Slovenije)

The Bank of Slovenia is the central bank of the Republic of Slovenia and the Regulator in the banking sector. It was established by the *Bank of Slovenia Act*, which governs its status, competence, and governance.

The Bank of Slovenia's competencies are based on four main pillars:

(1) Monetary policy relates to the central bank's decisions that exert an influence on prices and the availability of money in the economy. Under the *Bank of Slovenia Act*, maintaining price stability is the objective of the Bank of Slovenia, and it is also the primary objective of the European System of Central Banks.

(2) Micro-prudential (banking system) supervision is part of the Bank of Slovenia's mandate relating to the maintenance of financial stability. The Bank of Slovenia defines, implements, and supervises the system of prudential rules for the operation of banks and savings banks in the Republic of Slovenia. The objective of the Bank of Slovenia's supervisory activities is to identify risks in all areas of the operations of banks and savings banks, such as credit risk, liquidity risk, operational risk, capital risk, interest rate risk, profitability risk, internal controls, corporate governance, reputation, anti-money laundering. The Bank of Slovenia examines compliance with the relevant legislative provisions, grants and withdraws authorizations in accordance with the applicable laws, sets out capital requirements, and is responsible for processing notifications under the ZBan-3.

The competencies in the area of micro-prudential supervision are divided between the Bank of Slovenia and the ECB (see below).

*In contrast to prudential supervision, non-prudential supervision is exclusively the responsibility of the Bank of Slovenia. The central focus of this supervision is anti-money laundering and countering the financing of terrorism (AML/CFT), which in addition to banks and savings banks covers other institutions that are supervised by the Bank of Slovenia in accordance with the ZPPDFT-2 (payment institutions, electronic money institutions, currency exchange offices, and entities engaged in virtual currency activities). The Bank of Slovenia carries out certain activities in the area of AML/CFT in conjunction with the Office for Money Laundering Prevention.

(3) Macroprudential policy: The Bank of Slovenia carries out macroprudential supervision and pursues macro-prudential

policy. In the area of macroprudential supervision, the Bank of Slovenia identifies, monitors, and assesses systemic risks to financial stability, and adopts the necessary measures for the prevention and mitigation of systemic risks. In its role as the designated authority, the Bank of Slovenia is responsible for implementing Article 458 of *Regulation (EU) No 575/2013* and is thus responsible for defining measures to mitigate macroprudential or systemic risks in connection with banks and for setting capital buffer requirements. The Bank of Slovenia is responsible for the development and implementation of macroprudential measures for the banking sector and leasing companies. The legal basis for the implementation of macroprudential policy is provided by the Capital Requirements Regulation (*Regulation 575/2013/EU*), the Banking Act (ZBan-3), and the Macroprudential Supervision of the Financial System Act (ZMbNFS; *Official Gazette of Republic of Slovenia, no. 100/13*).

(4) Bank resolution and deposit guarantee scheme: Under the rules implementing the EU Recovery and Resolution Directive (RRD), i.e., the *Resolution and Compulsory Winding Up of Banks Act* (ZRPPB-1), the Bank of Slovenia is the designated national resolution authority for banks with their seat in Slovenia. As such, it is competent for implementing bank resolution measures under ZRPPB-1 (except for the powers and tasks for which the Single Resolution Board is responsible in accordance with *Regulation 806/2014/EU*), including exclusive competence for deciding on measures regarding compulsory liquidation of banks.

The Bank of Slovenia is also the operator of the deposit guarantee scheme in accordance with the Deposit Guarantee Scheme Act (ZSJV), whose basic objective is to protect depositors and to maintain their confidence in the banking system. Pursuant to the ZSJV, deposits at a bank or savings bank with the head office in Slovenia are guaranteed up to the amount of EUR 100,000 EUR.

Other tasks:

The Bank of Slovenia is part of the European System of Central Banks and part of the Eurosystem, within which it implements the Eurosystem's common monetary policy, manages official foreign reserves (joint management of the ECB's foreign reserves), is responsible for the smooth operation of payment systems and issues euro banknotes.

The Bank of Slovenia also performs certain other tasks as part of its legal mandate, such as acting as the payment/fiscal agent of the state or as a representative of the state at international monetary organizations, managing accounts for the state, government bodies, and public-sector entities, attending to financial, monetary, banking and balance of payments statistics, and managing the central credit register. A number of the Bank of Slovenia's tasks relate to the operation of critical national infrastructure under the Critical Infrastructure Act (ZKI).

The Bank of Slovenia is also the competent supervisory authority under *Regulation 2017/2402/EU* governing securitization.

■ European Central Bank (ECB)

Slovenia is part of the Eurozone and, as such, the European Central Bank has become the supervisor of Slovenian banks under the EU's Single Supervisory Mechanism introduced by *Council Regulation (EU) No 1024/2013*.

The Bank of Slovenia is a member of the Single Supervisory Mechanism under which the ECB – in cooperation with the national supervisory authority – directly supervises (groups of) so-called significant credit institutions (Sis), which are deemed to be relevant to the functioning of the Eurozone banking system. In operational terms, this supervision is conducted by joint supervisory teams (JSTs). The Bank of Slovenia participates in the supervisory activities of the ECB via the JSTs, while the final supervisory decisions with regard to these banks are made by the ECB.

Other credit institutions remain to be subject to supervision by the Bank of Slovenia and will only be indirectly supervised by the ECB. Namely, the supervision of banks and savings banks that do not meet the criteria for being classed as significant institutions, i.e., less significant institutions (LSIs), is conducted by national supervisors, in accordance with national and EU legislation, having regard for the rules and methodology of the ECB and SSM. National supervisors regularly submit supervisory data for less significant institutions to the ECB and inform it of the material findings of their supervision. The ECB can, however, take over the supervision of less significant institutions in specific cases.

The ECB is currently responsible for the direct supervision of approximately eight Slovenian banks (credit institutions) qualifying as significant institutions and representing the most important banks in the country, while the Bank of Slovenia remains competent for six banks and saving banks that are regarded as less significant banks (source: Bank of Slovenia's website and annual report for 2021).

■ Securities Market Agency (Agencija za trg vrednostnih papirjev, ATVP)

The Securities Market Agency issues licenses and supervises the securities market. With respect to the banking sector, the Securities Market Agency plays an important role in case of takeovers. Namely, the Securities Market Agency issues takeover bid authorizations and supervises the procedural steps

of takeovers. Apart from that, the Securities Market Agency is also competent for the supervision of the banks providing (ancillary) investment services.

■ Office of the Republic of Slovenia for Money Laundering Prevention (*Urad Republike Slovenije za preprecevanje pranja denarja*)

The Office of the Republic of Slovenia for Money Laundering Prevention performs tasks related to the prevention of money laundering and financing of terrorism. It provides an inspection of the implementation of the ZPPDFT-2.

1.3. What are the current priorities of regulators and how does the regulator engage with the banking sector?

The supervisory priorities of the Bank of Slovenia are not publicized in advance (*ex-ante*), therefore its priorities can be seen only from their annual reports in which the Bank of Slovenia describes its priority areas in the preceding year (*ex-post*), such as 2020 and 2021 (the annual report for 2022 has not yet been published). In general, it could be said that capital adequacy and credit risk management remain the top priority of the Bank of Slovenia.

In terms of banking supervision, the outbreak of the COVID-19 epidemic meant that the Bank of Slovenia's supervisory activities in 2020 and 2021 were refocused on monitoring and assessing the banks' ability to deal with the consequences of the epidemic in the areas in which the coronavirus pandemic could have an impact: credit risk management, capital adequacy, business model sustainability, and management. In 2020 the stress tests were postponed until 2021 and the Bank of Slovenia took a pragmatic approach to carrying out annual SREP activities in 2020, while in 2021 the Bank of Slovenia resumed the implementation of SREP in common and comprehensive scope.

After focusing on the Covid crisis for the past two years, the Bank of Slovenia has now shifted its focus on the recent high inflation levels that have been caused due to interruptions on the demand side of the supply chains. The Bank of Slovenia is also expected to follow the general priorities set by the SSM. The Bank of Slovenia focuses on the macro-financial consequences of the geopolitical tensions caused by Russia's invasion of Ukraine and challenges stemming from banks' digital transformation strategies or physical and transition risks from global climate change. In aiming to address these challenges the SSM set the following supervisory priorities for 2023-2025:

■ strengthening resilience to immediate macro-financial and geopolitical shocks;

■ addressing digitalization challenges and strengthening management bodies' steering capabilities;

■ stepping up efforts in addressing climate change (Source: ECB, *ECB Banking Supervision – SSM supervisory priorities for 2023-2025*).

The Bank of Slovenia is proactively engaging with the banking sector, mainly through regular inspection, evaluation, and the issuance of executive decisions and recommendations. Supervisory measures are drawn up when breaches of regulations or deficiencies are identified. The more important measures imposed on banks and savings banks, members of their management bodies, and shareholders are issued in the form of the binding legal acts set out by the ZBan-3, i.e., in the form of orders and decisions.

Supervisory measures on significant banks are imposed by the ECB, whereas supervisory measures on less significant banks are imposed by the Bank of Slovenia.

The Bank of Slovenia's supervision takes the form of **(1)** an ongoing supervisory review and evaluation process (SREP) on an annual basis, and **(2)** on-site inspections at banks.

As a part of its risk-based approach, where supervisory activities are focused on the most material risks at each bank, the Bank of Slovenia sets out specific supervisory activities for each bank, thereby responding to a change in the bank's risk profile or to changes in the banking system.

II. AUTHORISATION

2.1. What licenses are required to provide banking services in your jurisdiction? What activities do they cover?

Banks may provide banking services, financial services, and ancillary financial services when they obtain authorization to provide those services in accordance with ZBan-3 or Regulation 1024/2013 (Banking License).

The Banking License covers the following activities:

1) acceptance of deposits and other repayable funds from the public (banking services); and

2) the following financial services:

■ granting of loans including consumer loans, mortgage loans, factoring, financing of commercial transactions, including forfeiting;

■ financial leasing (lease or rent);

■ payment services and electronic money issuance;

- issuance and administration of other payment instruments (e.g., travelers' cheques and bankers' drafts);
- issuance of guarantees and other sureties;
- trading for own account or for the account of customers in money-market instruments, foreign legal tender, including currency exchange transactions, standardized futures and options, currency and interest-rate instruments, and transferable securities;
- participation in securities issues and the provision of related services;
- advice to undertakings on capital structure, industrial strategy and related questions and advice, and services in connection with mergers and acquisitions;
- money broking on interbank markets;
- portfolio management and related advice;
- safekeeping of securities and other related services;
- credit reference services;
- leasing of safe deposit boxes;
- investment services and activities, and ancillary investment services in accordance with the law governing the market in financial instruments.

Banks that intend to provide financial services should obtain prior authorization to provide financial and additional services referred to in Articles 5 and 6 of ZBan-3. The application for the authorization for financial services can be filed in parallel with or separate from the authorization for banking services. The ECB is competent for issuing the authorization for banking services for the banks with their seat in Slovenia, while the Bank of Slovenia is competent for issuing the authorization for financial services.

A bank that acquired authorization to provide banking services can provide additional financial services upon notification to the Bank of Slovenia.

Banks may also provide additional services, i.e., management of their own assets, controlling and operating databases (including personal data), or similar operations that support the provision of services by credit institutions.

2.2. What is the procedure for obtaining a banking license? How long does this typically take?

In order to obtain a Banking License (for the provision of banking and financial services), the applicant should submit a written application (License Application) to the Bank of Slovenia. Before the formal submission of a License Application, it is customary that the applicant will request an informal introductory meeting with the competent officials of the Bank of Slovenia to introduce the managers, present the intended business model and strategy, and generally discuss the licensing process, such as timing for the authorization process and required documentation. The formal process starts with the submission of a written License application.

