AS "Reģionālā investīciju banka"

Pilar III

Information Disclosure year 2017

The information which is required to be disclosed under the EU Regulation 575/2013 is published by the bank on its website at least once a year.

Risk Management

Risk management is one of the Bank's strategic tasks. For the purposes of the Bank's risk management, the Risk Management Strategy has been developed for the management of the following risks:

Credit Risk and Residual Risk

The overdue loan – the loan, the repayment of which is not performed by the Customer, observing the term and procedure, stipulated and agreed between the Bank and the Customer in the mutually concluded contract/-s

Losses incurred due to the decrease in value in the result of the quality deterioration:

The objective evidences, proving that the losses have been incurred due to the decrease in value of the loans or loan groups in the result of the quality deterioration, include such verifiable information, which comes into the Bank's field of vision regarding such cases of losses:

- the significant financial difficulties of the debtor;
- the non-compliance with the provisions of the agreement, that is, the delay of payment of the loan's principal sum or delay of interest payment;
- the concession, granted to the borrower, due to such economic or legal reasons, which pertain to the borrower's financial difficulties, but in another case, such concession wouldn't be granted by the Bank (that is, the Bank has made the loan restructuring);
- there exists a relatively high probability that the borrower will start a bankruptcy procedure or another type of financial reorganization;
- the loss of an active market due to the financial difficulties of the corresponding issuer of the financial assets;
- the use of the granted loan funds for the purposes, not stipulated by the credit agreement;
- the non-occurrence of the preconditions, necessary for the credited project's implementation;
- the non-fulfillment of the person's, related with the borrower, obligations, which influence the borrower's ability to meet his/her debt obligations against the Bank.

The decrease in value of the collateral security in cases, when the loan repayment directly depends on the value of the collateral security.

Credit risk is a risk of losses in case the borrower (loan taker, debtor) or business partner of the Bank is unable or refuses to fulfill his/her obligations towards the Bank under the agreement provisions. Credit risk is related to the Bank's operations which create claims of the Bank against other parties and which are reflected in the Bank's balance and off-balance sheets.

The residual risk is a risk that the credit risk mitigation methods used by the Bank might turn out to be less efficient than planned.

The Bank's principles with respect to assessment, monitoring and accepting of credit risk have been described and approved within the Credit Policy, Business Partner Policy and Investment Policy.

The Bank categorizes and controls its credit risk by determining limits of different types and amounts: limits for the acceptable risk for each debtor, related debtors' groups, geographic regions, business sectors, types and amounts of guarantees, currencies, terms and ratings granted by international agencies.

Credit risk is also regularly monitored individually for each debtor evaluating the debtor's ability to repay the principal amount and interest, as well as changing the limits set, if necessary.

The Bank's exposure to credit risk is also monitored and minimized by ensuring adequate collaterals and registering the guarantees on behalf of the Bank. The real value of these guarantees and collaterals is regularly reviewed.

The collateral is a property or rights which can serve as the alternative source of the loan repayment in a case, if the Customer does not meet his/her debt obligations.

As collateral, the Bank accepts assets that meet the following criteria:

- has the market value of assets as determined in the pledge assessment by independent expert and its changes are predictable within the loan agreement term. Both the market value of assets and value in case of urgent, forced sale are considered;
- assets are liquid, i.e. they may be disposed in a comparatively short term for a price which is close to the urgent, forced sale value (or market value);
- there is a legal and actual opportunity to control these assets in order to prevent their misuse by the debtor or asset owner;
- the Bank's rights to these assets have a legal priority over other creditors of the owner's assets (or over those creditors' rights which are in a more privileged position with respect to the Bank's rights in the total amount, which makes up an insignificant amount in comparison with the collateral value), as the exception admitting the legal priority of Bank Pivdennyi's claims

Only certain types of assets are accepted as collateral, and each type of collateral has its own defined limits with respect to the maximum loan amount against such collateral. Most frequently accepted types of collaterals:

- time deposits placed with the Bank;
- real estate;
- industrial production facilities;
- land (depending on its geographical location, possibilities of its use, communications, cadastral value, etc.);
- unused motor (passenger) cars;
- unused lorries, tractors;
- used (second-hand) motor (passenger) cars, which are not older than 7 years, and the lorries, which are not older than 9 years, the tractors, which are not older than 5 years;
- other motor cars/lorries and tractors;
- ships/vessels;
- stocks (goods in the customs warehouses or otherwise controlled goods in the warehouse of their owner);
- technological equipment and machinery;
- other fixed assets of the company;
- accounts receivable (as a totality of objects;
- securities, capital shares, bills of exchange;
- guarantees.

The value of the real estate shall be determined based on the opinion of the independent experts and this evaluation shall be corrected, based on the Bank's experience and normative documents.

The market value of the stocks (the goods in the customs warehouses or otherwise controlled goods) and the market value of the stocks (the goods in the warehouse of its owner) shall be determined, based on the publicly available prices, the pricing mechanism of which is understandable and acceptable for the Bank.

The market value of the technological equipments and machineries shall be determined, according to the balance sheet residual value of the equipments, if the fixed assets accounting methods, applied by the Customer, correspond to the generally accepted practice, and if possible, it is also recommended to receive the experts' opinion. If the residual value of the fixed asset is big, then the documents, confirming the purchase value of this fixed asset, shall be checked.