The License Application should include all relevant information and documentation required for the assessment of the regulatory requirements under ZBan-3 (and other applicable regulations), such as a notarized version of the Articles of Association, description of the business model and business plan, information on shareholders with a qualified holding or information on 20 largest shareholders, information on related parties, organizational structure of the bank, written procedures for risk management, AML, conflicts of interest, internal controls, fit and proper assessment of the management and other relevant evidence proving that the bank meets the requirements under ZBan-3.

When submitting the License Application, the applicant must also ensure: **(1)** that the future qualifying holders submit a request for the granting of authorization to acquire a qualifying holding in the bank; and **(2)** that future members of the bank's management board submit a request for the granting of an authorization to perform the function of a member of the bank's management board.

The Bank of Slovenia may submit the License Application to regulators in other states for consultation if the respective bank is connected to or controlled by a company/bank in that state.

The Bank of Slovenia may refuse the License Application if the applicant fails to meet the organizational requirements, the standards required in the interest of sound and prudent management of the institution with respect to future qualifying holders or members of management bodies, corporate governance requirements, or conditions under *Regulation 575/2013/EU*. The Bank of Slovenia will also refuse the License Application if the laws of the State of the person that is closely connected to the bank would prevent the exercise of effective control over the bank. For the purpose of preventing violations of ZBan-3 or *Regulation 575/2013*, the Banking License may include conditions or limitations on the provision of banking services for which the authorization is being granted.

If the applicant meets the required criteria under the national law, the Bank of Slovenia will prepare a Draft Decision and forward it to the ECB for approval and notify the applicant and the ECB thereof. The Draft Decision is deemed to be approved if the ECB gives no objections within 10 days from

its receipt. The due date for objections can be prolonged for another 10 days in duly justified cases. If the ECB opposes the Draft Decision, it gives a written statement in which it shall present the underlying reasons for its objection.

If the applicant has also filed an application to provide financial services or ancillary financial services in parallel with its request for the granting of authorization to provide banking services, the Bank of Slovenia shall decide on the request for the granting of authorization to provide financial and ancillary financial services until the ECB gives it decision on the provision of banking services.

ZBan-3 provides a maximum period of review in which the Bank of Slovenia must decide on the License Application. Namely, the Bank of Slovenia must issue a decision on granting the authorization to provide banking, financial, and ancillary financial services within six months of receiving the License application. Such a review period, however, only starts when the Bank of Slovenia establishes that the application and supporting documents are complete.

2.3. Can a foreign bank operate in your jurisdiction on the basis of its domestic license?

Yes, under the EU passporting regime a foreign bank established in another Member State of the European Union (the EU Member State Bank) with a banking license issued by a competent authority in that Member State (home member state regulator) may provide banking services and/or financial services, for which it holds a domestic license, in Slovenia on the basis of that domestic license. The home member state regulator has to notify the Bank of Slovenia of the intended operation of the bank in Slovenia.

The EU Member State Bank may operate in Slovenia directly by providing cross-border services or through a branch, which will be entered in the Slovenian Business Register.

The EU Member State Bank will continue to be subject to the supervision of its home member state regulator, but the Bank of Slovenia will monitor the conduct of its business and assist the home member state regulator in its supervision.

The EU passporting regime does not apply to foreign banks established in third countries, who may provide banking and financial services in Slovenia only through a branch, whereas authorization to establish a branch is required in case the bank is an entity from a third state. The authorization to establish a branch is issued by the Bank of Slovenia and includes the list of banking and financial services that can be offered by the respective branch.

2.4. What are the restrictions on ownership, including foreign ownership of banks?

Other than the request that all future qualifying holders must apply for authorization to acquire a qualifying holding (see Section 2.5.), there are no restrictions on foreign ownership of the banks in Slovenia on the level of banking regulation. Certain restrictions can nonetheless be imposed on the political level (e.g., restrictions due to sanctions against Russia). Restrictions also apply to shareholders from countries whose domestic laws would prevent the exercise of effective control over the bank. Banks with such ownership will not be able to obtain a banking license.

Potential restrictions on foreign ownership of banks can also result from the foreign direct investment screening regime. In 2020 the Act Determining the Intervention Measures to Mitigate and Remedy the Consequences of the COVID-19 Epidemic (ZIUOOPE; *Official Gazette of Republic of Slovenia, no. 80/20, as amended*) implemented foreign direct investment screening rules (FDI) in Slovenia. According to the ZIUOOPE, any entity from another EU Member State/third country that will acquire at least a 10% share in a Slovenian bank should notify the intended acquisition to the Ministry of Economic Development and Technology no later than 15 days from the signing of the agreement on the transfer of shares. The Ministry then carries out the screening procedure, in which they decide whether the FDI will be approved. If the FDI poses a threat to the security or public order in Slovenia, the FDI will be prohibited or canceled. In such a case, the agreement on the transfer of shares becomes null and void. However, there is no general rule as to specific countries or types of persons that could not be granted authorization. The current FDI regime applies until July 30, 2023.

2.5. What are the requirements for a proposed acquisition and acquirer of a qualified holding in a bank? Would the same requirements apply in the case of an increase of a qualifying holding?

Acquisition of a 'qualifying holding' in the banks requires prior approval based on the "fit and proper" assessment of the Bank of Slovenia (or the ECB, as applicable). Participation in a bank is deemed to be a "qualifying holding" when it represents 10% or more of the shares and/or voting rights in the bank or crosses other relevant thresholds (20%, 30%, or 50%). In addition, obtaining rights to appoint the (majority of) the management board or other means of providing significant influence over the management of the bank also falls within the scope of a "qualifying holding."

The Bank of Slovenia decides on the authorization based on the criteria laid down in Article 73 of the Banking Act (suitability criteria). The criteria for the assessment of the future

qualifying holders are harmonized at the EU level and aim (*inter alia*) to ensure that the qualifying holders:

(i) have a good reputation, whereby in this context the Bank of Slovenia takes into consideration also the reputation, knowledge, skills, and experience of all members of the management or supervisory bodies who will manage or otherwise influence the bank after the acquisition of qualifying holding,

(ii) have the necessary financial soundness that will allow the target bank to meet its prudential requirements, and

(iii) that the transaction leading to the acquisition of the qualifying holding is not financed with money derived from criminal activities nor does it increase the risk of money laundering.

In case the bank is supervised by the ECB, the Bank of Slovenia will preliminarily assess these criteria and make a Draft Decision. The notification of the qualifying holding and the Draft Decision will then be submitted to the ECB for final decision and the ECB will assess whether to approve or oppose the acquisition of the qualified holding. In case of approval, the future qualifying holder needs to acquire the qualified share (within the approved range of voting rights) within the time limit set by the authorization.

Each authorization for the acquisition of a qualified holding includes a range in the share of voting rights that may be acquired (e.g., from 10-20 %, 20% to 1/3 of voting rights, and so on). In case of an increase of a qualified holding, the qualified shareholder has to obtain a new authorization prior to acquisition. A new authorization is also required if the acquirer failed to acquire the shares within the time limit set by the authorization.

III. REGULATORY CAPITAL AND LIQUIDITY

3.1. How are banks typically funded in your jurisdiction?

Banks are normally funded through a combination of share capital supplemented by various items of tier 1 and tier 2 capital (see Section 3.2.)

3.2. What capital and own funds requirements apply to banks in your jurisdiction?

The minimum amount of a bank's initial capital is EUR 5 million and is determined in accordance with Article 12 of *Directive 2013/36/EU* (CRD).

The initial capital of the bank should include one or more common equity tier 1 items referred to in points **(a)** to **(e)** of Article 26(1) of *Regulation 575/2013/EU* (CRR). The initial capital thus includes **(a)** capital instruments (subject to conditions laid down in Article 28 or, where applicable, Article 29 of *Regulation 575/2013*), **(b)** share premium accounts related to the instruments referred to in point **(a)**, **(c)** retained earnings, **(d)** accumulated other comprehensive income and **(e)** other reserves.

Capital and own funds requirements in Slovene jurisdiction are laid down in the relevant provision of *Regulation 575/2013/EU* (CRR).

3.3. Has your jurisdiction implemented the Basel III framework? Are there any major deviations?

The EU Basel III regulatory capital framework has been implemented by the European Union by *Regulation 575/2013/EU* and *Directive 2013/36/EU* (CRD package), which respect the balance and ambition of the Basel III framework. Slovenian law follows the international standards adopted with the Basel III framework as implemented with the CRD package.

Slovenia has implemented and fully complies with the CRD IV/CRR framework, which reflects the Basel III standards. *CRD Directive 2013/36/EU* has been transposed into national law and *CRR Regulation (EU) No 575/2013* applies directly.

IV. REPORTING, ORGANISATIONAL REQUIREMENTS, INTERNAL GOVERNANCE, AND RISK MANAGEMENT

4.1. What key reporting and disclosure requirements apply to banks in your jurisdiction?

■ Financial statements and auditor's report

It is mandatory for banks to publish their annual report, together with the auditor's report, on their official website and submit their annual financial statements and audit reports to the Agency of the Republic of Slovenia for Public Legal Records and Related Services for its publication.

General rules applicable to books of account and annual reports of the bank are included in the Companies Act (ZGD-1; *Official Gazette of Republic of Slovenia, no. 65/09, as amended*) and in the law governing auditing. Banks are subject to the reporting provisions applicable to large companies and are thus obliged to audit their financial statements in accordance with the ZGD-1. According to the ZGD-1, banks should follow international accounting standards when preparing their financial statements. Annual financial statements of a bank shall include:

■ The Balance sheet,

■ The Income statement,

- The Notes to the financial statements,
- The Cash flow statement,
- The Statement of changes in equity,
- The Statement of other comprehensive income, and
- The Management report.

Members of the management body and supervisory body must jointly ensure that the annual reports, including the corporate governance statement and the statement of non-financial performance, are drawn up and published in accordance with the ZGD-1, the Slovenian accounting standards, and international accounting standards.

Banks are obliged to disclose financial information related to their financial statements to the Bank of Slovenia. A bank shall submit the following to the Bank of Slovenia within eight days of receiving the auditor's report, but no later than four months after the end of the calendar year:

1. The annual financial statement (and consolidated financial statement if applicable);

2. The auditor's report on the auditing of the (consolidated) annual financial statement; and

3. The additional auditor's report on the bank's compliance with risk management rules.

Banks must publish their annual reports together with the auditor's report on their websites within four months of the end of the calendar year (i.e., by the end of April each year following the relevant financial period) and must keep their annual reports on their websites for a minimum of a five-year period.

Additionally, parent banks with their seat in Slovenia that control one or more subsidiaries are obliged to publish consolidated reports. The obligation to prepare consolidated financial statements applies to companies with their seat in Slovenia, which are parent companies of one or more companies (subsidiaries) if the parent company or any subsidiary is organized as a limited liability company, dual company, or another similar legal form of the same kind under the law of the home country of that subsidiary. The consolidated annual financial statement must give a true and fair view of the financial position of all the companies in the group. The consolidated annual financial statement should be published on the same day as the annual financial statement of the parent bank.

- Other reporting obligations under the Banking Act

In addition, the banks in Slovenia have several reporting obligations under the Banking Act (ZBan-3), *Regulation 575/2013/EU*, and other legislation. For example, banks are required to report on payment transactions with foreign subjects, liquidity information, submit financial statements, etc. Reporting obligations apply to banks with their seat in Slovenia, which obtained a Banking License in accordance with the ZBan-3.

Banks report to the Bank of Slovenia in relation to compliance with ZBan-3. For example, banks are obliged to report on qualified holdings and significant circumstances, whereby significant circumstances means information that is to be entered into the Business Register by law, information on the summoning of the General Meeting and any resolutions adopted thereat, information on acquisition or disposal of shares, business holdings or membership rights in legal entities, information regarding ceasing to provide certain services/offer certain products and information on transactions with related parties. Significant circumstances also include information on corporate governance, own funds assessment, and other information indicating compliance or non-compliance with obligations under ZBan-3 and other rules.

Furthermore, banks report to the Bank of Slovenia regarding several requirements under *CRR Regulation 575/2013/EU*, e.g., on the exclusion of an entity from the scope of prudential consolidation, sub-consolidation, or payment of interim or year-end profits, etc. The Banks need to publish disclosures set out in part 8 of *CRR Regulation 575/2013/EU* on their official website.

The banks need to explain on their official website how they meet the requirements under applicable laws, regulations, and guidelines with regard to:

1. the bank's internal governance arrangements and organizational structure;

2. the policy for selecting members of the management body; and

3. the remuneration policy.

Furthermore, parent banks in the Republic of Slovenia need to annually publish information on the legal and organizational structure of the banking group, including a description of the internal governance arrangements, the arrangements with regard to close links, and the arrangements regarding the governance of subsidiaries on their official website or provide reference to the equivalent information in the line of the publication of the aforementioned description.

Key procedural steps regarding the reporting are governed by the Decision on the reporting of particular facts and circumstances by banks and savings banks (*Official Gazette of Republic*

of Slovenia, no. 115/21, as amended). The reporting is done online using a qualified electronic signature. The Decision on the reporting of particular facts and circumstances by banks and savings banks contains the prescribed reporting forms.

Banks that fail to comply with reporting obligations under the Banking Act (do not submit a report or report false information) can be fined for an offense. Fines for the said infringements range from EUR 25,000 to EUR 250,000.

■ Reporting obligations – AML

Banks also have a general obligation to report important information in accordance with the ZPPDFT-2 (please see our answer under Section 4.5.).

4.2. What are the organizational requirements for banks, including with respect to corporate governance?

The corporate governance and organizational requirements for banks are regulated by numerous regulations and recommendations. The fundamental rules referring to the corporate governance of banks are laid down in the Companies Act (ZGD-1) and the Banking Act (ZBan-3).

The Banking Act lays down basic principles and specific features of the organizational structure of banks. Banks in Slovenia can only be incorporated as joint stock companies (*delniska druzba*) or Societas Europaea (SE). The minimum share capital of a bank is EUR 5 million. The shares of a bank may only be issued as registered shares and may (normally) be paid up in cash only.

A bank may choose to have either a two-tier system of governance with a management board and a supervisory board or a one-tier system of governance with a board of directors. The management body of a bank should have at least two members, whereby no authorized representative of the bank (member of the management body or procurator) shall have the power to independently represent the bank with respect to all of its assets. Members of the management body and members of the supervisory board should obtain authorization from the Bank of Slovenia (as described below).

Assessment of the suitability applies to a member of the management body (management board or board of directors) and members of the supervisory board.

Members of the management body should first be approved by the supervisory board. When appointing a member of the management body, the supervisory board should issue a decision appointing a member of the management body (Decision). Such a Decision is subject to conditions related to submitting a request for a license and obtaining a license from the Bank of Slovenia. After the supervisory board gives the Decision, the candidate shall submit a request to obtain a license to the Bank of Slovenia (Request). The request shall be filed within 15 days of the Decision; otherwise, the Decision will be annulled. The Request shall include a business strategy and proof of eligibility, i.e., proof that the candidate has the knowledge, skills, and reputation needed to take up the position. As part of the evaluation process, the Bank of Slovenia may request an evaluation of the candidate from the bank or conduct an interview with the candidate. The Bank of Slovenia grants or refuses the license to a member of a management body based, depending on whether the eligibility criteria are met and whether the designation process was appropriate. The Bank of Slovenia may check if the member of the management body meets the eligibility criteria at any time during the term of office.

Appointment of members of the supervisory body is made in a similar manner. A member of the supervisory body should first be appointed by the general meeting of the bank (Decision of the General Meeting). The Decision of the General Meeting is subject to conditions related to submitting a request for a license and obtaining a license from the Bank of Slovenia. The candidate shall submit a request to obtain a license to the Bank of Slovenia (Request) within 15 days; otherwise, the Decision of the General Meeting will be annulled. The Request shall include the personal data of the candidate and proof of eligibility, i.e., proof that the candidate has the knowledge, skills, and reputation needed to take up the position. As part of the evaluation process, the Bank of Slovenia may request an evaluation of the candidate from the bank or conduct an interview with the candidate. The Bank of Slovenia grants or refuses the License based, depending on whether the eligibility criteria are met and whether the designation process was appropriate. The Bank of Slovenia may check if the member of the supervisory body meets the eligibility criteria at any time during the term of office.

In relation to banks supervised by the ECB in accordance with the rules of *Regulation (EU) 1024/2013*, the ECB shall decide on the granting of these licenses. The Request should be made to the Bank of Slovenia, but the procedure will be conducted in accordance with the Regulation.

4.3. What are the local rules for loans to the management body and their related parties?

The general rules on granting loans to the members of the management body are governed by the Companies Act (ZGD-1). In principle, it is permitted to grant loans to the members of the management body and their related parties subject to some limitations laid down in the Companies Act. A loan may be granted only based on a decision of the supervisory board/

board of directors (hereinafter: Decision). The Decision should include all basic information on the loan (e.g., type of interest rate, repayment term, etc.). Any loans granted without the Decision shall be immediately returned to the bank unless the supervisory board/board of directors adopts a Decision afterward. The same rules apply to loans granted to family members or companies owned by the management body member. Granting a loan to a member of the management body and/or their related party should not impair the bank's share capital and tied-up reserves. Any loan given to a member of the management body or their related party that infringes the latter shall be null and void. Loans to the member of the management board shall not be given on terms more favorable than those normally offered by the bank to other persons, except in case of objectively justified reasons.

The Banking Act (ZBan-3) provides additional rules on transactions between banks and their related parties (including members of the bank's management body, supervisory body, and members of their close family) that should be taken into account:

- Banks have to keep a register of their related parties and ensure that data on exposures to these persons are adequately documented. Banks are obliged to provide this information to the Bank of Slovenia or the ECB upon request;

- Banks should set conditions and restrictions for exposures to their related parties, establish exposure monitoring and management and determine any possible exceptions to these policies;

- Banks may not enter into transactions with related parties on terms that are more favorable than those normally offered by the bank to other parties, except where there are objective reasons for doing so, especially if the related party is being restructured. If doing so, the bank is obliged to inform the Bank of Slovenia or the ECB thereof;

- The approval of the Supervisory Board is required for transactions with related parties: **(i)** if, as a result of that transaction or the aggregate value of all transactions, the bank's total exposure to that related party, including indirect exposure, reaches or exceeds EUR 100,000, and for each subsequent transaction that increases the bank's total exposure to that related party by a further EUR 100,000, and **(ii)** if the transaction with the related party is concluded on terms more favorable than those normally offered by the bank to other parties due to objective reasons;

- Amounts of the loans given to the members of management bodies need to be disclosed in the annex to the bank's financial statement.

4.4. What are the main legal provisions governing risk management in the banking sector in your jurisdiction?

The main legal provisions governing risk management are laid down in the Banking Act (ZBan-3), *Regulation 575/2013/EU* (as amended with *Regulation (EU) 2019/876*), and several implementing regulations adopted by the Bank of Slovenia. Risk management is also governed by several regulatory technical standards, guidelines, etc.

Banks should take into account significant market risks when assessing and providing adequate capital. Banks must set up a specific risk management function and give it sufficient powers so that it is able to implement the tasks they have by law. The function must be separate from other functions and the function holder shall be independent and report directly to the management body. Risk management is the responsibility of the management board and the supervisory board. Banks should put in place an effective internal system to ensure that these bodies are informed of risks immediately. They should implement, *inter alia*, appropriate policies addressing credit, market, securitization, and liquidity risk. Banks should regularly carry out risk assessments.

The Bank of Slovenia may impose higher capital requirements on a certain bank that bears a higher level of risk in the course of its business. The Bank of Slovenia also sets requirements for the maintenance of capital buffers to prevent or limit macro-prudential and systemic risk, in accordance with ZBan-3.

4.5. What are the legal requirements applicable to banks in combating money laundering and terrorist financing area?

The ZPPDFT-2 applies to all banks established in Slovenia as well as Slovenian branches of third states banks and EU Member States banks. In order to comply with the ZPPDFT-2 banks need to carry out risk assessments, adopt internal measures to ensure the prevention of money laundering, appoint a compliance officer, keep records, etc.

Banks should also carry out customer due diligence. Customer due diligence should be conducted, *inter alia*, for transactions that exceed EUR 15,000, for suspicious transactions, etc. In the course of customer due diligence, banks should identify the party's true identity as well as the identity of the beneficial owners of the party. According to the ZPPDFT-2 banks are prohibited from engaging in certain transactions that pose a risk of money laundering, e.g., banks shall not offer anonymous accounts, savings books, or safes, and shall not engage in shadow banking. The ZPPDFT-2 also restricts cash transactions between subjects (transactions exceeding EUR 5,000 shall not be made in cash). Banks are obliged to report to the AML Office on any cash transactions that exceed EUR 15,000.

Banks have a reporting obligation to the AML Office and in accordance with this reporting obligation, banks should notify the AML Office of large cash transactions, unusual transactions (e.g., transactions related to high-risk countries), and suspicious transactions. Suspicious transactions are transactions with respect to which there exists a risk that they are connected to money laundering. In order to indicate suspicious transactions banks should make a list with possible indicators that point to potential money laundering.

4.6. Are there any legal provisions regulating banking secrecy in your jurisdiction?

Yes. Bank secrecy is governed by chapter 5.5 of the Banking Act (ZBan-3). The ZBan-3 determines the meaning, use, and protection of confidential data of the clients. ZBan-3 defines confidential data as any data, facts, and circumstances about the individual client in the bank's possession. Banks have a general obligation to protect confidential data regardless of the means by which they obtained that information. In some cases, banks are obliged to share the data with national authorities, e.g., banks shall submit the data if requested by the Bank of Slovenia or the ECB. Banks may also share confidential data with the police or prosecutor's office when they report a crime.

V. TRENDS

5.1. What are the main trends in the banking sector in your jurisdiction?

The number of credit institutions in Slovenia has been falling in recent years and this trend will presumably continue. For several years, there has been a trend of acquisitions of smaller banks by larger ones. The concentration in the Slovenian banking system is thus gradually increasing.

The banking sector has also undergone a digitalization of its business. Digitalization is one of the main trends and goals in all Slovenian banks. The COVID-19 crisis has visibly accelerated the digitalization of the bank's operations; there has also been a rise in mobile banking. In recent years, banks have been closing smaller premises due to the increasing use of mobile banking. It is also expected that this trend is going to continue in the following years. Banks in Slovenia are increasingly focusing on sustainable development and are focusing on addressing environmental, social, and governance challenges in this area.

Another trend in the banking sector is the expansion of the range of services offered by banks. Slovenian banks tend to offer a wider range of financial products. However, in general, Slovenian banks still offer mostly basic banking services and do not offer services beyond traditional banking.

5.2. What are the biggest challenges in the banking sector at the moment?

Slovenian banks face several structural challenges, such as:

- finding profitable business models,
- adapting to the technological challenges that are changing the competitive environment, and
- successful implementation of environmental changes to maintain a presence in a changing market.

Slovenian banks will have to effectively respond to these challenges, otherwise, we cannot expect the banks to catch up and keep up with the competitors from other EU countries.

The banking sector also faces challenges due to geo-political uncertainty, the vulnerability of the economy to a possible recession, potential liquidity outflows, a deterioration in the outlook for interest rates, and regulatory and other tax measures affecting banks. Slovenian banks have managed to reduce the number of NPLs despite the COVID-19 crisis. However, due to the outbreak of the war in Ukraine, the banking sector in Slovenia again faces increased macroeconomic risk and credit risk.

5.3. What's new in fintech?

The Bank of Slovenia has set up a special website called the Fintech Innovation Hub. The Fintech Innovation Hub enables the exchange of information related to innovative business models and provides clarification of regulatory requirements. It targets business entities planning to provide solutions based on financial technologies (fintech) and that are interested in which regulatory requirements they will need to fulfill if they provide such services in Slovenia or within the European Economic Area.

Market entities that develop innovative financial solutions based on advanced technologies may participate at the Fintech Innovation Hub and address their queries regarding regulatory requirements to the Bank of Slovenia. In order to ensure the neutral role of the Bank of Slovenia, no specific advice related to business entities' innovative services can be provided.

According to the Bank of Slovenia, alternative methods of payment, services related to crypto assets, blockchain and DLT technologies apps, crowdfunding, regulatory technologies, etc. are the most common business models considered in its Fintech Innovation Hub. In general, companies offering cryptocurrency exchange, custody, and trading services are not regulated and do not need a license from the Bank of Slovenia to carry out these activities. There is no general law that would regulate fintech. However, certain services in the field

of fintech may fall within the definition of payment services and are therefore regulated in accordance with ZPlaSSIED and the *Payment Services Directive*. In such cases, the fintech service providers will have to obtain authorization from the Bank of Slovenia.

Several foreign fintech companies are offering their services in Slovenia. However, there is also a rise in Slovenian fintech companies offering, inter alia, peer-to-peer financing, installment payments via platforms, etc. Slovenian banks normally offer only basic banking and financial services and are (for now) not included in offering services beyond traditional banking (fintech). These services are currently provided by other market players.

Slovenian AML Office keeps a Register of virtual currencies services providers in accordance with the ZPPDFT-2. The aim of the register is to supervise activities connected to money laundering and financing of terrorism in this sector. In December 2022, 17 companies were registered with the Register of virtual currencies services providers.

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I. LEGAL FRAMEWORK

1.1. Which main legislative and regulatory provisions govern the banking sector in your jurisdiction?

The *Banking Law No. 5411* (BankL.) is the primary legislation governing the banking sector. Other main legislations are as follows:

- The *Capital Markets Law No. 6362*
- The *Bank Cards and Credit Cards Law No. 5464*
- The *Law No. 6493 on Payment and Security Settlement Systems, Payment Services, and Electronic Money Institutions*
- The *Financial Leasing Law No. 3226*
- The *Law on the Central Bank of Turkey No. 1211*
- The *Mortgage Law No. 5582*
- Applicable tax laws

Additionally, the Banking Regulation and Supervision Agency (BRSA), the Central Bank of Turkey (CBT), and the Capital Markets Board (CMB) have the authorization to issue secondary legislation regarding the banking sector.

1.2. Which bodies are responsible for enforcing the applicable laws and regulations? What are their main competencies?

According to Article 1 of the BankL., the purpose of the BankL. is to determine the procedures and principles for ensuring confidence and stability in financial markets, effective functioning of the credit system, and the protection of the rights and interests of the ones who deposit. In this respect, in accordance with Article 82 of the BankL., the BRSA, which was established to fulfill the aforementioned purpose as a public entity, has administrative and financial autonomy, and will independently fulfill and carry out the duties and powers related to regulation and supervision assigned to it by the BankL. and related legislation. Furthermore, it is also stipulated under the same article that the decisions of the BRSA cannot be subject to a review of expediency and no authority or person is authorized to give orders or instructions to affect the decisions of the BRSA.

The BRSA is generally responsible for the supervision, regulation, operation, and authorization of the establishment of banks operating in Turkey, foreign banks' branches in Turkey, financial leasing companies, factoring companies, financial holding companies, and asset management companies. Additionally, the BRSA is also responsible for authorizing independent audit companies as well as valuation and rating organizations that provide services to banks or financial holding companies.

Additionally, pursuant to Article 6 of the *Regulation of the Organization of the Banking Regulation and Supervision Agency* dated March 16, 2014, the Banking Regulation and Supervision Board (BRSB) is established as the decision-making body under the BRSA. The BRSB adopts secondary legislation in line with the international principles and standards related to the sector or field that the BRSB is responsible to regulate and supervise. The BRSB is also responsible for providing suggestions to the strategic plans of the BRSA, goals, and objectives as well as its human resources and labor regulations for the BRSB's organizational divisions according to Article 7 of the Regulation of the Organization of the Banking Regulation and Supervision Agency.

1.3. What are the current priorities of regulators and how does the regulator engage with the banking sector?

Digital transformation accelerated globally, including in Turkey, especially after 2020. The banking industry is among those most impacted by this transformation. One of the biggest transformations in the banking sector is the digitalization of traditional banks to provide branchless banking services to their customers. In this respect, the BRSA published the *Regulation on the Operating Principles of Digital Banks and Banking as a Service Model* on December 29, 2021, to set out the principles applicable to branchless banking in Turkey.

The adoption of the electronic lira is another innovation in the Turkish banking sector. Within this framework, there are regulations and decisions issued by the BRSA which support the development of electronic lira issuance. For instance, under Turkish Law, *Law No. 6493 on Payment and Securities Settlement Systems, Payment Services and Electronic Money Institutions* (Law No.6493) was published on June 27, 2013, in order to regulate the supervision and activities of legal entities qualified as electronic money institutions. In addition to *Law No. 6493*, the *Regulation on Payment Services and Electronic Money Issuance, Payment Service Providers* dated December 1, 2021, the *Communique on the Management and Supervision of the IT Systems of Payment and Electronic Money Institutions and the Data Sharing Services of Payment Service Providers in Payment Services Area* dated December 1, 2021, and the *Communique on Amendment to the General Communique of the Financial Crimes Investigation Board* dated January 14, 2023, also fall under the relevant legislation.

II. AUTHORISATION

2.1. What licenses are required to provide banking services in your jurisdiction? What activities do they cover?

Under the Turkish banking sector, there are three types of banks that may be established as per the BankL.: **(i)** deposit bank, **(ii)** participation bank, and **(iii)** development and investment bank. The BankL. provides for a dual license system for the establishment and operation of all three types of banks. Accordingly, the establishment license is the first license to be obtained from the BRSA in accordance with Article 6 of the BankL. In this respect, the conditions must be fulfilled in accordance with Article 7 of the BankL. to acquire an establishment license are as follows:

- being established as a joint stock company,
- shares should be issued for cash and must be registered,
- requirements regarding the founders under Article 8 (as also stated under Section 2.4.) must be fulfilled,
- members of the board of directors (Board) shall bear the qualifications set out in the corporate governance provisions in the BankL. and shall have the professional experience required for carrying out the planned activities,
- envisaged fields of activity shall be in harmony with planned financial, managerial, and organizational structure,
- paid-up capital, consisting of cash and free of all kinds of collusion, should not be less than TRL 30 million,
- articles of association shall not conflict with the provisions of the BankL.,
- having a transparent and open partnership structure and organizational chart that will not constitute an obstacle to the efficient supervision of the institution,
- should not be any element that may prevent its consolidated audit,
- the work plans for the envisioned fields of activity, the projections regarding the financial structure of the institution including capital adequacy, the budgetary plan for the first three years, and an activity program including internal control, risk management, and internal audit system showing the structural organization must be submitted.

The application process and procedures for the afore-mentioned license are regulated in detail under the *Regulation on the Indirect Shareholding and Transactions Subject to Permission of Banks* (License Regulation). Accordingly, pursuant to Article 6 of the BankL., at least five affirmative votes of the members of the BRSB are required in order to be authorized for the establishment.

Secondly, as per Article 10 of the BankL., a bank that has been granted an establishment license must also obtain an operating license from the BRSA to provide banking services. Pursuant to Article 10 of the BankL., the operating license covers all activities stipulated under Article 4 of the BankL. unless otherwise decided upon by the BRSA. In this respect, Article 4 of the BankL. lists the following activities as the ones that can be carried out by banks:

- Accepting deposits and participation funds,
- Granting any sort of loan, either cash or non-cash,
- Carrying out any type of payment and collection transactions, including cash and deposit payment and fund transfer transactions, correspondent bank transactions, or use of check accounts,
- Safe-keeping services,
- Issuing payment instruments such as credit cards, bank cards, and travel checks, and executing relevant activities,
- Carrying out foreign exchange transactions, trading of money market instruments, trading of precious metals and stones, and safekeeping such,
- Trading and intermediation of forward, future, and option contracts, simple or complex financial instruments which involve multiple derivative instruments, based on economic and financial indicators, capital market instruments, goods, precious metals, and foreign exchange,
- Purchase and sale of capital market instruments and repurchasing or re-sale commitments,
- Intermediation for issuance or a public offering of capital market instruments,
- Transactions for trading previously issued capital market instruments for intermediation purposes,
- Guarantee transactions like undertaking guarantees and other liabilities in favor of other persons,
- Investment counseling services,
- Portfolio operation and management,
- Primary market dealing for purchase-sales transactions within the framework of liabilities assumed by contracts signed with the Ministry of Treasury and Finance and/or the CBT and associations of institutions,

■ Factoring and forfeiting transactions,

■ Intermediating fund purchase-sale transactions in the inter-bank market,

■ Financial leasing services,

■ Insurance agencies and individual private pension fund services and other activities are to be determined by the BRSB.

Moreover, depending on the type of bank, certain transactions that are mentioned in Article 4 of the BankL. are restricted to the bank in question. Accordingly, deposit banks cannot accept participation funds and engage in financial leasing services while participation banks cannot accept deposits, as they only accept participation funds. Additionally, development and investment banks cannot accept deposits or participation funds.

In addition to the above-mentioned, banks are additionally required to obtain a license from the CMB according to Article 39 of the *Capital Markets Law No. 6362* for the following activities: **(i)** receipt and transmission of orders in relation to capital market instruments, **(ii)** execution of orders in relation to capital market instruments in the name and on behalf of the customer or in their own name and in the account of the customer **(iii)** purchase and sale of capital market instruments for its own account, **(iv)** safekeeping and administration of capital market instruments in the name of the customer and portfolio custody services.

2.2. What is the procedure for obtaining a banking license? How long does this typically take?

According to Article 7 of the License Regulation, banks are required to apply for an operating license within nine months following the publication of the BRSB decision on the establishment license in the Official Gazette. The application is made by submitting the relevant statement to the BRSA. According to Article 10 of the BankL., the following conditions are required for the granting of an operating license:

■ The capital of the bank should have been paid in cash and must be at a level that enables the execution of planned activities,

■ A minimum one-fourth of the system entrance fee, equivalent to ten% of the minimum capital requirements indicated in Article 7 of the BankL., should have been paid to the account of the Savings Deposit Insurance Fund (SDIF) and the related document submitted to the BRSA by the founders,

■ Their activities should follow corporate governance provisions and should have the required personnel and technical infrastructure,

■ Their managers should bear the qualifications set out in the corporate governance provisions,

■ The BRSA should conclude that they bear the qualification required for executing the activities.

The BRSA conducts the evaluation regarding the operating license in line with Article 7 of the License Regulation and grants operating licenses to the approved applications within three months from the date of the first license application according to Article 10 of the BankL. The licenses granted become effective upon their publication in the Official Gazette.

2.3. Can a foreign bank operate in your jurisdiction on the basis of its domestic license?

The banks established abroad cannot operate in Turkey based on only their domestic license. Such banks may carry out banking activities in Turkey by only:

■ establishing a bank headquartered in Turkey and incorporated under Turkish law;

■ opening a branch in Turkey; or

■ opening a liaison office in Turkey

If the founders of the bank to be established in Turkey are a bank or financial institution established abroad, general conditions stipulated under Article 6 of the BankL. regarding establishment license and other related articles apply (Please see Section 2.1. for further information). Pursuant to Article 4 of the License Regulation, such founders must submit additional documents with the application for establishment permission including audited financial reports of the foreign shareholder and its affiliated companies, for the latest five years; statements issued by their authorized authority, proving that they are not restricted from banking activities or from accepting any participation funds in their resident country; detailed information and documents on their organizational structure; minutes and memoranda of their last general assembly meeting, and a list of their partners holding more than ten% of their capital, approved by official authorities of the country they are headquartered and as such.

A bank established abroad that will open its first branch in Turkey must meet the requirements related to the establishment stipulated under Article 9 of the BankL and if the required conditions under Article 9 are fulfilled such as its primary activities not have been prohibited in the country where they are headquartered and its paid-in capital reserved for Turkey being no less than TRL 30 million, a decision on the establishment permission is granted upon the affirmative votes of at least five members of the BRSA. If a foreign bank has already opened its first branch and desires to open its second branch, with reference to Article 13 of the License Regulation,

Article 8 of the BankL. regarding the establishment of branches in Turkey applies. For detailed information on operating licenses please see our explanations under Section 2.1.

As provided in Article 6 of the BankL., banks established abroad may also establish liaison offices in Turkey with the prior permission of the BRSA. Article 10 of the License Regulation sets out the conditions for opening a liaison office. In this framework, Article 4 of the *Communique on the Principles and Procedures for the Activities of Representative Offices Opened in Turkey* published in the Official Gazette dated April 1, 2008, provides activities that the representative offices can carry out as follows:

- Publicity of the bank and the services granted by that bank under which the representative office is operating,
- Strengthening the relations with credit institutions or financial institutions established in Turkey, and
- Conducting market research and reporting the data collected to the headquarter.

As per Article 10 of the License Regulation, the liaison offices cannot accept or collect deposits or participation funds, make credit cards available, or perform or mediate any other banking operation determined under Article 4 of the BankL.

2.4. What are the restrictions on ownership, including foreign ownership of banks?

Article 8 of the BankL. stipulates the required qualifications of the founding shareholders of a bank as follows:

- Not being bankrupt, not being in possession of a certificate of bankruptcy, not having an approved application for restructuring through reconciliation, or not being issued a decision for postponement of bankruptcy,
- Not holding qualified shares and not having control in banks that are subject to Article 71 of the BankL. such as banks whose operating license was revoked or transferred to the SDIF or banks that were transferred to the SDIF before the entry into force of the BankL.
- Not holding qualified shares or control in a stock broker subjected to liquidation, and in other financial institutions subject to liquidation, excluding voluntary liquidation, in development and investment banks whose operating licenses have been revoked, or in credit institutions whose shareholder rights except dividends and management and control have been transferred to the SDIF or whose permission to conduct banking transactions and accept deposits and participation funds have been revoked, prior to the transfer of aforementioned credit institutions to the SDIF or prior to their license and authorization for accepting deposit and participation fund have been revoked,
- Not having been convicted of the offenses stipulated in Article 8 of the BankL. such as embezzlement, extortion, bribery, theft, swindling, forgery, breach of trust, fictitious bankruptcy,
- Having the necessary financial strength and reputation,
- Having the integrity and competence required for the business,
- In the case of a legal entity, the risk group and its shareholding structure should be transparent and clear.

These conditions are also required for the real person shareholders who directly or indirectly hold qualified shares of the legal entity who is a founding shareholder of the bank (Article 8 of the BankL.) (For detailed information on qualified shares, please refer to Section 2.5.).

Article 3 of the *Foreign Direct Investment Law No. 4875* dated June 5, 2013, which regulates the procedures and principles regarding foreign investments, stipulates that foreign investors shall be treated equally with domestic investors. Accordingly, there are no special restrictions on foreign ownership under the BankL. This being the case, foreign entities such as financial institutions and banks are required to submit certain additional documents in their application for establishment permission pursuant to Article 4 of the License Regulation (for detailed information, please refer to Section 2.3.)

2.5. What are the requirements for a proposed acquisition and acquirer of a qualified holding in a bank? Would the same requirements apply in the case of an increase of a qualifying holding?

Qualified shares are defined by BankL. as shares that directly or indirectly represent 10% or more of the capital or voting rights of a corporation, and shares that give the privilege to appoint members to the BoD regardless of their share percentage.

Accordingly,

- any acquisition of shares of the bank that result in the acquisition by one person directly or indirectly of shares representing 10% or more,
- acquisition of shares that result in one shareholder holding directly or indirectly shares exceeding 10%, 20%, 33%, or 50% of the capital,
- transfers of shares that result in the shares held by a shareholder falling below the above-mentioned ratios, and

- assignment, transfer, or issuance of privileged shares granting the right to appoint members to the Board or audit committee,

are subject to the permission of the BRSB pursuant to Article 18 of the BankL. The documents listed in Article 11 of the License Regulation must be attached to the applications to be made to the BRSA regarding these acquisitions and transfers. In the case that a bank or a financial institution wishing to acquire the shares is established abroad, documents that must be submitted consist of documents set forth in Article 11 of the License Regulation including their business plans analyzing the benefit expected from the acquisition of shares, and describing which operations and activities will be carried out, and how internal audit, internal control, and risk management will be conducted, as well as an activity program indicating the structural organization of the bank, and describing the goals and targets of share investment, for three years following the date of purchase of shares; their articles of association; copies of decisions taken by authorized managerial bodies of them certifying the acquisition of capital shares of one of the existing banks; and their balance sheets and profit and loss statements and independent audit reports of the last five years and as such.

Shareholders holding qualifying shares must meet the qualifications required for founders of the bank set forth in Article 8 of the BankL. (Please refer to Section 1.4. for conditions required for founders).

There is no special regulation for the increase of qualified shares. Therefore, the general rule for capital increase which is Article 17 of the BankL. also applies to the increase of qualified shares. Pursuant to Article 17 of the BankL., capital increases must be paid in cash, free from all kinds of collusion, without resorting to internal resources (except for the resources permitted by the relevant legislation).

III. REGULATORY CAPITAL AND LIQUIDITY

3.1. How are banks typically funded in your jurisdiction?

Depending on the type of bank, different resources may be used by banks. For instance, deposit banks basically increase their resources by collecting deposits and providing credit support to individuals and institutions. In other words, deposits are the primary source of the funds used. Bonds, cash certificates, and other instruments are also issued by banks to raise funds. The main capital source of development and investment banks is the funds obtained from the capital market. Moreover, investment banking encompasses more than just lending money to investors. It provides their customers with all types of technical assistance, consulting, financial consulting, and financial providing engineering services, extending loans, performing mergers and privatizations, leasing, factoring transactions, and conducting market research. Lastly, since the participation banks carry out all their banking activities in accordance with the principles of interest-free banking, "the profit share" to be paid to the customer is generated as a result of the use of the funds collected in the pool. For example, the bank buys the goods that the customer needs in advance from the seller, adds the profit on it, and sells it to the customer on a deferred basis. A purchase and sale contract are drawn up between the customer and the bank. For this reason, there is a commodity in return for the funds used.

3.2. What capital and own funds requirements apply to banks in your jurisdiction?

A deposit bank must have a minimum of TRL 30 million in fully paid-in capital, as stated in Article 7 of the BankL. For development and investment banks, the minimum paid-in capital threshold is set at TRL 20 million.

Banks must keep some of the funds they collect in cash or easily convertible assets. Some of these assets are accounts held at the CBT. On the other hand, free reserves refer to reserves that banks are not required to hold. These are the reserves that banks choose to retain in order to cover unexpected deposit outflows and assess lucrative investment opportunities. In this respect, banks' reserves are the sum of required reserves and free reserves.

3.3. Has your jurisdiction implemented the Basel III framework? Are there any major deviations?

It is worth mentioning the implementation of *Basel II* to explain the relationship between Turkey and the application of Basel III since Turkey actively participated in the preparation of the *Basel II* criteria. More clearly, the BRSA prepared opinions on the draft texts of the criteria and conducted the third numerical impact study with 6 banks, and hosted the final meeting. Additionally, to fully implement the criteria, a committee has been established within the BRSA for the implementation of Basel II. Following the US-originated 2008 financial crises, Basel III was published to eliminate the inadequacies of *Basel II* and to introduce new approaches to prevent crises and minimize damage. Basel III has brought new regulations on capital increasing, creating leverage ratios, liquidity-related regulations, and the creation of cyclical capital buffers. In order to implement Basel III, a number of new regulations and amendments were introduced in Turkey. In this line, the *Regulation on Equity of Banks* dated September 5, 2013, and the *Amendment on the Regulation on Measurement and Assessment of Capital Adequacy of Banks* dated February 4, 2022, came into force. Therefore, it is stated that the Turkish banking system is generally compatible with the criteria introduced

by Basel III. Due to the pandemic that emerged in 2020 and economic problems, the transition to the implementation of *Basel IV* still continues.

IV. REPORTING, ORGANISATIONAL REQUIREMENTS, INTERNAL GOVERNANCE, AND RISK MANAGEMENT

4.1. What key reporting and disclosure requirements apply to banks in your jurisdiction?

Pursuant to Article 37 of the BankL., banks are obliged to account for all their transactions in accordance with the accounting and financial reporting standards published by the Public Oversight, Accounting, and Auditing Standards Authority and to disclose their financial reports in a clear and auditable manner to meet the need for information. Accordingly, banks are required to issue a year-end financial report and interim period financial reports in accordance with Article 10 of the *Regulation on the Procedures and Principles for Accounting Practices and Retention of Documents by Banks* dated November 1, 2006 (Accounting Regulation):

- Year-end financial report: Banks are obliged to submit their year-end consolidated and unconsolidated financial reports to the BRSA and Banks Association of Turkey and the Participation Banks Association of Turkey (Associations of Institutions) electronically and announce their year-end consolidated and unconsolidated financial statements in the Official Gazette by the end of April following the relevant year (Article 14 of the Accounting Regulation). The Associations of Institutions are required to publish the year-end financial report and interim financial reports of each bank submitted to them on their website.

- Interim period financial reports: Banks must submit their unconsolidated interim financial reports to be drawn up as of the end of March, June, and September to the BRSA and the Associations of Institutions electronically within 45 days and the consolidated ones within 75 days of the end of the related months (Article 14 of the Accounting Regulation).

In this respect, banks publish their year-end financial reports and interim period financial reports on their websites so that they are openly accessible for at least the previous five years according to Article 14 of the Accounting Regulation.

Additionally, copies of the financial statements and profit and loss statements to be prepared as of the end of each month and other additional information and explanations to be requested by the BRSA must be sent by banks to the BRSA within 30 days following the relevant period as per Article 14 of the Accounting Regulation.

The year-end financial reports to be submitted by banks to their general assembly are subject to independent audit in accordance with Article 39 of the BankL. In this context, pursuant to Article 4 of the *Regulation on Independent Audit of Banks* dated April 2, 2015 (Independent Audit Regulation), which sets out the procedures and principles regarding the independent audit of banks, banks are obliged to have an interim independent audit as of the end of March, June, and September and an annual independent audit as of the end of the accounting period (Article 4 of the Independent Audit Regulation). Banks are required to send such independent audit reports to the BRSA and the CBT within the time periods specified in Article 4.

Furthermore, pursuant to Article 31 of the BankL., banks are obliged to report their risk policies in accordance with the principles determined by the BRSA (Please see Section 4.4. for more details). In addition, the internal audit report to be prepared by the internal audit unit or authorized inspectors within the scope of internal audit activities shall be submitted to the Board at least quarterly by the audit committee (Article 32 of the BankL.).

4.2. What are the organizational requirements for banks, including with respect to corporate governance?

As provided for in Article 22 of the BankL., banks are obliged to comply with the corporate governance structures and principles to be determined by the BRSA in consultation with the CMB and the Associations of Institutions. In this regard, the *Regulation on Corporate Governance Principles of Banks* (Corporate Governance Regulation) dated November 1, 2006, has been published by the BRSA to specify the policies regarding the corporate governance of banks.

According to the provisions of the BankL. and the Corporate Governance Regulation regarding the organizational structure of banks, banks are required to have the following:

- Board
- General manager and deputy general manager
- Audit committee
- Credit committee
- Remuneration committee
- Corporate governance committee (in line with the Corporate Governance Regulation)
- Compliance officer and compliance unit (in line with the Regulation on Program of Compliance with the Obligations of Anti-Money Laundering and Combating the Financing of

Terrorism (AML/CTF Compliance Regulation))

■ Internal control, internal audit, and risk management units (in line with the Regulation on Internal Systems and Internal Capital Adequacy Assessment Process of Banks (Internal Systems Regulation))

In the scope of BankL., the managers of the bank consist of the chairman and members of the Board, audit committee and credit committee, the general manager and deputy general manager(s) as well as employees who have signing authority including regional managers, etc. The qualifications that such management bodies should possess can be listed as follows:

■ Board (Article 23 of the BankL.): The Board must consist of at least five members, including the general manager, who is a natural member of the Board. Half of the members of the Board plus one member must possess the qualifications required for a general manager in Article 25 of the BankL., such as educational background and professional experience. Also, the chairman of the Board and the general manager of the bank must be different persons. In addition, the members of the Board are required to have the first four qualifications specified in Article 8 of the BankL regarding the founders of the bank (Please see Section 2.4. for further information).

For the banks established abroad, it is foreseen to establish a board of managers in their main branch office in Turkey, which will be considered as the Board in the application of the BankL. This board should consist of three members who shall meet the conditions stipulated in Article 23 of the BankL. for the members of the Board and shall have the same authority and responsibility as the Board. Upon election or appointment, the members of the Board and the board of managers of the bank shall take office by taking an oath before the local commercial court (Article 27 of the BankL.).

■ Audit committee (Article 24 of the BankL.): The audit committee, which is tasked with assisting the Board in its oversight and audit activities, should consist of at least two members to be appointed from among the members of the Board who do not have executive duties. Members of the audit committee shall bear the qualifications foreseen by Article 6 of the *Internal Systems Regulation* such as including for the last two years prior to the date of appointment, not having been employed by the bank or its consolidated partnerships; not having been partners or employees of the institutions performing independent audit or rating or valuation of the bank or its partnerships subject to consolidation or of foreign entities which are legally affiliated with the said institutions, and not having taken part in the process of independent audit, rating or valuation; not being a qualified shareholder in the bank and/or its consolidated affiliates and subsidiaries, not having been partners or employees of the institutions providing consultancy or support services to the bank and/or its consolidated affiliates and subsidiaries, or among persons providing such services; not being spouses, or relatives by blood or by marriage of up to (and including) the second degree, of the controlling shareholder, the executive directors or the CEO; not having served on the audit committee of the same bank for a period in excess of nine years intermittently or permanently; not receiving any remuneration or similar income under any name whatsoever from the bank and/or its consolidated affiliates and subsidiaries, based on its or their profitability, except for payments made to all personnel out of profit under the articles of association or a resolution of the general assembly of shareholders; having received education at the undergraduate level as a minimum and having a minimum of ten years-experience in banking or finance; not having duty in another commercial institution other than the ones mentioned in Article 6 of the *Internal Systems Regulation*.

■ General manager and deputy general managers (Article 25 of the BankL.): Bank general managers and bank deputy general managers must meet the educational background and professional experience requirements stipulated in Article 25 of the BankL.

Accordingly, general managers of banks are required to:

- have at least a bachelor's degree in law, economics, finance, banking, business administration, public administration, or equivalent fields, and those who have a bachelor's degree in engineering must have a graduate degree in the specified fields;
- have at least ten years of professional experience in banking or business administration.

Deputy general managers of banks are required to:

- have at least an undergraduate degree in law, economics, finance, banking, business administration, public administration, or equivalent fields
- have at least seven years of professional experience.

Pursuant to Article 26 of the BankL., the general manager and the deputy general managers are required to have the first four qualifications specified regarding the founders of the bank (Please see Section 2.4. for further information).

4.3. What are the local rules for loans to the management body and their related parties?

Pursuant to Article 50 of the BankL., banks cannot **(i)** grant cash or non-cash loans to; or **(ii)** purchase bonds or similar securities to its members of the Board, the general manager, deputy general managers, and employees authorized to extend loans; their spouses and children and enterprises which they individually or jointly own 25% or more of the capital; and its

other employees as well as their spouses and children.

However, as per Article 50 paragraph 5 of the BankL., the above-mentioned restriction does not apply to Board members and bank employees as well as their spouses and children if the loan amount given does not exceed five times their monthly net remuneration. Moreover, checkbooks or credit cards could be issued amounting to up to three times the sum of their monthly net remuneration.

Another restriction under Article 51 of the BankL. regarding extending loans is based on the accountability of employees who are authorized to extend loans. According to the said restriction, they cannot participate in the evaluation and decision-making stages of loan transactions to which they, their spouses, and children are parties; and are obliged to inform the audit committee of this matter in writing.

Other procedures and principles regarding the loans to be extended within this scope are set out in the Regulation on Loan Operations of Banks dated November 1, 2006.

4.4. What are the main legal provisions governing risk management in the banking sector in your jurisdiction?

Banks are obliged to create, implement, and report risk policies in accordance with the principles to be determined by the BRSA for risk management under Article 31 of the BankL. Accordingly, the *Internal Systems Regulation* has been issued by the BRSA to determine the procedures and principles regarding risk management systems. According to Article 37 of the Internal Systems Regulation, risk management activities consist of timely and comprehensive identification, measurement, monitoring, control, and reporting of the risks exposed to a consolidated/unconsolidated basis and the risks arising from the transactions carried out with the risk group of the bank. The risk group of a bank consists of the bank's qualified shareholders, directors, general manager, assistant general managers, and its executives working in job positions equivalent or superior to the ones listed above in terms of their powers and job duties, even if actually employed with other job positions, and their spouse and children, and the partnerships or corporations controlled by them directly or indirectly, jointly or alone, or participated by them with unlimited liability, or served by them as a director or as general manager as per Article 49 of the BankL. Activities related to risk management are carried out by the risk management unit and its personnel by filing reports to the Board of the bank. Article 36 of the Internal Systems Regulations outlines the key factors that banks should consider when establishing their risk management strategies such as ensuring conformity with the nature and complexity of the bank activities, monitoring, and managing the capacity of the bank, considering past experience, determining the strategy, policy, and implementation procedures of the bank's business line.

In this respect, banks are required to carry out risk management activities by taking into account the guides published by the BRSA such as the *Guideline for Liquidity Risk Management* dated March 31, 2016, and the *Guideline on Operational Risk Management* dated March 31, 2016 (Article 35 of the Internal Systems Regulation).

4.5. What are the legal requirements applicable to banks in combating money laundering and terrorist financing area?

Money laundering and terrorist financing are regulated as crimes under various laws and regulations, especially under the *Turkish Criminal Code* (TCC). In this regard, Article 282 of the TCC which defines the crime of money laundering, stipulates that if such a crime is committed by perpetrators who are legal entities such as banks, security measures will be applied. These security measures can be the revocation of a license or permit, confiscation of property or material interests, imposition of administrative fines, or a prohibition against participating in public tenders.

In addition, the *Law on Prevention of Laundering Proceeds of Crime No. 5549* (AML Law) was published to determine the principles and obligations within the framework of anti-money laundering (AML). Under the AML Law, combat against money laundering is carried out by the Financial Crimes Investigation Board (FCIB/MASAK), which has various authorities such as collecting, analyzing, and evaluating data together with receiving reports of suspicious transactions (Article 4 of the AML Law).

The key obligations that banks are subject to under the AML Law are as follows:

■ Customer identification (Article 3 of the AML Law): Banks shall identify the persons carrying out transactions and the persons on behalf of or for the benefit of whom the transactions are conducted within or through the bank before the transactions are conducted.

■ Suspicious transaction reporting (Article 4 of the AML Law): Banks are bound to report to the FCIB any information, suspicion, or reasonable grounds to suspect that assets subject to transactions conducted or attempted to be conducted within or through the bank have been illegally obtained or used for illegal purposes.

■ Periodically Reporting (Article 6 of the AML Law): Banks are responsible to notify the FCIB of transactions to which they are a party or intermediary to that one alone the amount determined by the Ministry of Treasury and Finance.

- Retaining and submitting (Article 8 of the AML Law): Banks are required to keep the documents, books, and records, and identification documents related to their obligations and transactions stipulated in the AML Law for eight years and submit them to the authorities upon request.

Pursuant to the *AML/CTF Compliance Regulation* published by FCIB dated September 9, 2008, within the framework of the AML Law, banks (except for the CBT and development and investment banks) must establish a compliance program to prevent money laundering and terrorist financing (Article 4 of the AML/CTF Regulation) and must appoint a compliance officer within 30 days of obtaining an operating license to carry out such program (Article 16 of the AML/CTF Regulation). The required qualifications, duties, authorities, and responsibilities of the compliance officer are set forth in Articles 17 and 19 of the AML/CTF Compliance Regulation. In accordance with Article 18 of the AML/CTF Compliance Regulation, a compliance unit is established by the Board of the bank to assist the compliance officer in the execution of the compliance program.

Additionally, in cases where there is a strong suspicion that money laundering or terrorist financing crimes have been committed, it is stipulated under Article 17 of the AML Law that the suspect's assets in the bank may be seized in accordance with Article 128 of the *Criminal Procedure Code No. 5271* dated December 4, 2004.

Moreover, *Law No. 6415 on the Prevention of the Financing of Terrorism* dated February 7, 2013, entered into force in 2013 to regulate the crime of terrorism financing and to determine the procedures and principles regarding the freezing of assets to prevent terrorism financing.

Other legislations related to AML/combating terrorist financing are as follows: the *Anti-terror Law No. 3713*, the BankL., the *Misdemeanors Law No. 5326* dated March 30, 2005, international conventions such as the *Council of Europe Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds from Crime and on the Financing of Terrorism*, as well as communiques issued by FCIB and other related regulations.

It is important to note that Turkey has been a member of the Financial Action Task Force since 1991 and its banking sector adheres to the recommendations, standards, and guidelines issued by this organization.

4.6. Are there any legal provisions regulating banking secrecy in your jurisdiction?

Within the scope of banking secrecy, the concepts of bank secret and customer secret are broadly regulated in Article 73 of the BankL. under the heading of "Confidentiality". In accordance with Article 73 of the BankL., the *Regulation on Disclosure of Confidential Information* dated June 4, 2021, defines the customer secret as any data belonging to real and legal persons within the framework of customer relations with banks. On the other hand, even though the bank secret is regulated broadly under the Article 73 of the BankL. it is not defined clearly. However, Article 2 of the Draft Law on Trade Secrets, Bank Secrets, and Customer Secrets defines bank secret as "*information on the financial, economic, credit and cash situation of the bank known by the members of the management and supervisory bodies, members and other officials of the bank, and all kinds of information and documents related to the bank's customer potential, lending, deposit collection, management principles, other banking services and activities, and risk positions.*" However, the aforementioned regulation has remained as a draft since 2011, and a new regulation is expected in this direction.

Moreover, disclosure of both the bank secret and customer secret is considered a crime under the BankL and the TCC. According to Article 73 of the BankL., persons who acquire confidential information belonging to banks and their subsidiaries, affiliates, and jointly controlled entities as well as their customers within the scope of their duties or their positions are prohibited from disclosing such information to persons who are not expressly authorized under the banking legislation. Violations of the non-disclosure obligation stipulated in Article 73 of the BankL. constitute a criminal offense under Article 159 of the BankL. and are punishable by imprisonment or a judicial fine. The use of these secrets for self-benefit or the benefit of others is considered an aggravating circumstance. In the same direction, Article 239 of the TCC punishes the disclosure of information and documents deemed to be banking secrets to unauthorized persons.

Additionally, the *Circular on the Disclosure of Client Information No. 2022/1* dated August 11, 2022, regulates the procedures and principles regarding the sharing and transferring of banking secrecy in accordance with Article 73 of the BankL. and the *Regulation on Disclosure of Confidential Information*.

V. TRENDS

5.1. What are the main trends in the banking sector in your jurisdiction?

The main trends in the banking sector in Turkey relate to electronic lira issuance and branchless banking services. Please see Section 1.3. and 5.3 for further information.

5.2. What are the biggest challenges in the banking sector at the moment?

After the COVID-19 pandemic, there were severe supply-side contractions on a global scale. In addition, geopolitical and

macroeconomic uncertainties led to global high inflation. In an inflationary environment, central banks of many countries pursued contractionary monetary policy by taking macroprudential measures, and in this context, policy rates were raised. Higher policy rates imply higher funding costs, especially for the banking sector. At the same time, the expectation of recession in the markets along with the rise in interest rates leads to a significant decline in loan demand. The same recession expectation significantly increases the default risk for loans. This makes it difficult for banks to calculate the risk of non-performing loans.

In terms of the banking sector in Turkey, the CBT has recently lowered the policy rate contrary to the generally accepted economic policies. As a result of these policies, inflationary pressure on the Turkish Lira has increased and this increase has led to a depreciation of the Turkish Lira relative to other currencies. One of the main ways for banks to hedge against exchange rate appreciation is to hold their assets in foreign currency and foreign currency-denominated assets. However, Turkish banks can lend almost exclusively in Turkish Lira, which forces them to stay in the Turkish Lira. Therefore, the banking sector cannot hedge itself against rising FX risk. These difficulties arise from the regulations that banks are obliged to comply with, such as the prohibition of borrowing loans in FX or restriction on FX Asset transactions for Turkish citizens and Turkish corporations. In this direction, with the BRSA's decision numbered 10,250 and dated June 24, 2022, on Turkish lira borrowing by companies, other than banks and financial institutions, which are subject to independent audit has become subject to an FX Asset restriction. Additionally, with *Communique No. 2022-32/66*, fees driving from contracts will have to be paid in TRL in the sale of goods contracts other than those for vehicles. In this way, the new regulation expanded the scope of the prohibition on foreign currency transactions.

Turkish banks are obliged to comply with the liraization policies in deposits within the scope of the *2023 Monetary Policy and Liraization Strategy* published by the CBT on December 30, 2022. In this direction, many new regulations have been introduced and continue to be introduced. The most recent one is the CBT's announcement that it has decided to set the required reserve ratios as 0% for Turkish lira deposits with maturities longer than three months to encourage the extension of the maturity of Turkish lira deposits.

As of 2023, securities returns, which were one of the key drivers of profitability in the banking sector in the previous year, are expected to decline, posing the risk of a contraction or limited growth in banks' return on assets.

In addition, the increasing global digitalization trend has also affected the banking sector. The increasing pace of digital banking transactions and digital transformation increases the reputational risk of banks in the event of a failure in the competitive digital banking space. Please see our further explanations on the digitalization of the banking sector in Turkey below section.

5.3. What's new in fintech?

The Digital Turkish Lira Project is being carried out under the leadership of the CBT in line with the widespread use of digital currency systems around the world. As part of this project, the CBT recently announced that the first payment transactions on the Digital Turkish Lira Network were successfully realized. In 2023, the CBT aims to increase cooperation in this area with the participation of selected banks and financial technology companies. Efforts on the legal aspects of the Digital Turkish Lira are also on the way.

In addition, there are ongoing efforts in the field of "Open Banking." In general, "Open Banking" is sharing the private financial data of customers in banks with third parties upon the request and consent of the customers. Such financial data is made accessible to fintech companies through a common platform. In this context, the CBT recently announced that the "Open Banking Gateway" infrastructure, through which financial service users can manage their accounts with different payment service providers from a single access point and place payment orders, has been established and is currently in service. Some banks have also started to serve as account service providers through this infrastructure. The key regulations regarding Open Banking services are *Law No. 6493 and Regulation on the Operating Principles of Digital Banks and Service Model Banking* dated December 29, 2021.

Other recent developments in the field of fintech are the Instant and Continuous Transfer of Funds (FAST) system, which was put into use in 2021 as a 24/7 payment system in Turkey, and the Easy Addressing System that enables the use of the Republic of Turkey identity number, phone number and e-mail address instead of IBAN in payments. As of 2023, Payment and Electronic Money Institutions, defined under *Law No. 6493 dated* June 27, 2013, can participate directly in the FAST System if they fulfill the necessary conditions. In addition, it has been announced by the CBT that the FAST Workplace Payments system, which enables instant payments from account to account by scanning the TR-QR Code displayed on the screens of mobile applications and POS devices and will be available in the first quarter of 2023.

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I. LEGAL FRAMEWORK

1.1. Which main legislative and regulatory provisions govern the banking sector in your jurisdiction?

Ukrainian banking legal framework consists of two levels of regulations. The higher level contains laws adopted by the Ukrainian Parliament. The lower one contains regulations of the primary banking regulator – the National Bank of Ukraine (NBU).

The main regulations are:

■ The *Law of Ukraine "On Banks and Banking Activity"* dated December 7, 2000 (Banking Law). The Banking Law defines the structure of the Ukrainian banking system and stipulates economic, organizational, and legal principles of establishment, business, reorganization, and liquidation of banks;

■ The *Law of Ukraine "On the National Bank of Ukraine"* dated May 20, 1999. This law sets out the structure and powers of the NBU;

■ The *Law of Ukraine "On Households Deposit Guarantee System"* dated February 23, 2012 (Deposit Guarantee System Law). The law establishes the households deposit guarantee system, specifies the authority of the Households Deposit Guarantee Fund and powers of the Households Deposit Guarantee Fund regarding the liquidation of banks and removal of insolvent banks from the market;

■ The *"Regulation on Licensing of Banks"* adopted by the *Resolution of the NBU No. 149* dated December 22, 2018. This regulation specifies the procedure of a bank creation and licensing, the procedure of receiving the NBU's approval for the acquisition and increasing of a qualifying holding in a bank, qualification requirements for certain management positions, etc.;

■ *The "Instruction On the Regulation Procedure for Banking Activity in Ukraine"* adopted by the *Resolution of the NBU No. 368* dated August 28, 2001. The instruction is the regulatory document that sets requirements for financial indicators, calculation procedures of financial indicators, and capital requirements.

1.2. Which bodies are responsible for enforcing the applicable laws and regulations? What are their main competencies?

As mentioned above, the main banking regulator in Ukraine is the NBU. As a central bank, the NBU:

■ conducts monetary policy (issues Ukrainian hryvnia (local currency); ensures its stability);

■ secures the financial stability of Ukraine;

■ regulates and supervises banks;

■ acts as a lender of last resort for banks;

■ carries out foreign exchange regulation (regulates foreign exchange transactions; conducts currency control supervision over commercial banks);

■ enforces the law in case of violation of laws/regulations by a bank;

■ etc.

Another important body is the Household Deposit Guarantee Fund (Fund) – a special government body whose main role is to secure the functioning of the household deposit guarantee system, to remove insolvent banks from the market, and to liquidate banks in cases, stipulated in the *Deposit Guarantee System Law*. The Household Deposit Guarantee Fund is empowered to:

■ maintain Register of Participants of the Household Deposit Guarantee Fund;

■ organize repayment of compensation for deposits;

■ regulate, oversee, and analyze commercial banks within the purpose of the Household Deposit Guarantee Fund;

■ enforce the law.

1.3. What are the current priorities of regulators and how does the regulator engage with the banking sector?

The current priorities of the NBU are driven by the effects of the full-scale invasion of the Russian Federation into Ukraine. The main goal of the NBU during the war is to secure the stability of the Ukrainian banking system by way of mitigating the negative consequences of the invasion. For that, the NBU maintains a permanent dialogue with local banks and other financial institutions to understand the ongoing financial situation.

Moreover, the NBU introduced temporary regulations that stipulate peculiarities of banking regulation for the period of martial law. Such temporary regulations release banks from liability for non-compliance with requirements if they occurred due to the full-scale invasion.

Finally, the NBU also closely overlooks the banking sector in order to determine banks having liquidity/solvency issues and banks that have sanctioned ultimate beneficiary owners or are controlled by the Russian Federation. The NBU either deprives such owners of their voting rights by passing them to appointed proxies or liquidates a bank having such owners/controllers.

II. AUTHORISATION

2.1. What licenses are required to provide banking services in your jurisdiction? What activities do they cover?

In order to provide banking services, a joint-stock company has to receive a banking license from the NBU. Under the Banking Law, the banking services include the following activities:

- attract funds (deposits) from an unlimited number of individuals and legal entities;
- open and maintain current and escrow accounts of clients;
- the place attracted funds in its own name, on its own terms, and at its own risk.

A local bank may also:

- provide currency valuables trading services to individuals and legal entities;
- invest;
- issue its own securities;
- provide safekeeping services;
- collect funds and transport currency valuables;
- provide consulting and information services regarding banking and other financial services;
- provide administration services in relation to the issuance of the bonds according to the *Law of Ukraine "On Capital Markets and Regulated Commodities Market"* dated February 23, 2006;
- provide payment services.

2.2. What is the procedure for obtaining a banking license? How long does this typically take?

The term of receiving a banking license depends on case-by-case bases. However, the overall procedure usually lasts around 12-16 months. The procedure for bank registration is as follows:

- Before registration of a future bank, a shareholder or an authorized representative of all shareholders shall receive approval of a future bank's charter by the NBU;
- To receive approval of a charter, such shareholder/authorized representative shall file a package of documents/information that includes, among others:
  - Application on approval of a charter of the newly created bank;
  - Corporate decisions and charter;
  - Documents for assessment of the business reputation of a shareholder;
  - Documents proving the financial condition of a shareholder;
  - Information on related parties;
  - Ownership structure;
  - Approval of the Antimonopoly Commission of Ukraine (if applicable);
- Within three months from the moment of filling of the documents by an applicant, the NBU decides on approval or rejection of a charter and informs the applicant;
- After approval, shareholders register a joint-stock company that will apply to the NBU for a banking license and notify the NBU about such registration;
- Within the year from the moment of registration of a joint-stock company, the company shall simultaneously file all required information/documents with the NBU. Such documents/information includes, among others:
  - Application for a banking license;
  - Information regarding the compliance of top management with the qualifying requirements;
  - Information that the bank has all required equipment and premises necessary for its activity;
  - Business strategy and business plan for the next three years;
  - Copies of internal policies that regulate internal procedures of provision of services;
  - Proof of payment of registration fee;
- Within three months from the moment of filing of the required documents, the NBU makes a decision on the issuance of the banking license and notifies a bank;
- In case of a positive decision of the NBU, the NBU includes a bank in the State Register of Banks and provides an excerpt from the State Register of Banks;
- After three days from the moment of inclusion in the State Register of Banks, a bank may carry out its banking activity.

2.3. Can a foreign bank operate in your jurisdiction on the basis of its domestic license?

A foreign bank may operate in Ukraine only based on a Ukrainian banking license provided by the NBU.

2.4. What are the restrictions on ownership, including foreign ownership of banks?

In general, there are no direct restrictions on ownership, including by foreign citizens. However, recently the NBU introduced amendments where citizens/tax residents/permanent residents of a state that conducted/conducts aggression against Ukraine (which includes only the Russian Federation so far) have an assailable business reputation. As consequence, residents of the Russian Federation will not be able to obtain solely or jointly with other individuals a qualifying holding (10% or more of shares) in a Ukrainian bank.

2.5. What are the requirements for a proposed acquisition and acquirer of a qualified holding in a bank? Would the same requirements apply in the case of an increase of a qualifying holding?

To acquire a qualifying holding (10% or more of shares) in a bank, an acquirer has to obtain prior approval of the NBU, unless the acquirer:

- Inherited a qualifying holding;
- Purchased controlling block of shares (more than 50% of shares);
- Acquired a significant share by himself or together with all other persons with whom such acquirer jointly owned a qualifying holding due to a) termination of legal relationships in relation to which the NBU approved the joint acquisition of a qualifying holding in a bank by such persons; or b) change in the composition of persons whom the NBU approved for the joint acquisition of a qualifying holding if the NBU has not approved sole ownership in the respective amount.

In the above-mentioned exceptions, an acquirer must receive approval from the NBU after the acquisition of a qualifying holding in a bank.

In order to obtain approval, an acquirer has to file the required documents no later than two months before the intended date of acquisition of a qualifying holding in a bank. Moreover, an acquirer has to meet qualification requirements that prove that the prospective acquirer has: 1) an unassailable business reputation; and 2) financial soundness. The approval should be obtained in each case when an acquirer reaches each threshold of a qualifying holding, i.e., 10%, 25%, 50%, and 75% of shares in a bank.

III. REGULATORY CAPITAL AND LIQUIDITY

3.1. How are banks typically funded in your jurisdiction?

The biggest stake in funding sources of banks belongs to individuals' deposits. Meanwhile, deposits of legal entities represent the second largest source of funding. The third largest source of funding is the capitalization of banks by their shareholders. Other sources of income have a relatively small stake in the overall volume of funding.

3.2. What capital and own funds requirements apply to banks in your jurisdiction?

In Ukraine, capital requirements for banks are regulated by the Instruction on the *Regulation Procedure for Banking Activity in Ukraine* adopted by *Regulation of the NBU No. 368* dated August 28, 2001. The most important indicator which is taken into account during the calculation of most of the capital ratios is regulatory capital. Regulatory capital consists of:

- basic capital (1st tier); and
- additional capital (2nd tier).

The basic capital includes charter capital and disclosed reserves (created or increased using undistributed earnings, share price premium, additional contributions, etc.). The charter capital of a bank shall be fully paid up and amount to no less than UAH 200 million (approximately EUR 5 million).

The additional capital may include undisclosed reserves, revaluation reserves, hybrid capital instruments that shall satisfy certain requirements, and subordinated debt. Additional capital cannot be more than 100% of the basic capital.

Finally, banks shall always comply with certain capital rations during their activity. For instance, banks shall maintain a capital adequacy ratio (i.e., the ratio of regulatory capital to the total book value of assets and off-balance liabilities) of no less than 10%. Moreover, 1st tier capital adequacy ratio (i.e., the ratio of basic ratio to the total book of value of assets and off-balance liabilities) shall be no less than 7%.

Last, but not least, the legislation obliges banks to have various buffers, including conservation buffer, countercyclical buffer, systemic risk buffer, and systemic importance buffer (for a systemic important bank).

3.3. Has your jurisdiction implemented the Basel III framework? Are there any major deviations?

Basel III framework has not been implemented into Ukrainian legislation so far. However, due to the Euro-integration process in Ukraine, some Basel III rules are used as a benchmark

for new Ukrainian banking regulations.

IV. REPORTING, ORGANISATIONAL REQUIREMENTS, INTERNAL GOVERNANCE, AND RISK MANAGEMENT

4.1. What key reporting and disclosure requirements apply to banks in your jurisdiction?

Ukrainian legislation puts on banks extensive reporting requirements, including the provision of statistical and financial information to the NBU on a regular basis. Requirements, terms, and details of the information that shall be submitted are regulated by the *Rules of Organization of Statistical Reporting that Shall be Submitted with the National Bank of Ukraine* adopted by *Regulation of the NBU No. 120* dated November 13, 2018, and the *Instruction on Procedure for Drawing Up and Publishing Financial Statements of Banks of Ukraine* adopted by *Regulation of the NBU No. 373* dated October 24, 2011.

Statistical information includes information on accounts balances, account balances turnover, transactions involving non-residents of Ukraine, reserves, largest clients, related parties, number of clients, etc. A bank shall disclose interim, annual, and consolidated financial statement on its website so that it was freely accessible to the public and submits them to the NBU.

4.2. What are the organizational requirements for banks, including with respect to corporate governance?

A bank shall be registered either as a joint-stock company or a cooperative bank. In practice, all banks use the joint-stock company option. The highest governing body of a bank is a general meeting of shareholders of a bank that have exclusive competence in respect of certain issues such as determining the main areas of activities of a bank, amending governing structure, issuance of stock, approving of regulations of a general meeting, a supervisory board or a board of directors and other vital matters.

A bank's executive body is a management board. The board is responsible for managing the operational activities of a bank and controlling all matters that do not belong to the exclusive competence of the general meeting and supervisory board. A supervisory board of a bank is responsible for overseeing the board, to protect the rights of depositors, creditors, and the bank's shareholders.

The banking regulation also sets qualification requirements for bank managers. Managers include a chief executive officer, its deputies, and members of the management board, a chairman of the supervisory board, its deputies and members of the supervisory board, and a chief accountant. In general, managers shall have an unassailable business reputation and professional suitability. Professional suitability means that a manager shall have:

- higher education;
- knowledge, professional, and managerial experience in the amount necessary for the proper performance of the duties;
- possibility to dedicate enough time for the performance of its duties;
- no real or potential conflict of interest;
- etc.

The CEO of a bank, chief accountant, and members of the supervisory board may take the position in a bank only after approval by the NBU.

4.3. What are the local rules for loans to the management body and their related parties?

The Banking Law stipulates special rules for the provision of loans to related persons of a bank and associated persons/affiliated entities of related persons. Related persons of a bank are:

1. Controllers of a bank;
2. Owners of a qualifying holding and persons through which indirect ownership of the qualifying holding in the bank is exercised by such persons;
3. Bank managers, head of the internal audit division, chief risk officer, chief compliance officer, chairmen, and members of the bank's board of directors and supervisory board committees;
4. Bank's congenerous parties and affiliates including banking group participants. A congenerous party is a legal entity that has common owners of qualifying holding with the bank. Affiliate means any legal entity in which the bank has a qualifying holding or a legal entity that has a qualifying holding in the bank;
5. Owners of a qualifying holding in the bank's congenerous parties and affiliates;
6. Managers of legal entities and banks' managers who are the bank's congenerous parties and affiliates, head of the internal audit function, chairmen, and committee members of such entities;
7. Associated persons of the individuals specified in paragraphs 1-6 of this section. Associated person means husband or wife, relatives in direct descent of such persons (father, mother, children, sibling, grandfather, grandmother, grandchildren), relatives in direct descent of wife or husband of such

person, husband or wife of a such relative in direct descent;

8. Legal entities where the individuals mentioned above are managers or owners of a qualifying holding;

9. Any entity, through which a transaction is performed in the interests of the persons referred to in this part.

A bank shall enter into any transaction with a related person only on an arms-length principle. A bank is obliged to determine whether a person is related to the bank before entering into contractual relations and/or conducting operations with a such person if such operation may change the volume of the bank's operations with related persons. An agreement that was entered into between a bank and its related person and that does not comply with an arms-length principle shall be deemed null and void from the moment of the agreement's execution.

4.4. What are the main legal provisions governing risk management in the banking sector in your jurisdiction?

The main legal provisions setting requirements for risk management are stipulated in the Banking Law. Specifically, the law requires that a bank hall have a comprehensive, adequate, and effective system of internal control that includes a system of risk management.

The system of risk management of a bank shall secure the detection, measuring, monitoring, control, reporting, and mitigation of all material risks of a bank. It shall take into account the size of the bank, complexity, volumes, types, and nature of the bank's operation, as well as its organizational structure and risk profile of the bank.

A bank shall also have its chief risk officer responsible for risk management of the bank. Meanwhile, the NBU shall have the right to require the bank to change a chief risk manager, if they do not have the required professional suitability and/or business reputation.

4.5. What are the legal requirements applicable to banks in combating money laundering and terrorist financing area?

Anti-money laundering and counter-terrorist financing matters are regulated by the *Law of Ukraine "On Prevention and Counteraction to Legalization (Laundering) of Criminal Proceeds, Terrorist Financing and Financing of Proliferation of Weapons of Mass Destruction"* dated December 6, 2019 (AML Law). The AML Law states that subjects of initial financial monitoring, including banks, shall, in particular:

- identify and verify customers by way of requesting needed documents from them and researching information obtained from other sources;
- identify ultimate beneficial owners of a legal entity-client;
- analyze and report financial transactions that fall under the meaning of a threshold transaction or suspicious transaction;
- conduct ongoing due diligence of its clients;
- report certain suspicious and threshold transactions to the authorized body when required by the legislation;
- etc.

The AML/CTF system of a bank shall be based on a risk-based approach meaning that the bank shall identify and assess the money laundering and terrorist financing risk on a case-by-case basis in accordance with the level of risk.

4.6. Are there any legal provisions regulating banking secrecy in your jurisdiction?

Yes. Banking secrecy covers information regarding the activities and financial position of a bank's client that became known to the bank in the process of servicing the client and cooperation with him or became known to third parties during the provision of services to the bank, or other information that is covered by banking secrecy under the legislation. For instance, banking secrecy includes information regarding:

- client's bank accounts;
- transactions rendered in favor of or under the instruction of a client;
- the financial position of a client;
- the organizational structure of a legal entity-client;
- the commercial activity of a client or the trade secret of a client;
- etc.

Banks and the NBU shall secure banking secrecy by way of giving access to such information to a limited number of personnel, special documentation procedures of documents that have banking secrecy, using technologies that prevent unauthorized access to the data, and using disclaimers warning about liability in case of violating banking secrecy.

However, the Banking Law stipulates cases when banking secrecy may be disclosed. For instance, information protected by banking secrecy may be disclosed upon instruction or permission of a legal entity or individual that is the owner of such information, upon court judgment, upon request of law enforcement authorities with strict limitation in connection to the scope of information that may be requested.

V. TRENDS

5.1. What are the main trends in the banking sector in your jurisdiction?

The main trends in the banking sector are driven by the consequences triggered by the Russian invasion of Ukraine. Even though the Ukrainian banking sector showed resilience and sustainability during the invasion, however, negative impacts on the banking sector may be already seen. For instance, according to estimation the Ukrainian GDP will drop by 30% in 2022 compared to the year 2021, the consumer price index will increase by more than 30% and real wages will decrease by 27%.

Smaller banks face liquidity and solvency issues that trigger attention from the NBU. A few banks have been already declared insolvent and are in the procedure of liquidation and removal from the banking market. Moreover, the NBU currently introduces independent proxies to banks that have sanctioned Russian ultimate beneficiary owners where such proxies are given the right to use the votes of such beneficiaries. Furthermore, two banks that had the Russian Federation in the ownership structure were removed instantly at the beginning of the war.

All the above forces banks to optimize their operational income by cutting expenses and amending a business plan. Banks are decreasing the number of their branches throughout the country, as well as laying off some of their personnel. The banking sector is significantly investing in purchasing the NBU's deposit certificate while the lending portfolio of the banking sector contracted substantially. Therefore, the Ukrainian banking sector currently undergoes the most complicated period of its lifetime, as a consequence, banks are taking measures aimed at supporting their liquidity and resilience.

Another trend is the digitalization of banking activity and financial services. In this aspect, Ukrainian banking legislation is quite progressive, and Ukrainian banks successfully use this to implement the most modern and technological and IT solutions in their activity.

5.2. What are the biggest challenges in the banking sector at the moment?

The biggest challenge in 2023 is the invasion of the Russian Federation in Ukraine and its consequences for the local economy. The results of 2022 proved that the Ukrainian banking system is very stable and was well prepared for the crises caused by the war. The main focus of Ukrainian banks in 2023 will be the financing of local companies (especially in such sectors as agriculture, construction, and energy) and the mitigation of risks in the retail sector.

5.3. What's new in fintech?

Over the last year, the main priority of the fintech sector was to ensure stable and uninterrupted functionality of transfer transactions. During 2022, 93 out of 100 transactions with payment cars were cashless. The war also shifted the interest of the Ukrainian fintech sector to cybersecurity which will be in the spotlight for the next years because of the high risk of cyberattacks by hackers.

Finally, the Ukrainian fintech regulation expanded due to the adoption of the *Law of Ukraine "On Virtual Assets"* dated February 17, 2022 (Virtual Assets Law) and the *Law of Ukraine "On Payment Services"* dated June 30, 2021 (Payment Services Law). The Virtual Assets Law sets a legal framework for transactions with virtual assets and will enter into force after the introduction of amendments to the Tax Code of Ukraine regarding the peculiarities of the taxation of virtual assets. Meanwhile, the Payment Services Law brings the Ukrainian payment regulation closer to the EU regulation, since it is substantially based on the *EU Revised Payment Services Directive* (PSD2) and the *E-Money Directive* (EMD).

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