The collateral security – movable or immovable objects, which are evaluated by the appraisal companies, appointed by the Bank, except for the cases, when the Bank's Board has authorized a competent employee to make an appraisal.

Any collateral, except land, securities, debtor debts and other nonmaterial assets, must be secured on behalf of the Bank for the loan agreement's term.

In order to efficiently manage credit risk and assess performance of the Bank's activity, the Bank carries out regular evaluation and classification of assets (incl. loans) and off-balance sheet liabilities. The main

evaluation criteria are the Customer's (borrower's) discounted future cash flow and creditworthiness – ability and willingness to fulfill the obligations under the loan agreement terms and conditions.

If a loan's default risk has significantly increased in comparison with the risk that had been accepted at the time of granting the loan, it is considered to be a problematic loan. The following is considered to be the characteristics of problematic loans:

- a significant delay of payment (30 working days or more);
- the breach of other terms and conditions of the loan agreement;
- the worsening of a customer's financial condition as reflected in his reports or other information;
- other creditor has filed a claim in court against the customer, or the State Revenue Service's request has been received on writing off funds from the current account;
- the value of the loan's collateral has significantly decreased.

The size of high-risk and overdue high-risk transactions as well as the size of the provisions set aside to cover bad loans by most important industries , thous. EUR is as follows:

	31.12.2016		31.12.2017		The Average Size in 2017	
High-risk Transactions by Industries	The Loan Balance to be Repaid	Special Provisions to Cover the Principal Amount	The Loan Balance to be Repaid	Special Provisions to Cover the Principal Amount	The Loan Balance to be Repaid	Special Provisions to Cover the Principal Amount
Forestry, agriculture	5 555	45	8 916	108	7 235	76
Manufacturing, processing industry	9 208	662	7 641	907	8 424	784
Trade	29 146	10 756	45 302	9 619	37 224	10 188
Transport	38 455	1 987	29 684	2 484	34 069	2 236
Financial services	4 343	3 168	3 482	2 176	3 913	2 672
Real estate operations	24 150	8 403	15 288	6 851	19 719	7 627
Construction	6 547	4 595	117	22	3 332	2 308
Accommodation and food services	3 259	1 387	3 139	1 386	3 199	1 387
Other services	709	0	587	0	648	0
Natural persons, overdrafts	12 230	3 054	10 966	2 935	11 598	2 994
The total size of high-risk transactions	133 598	34 052	125 121	26 488	129 359	30 270
	31.12.2016		31.12.2017		The Average Size in 2017	
Overdue (>90 days) High-Risk Transactions by Industries	The Loan Balance to be Repaid	Special Provisions to Cover the Principal Amount	The Loan Balance to be Repaid	Special Provisions to Cover the Principal Amount	The Loan Balance to be Repaid	Special Provisions to Cover the Principal Amount
Forestry, agriculture	0	0	0	0	0	0
Manufacturing, processing industry	1 434	662	907	907	1 170	784
Trade	1 963	1 964	7 020	5 161	4 492	3 563
Transport	3 343	1 987	2 742	2 309	3 042	2 188
Financial services	0	0	0	0	0	0
Real estate operations	11 133	6 159	6 867	3 778	9 000	4 969
Construction	5 476	4 595	22	22	2 749	2 308
Accommodation and food services	1 386	1 387	1 386	1 386	1 386	1 386
Natural persons, overdrafts	1 939	1 940	1982	1 982	1 961	1 961
The total size of high-risk transactions	26 674	18 690	20 926	15 625	23 800	17 158

The size of overdue high-risk transactions as well as the size of the provisions set aside to cover bad loans by most important regions , thous. EUR is as follows:

	31.12.2016		31.12.2017		The average extent in 2017	
Risk Transactions by Most Important regions*, EUR	The Loan Balance to be Repaid	Special Provisions to Cover the Principal Amount	The Loan Balance to be Repaid	Special Provisions to Cover the Principal Amount	The Loan Balance to be Repaid	Special Provisions to Cover the Principal Amount
USA	764	0	607	0	636	0
Austria	0	0	9 839	0	6 035	0
Bulgaria	0	0	375	0	210	0
Russia	38 536	0	20 716	0	29 498	0
China	739	0	0	0	436	0
Latvia	59 956	16 095	43 350	15 622	50 952	15 298
Ukraine	33 203	17 585	44 730	10 494	39 145	13 978
Germany	372	372	5 343	372	2 879	372
Others	27	0	161	0	138	0
The total size of high-risk transactions	133 597	34 052	125 121	26 488	130 104	29 648
	31.12.2016		31.12.2017		The average extent in 2017	
Risk Transactions by Most Important regions*, EUR	The Loan Balance to be Repaid	Special Provisions to Cover the Principal Amount	The Loan Balance to be Repaid	Special Provisions to Cover the Principal Amount	The Loan Balance to be Repaid	Special Provisions to Cover the Principal Amount
Germany	372	372	372	372	372	372
Latvia	21 098	13651	16 699	12 227	19 562	12 567
Ukraine	5 204	4667	3 854	3 026	4 343	3 600
The total size of high-risk transactions	26 674	18 690	20 926	15 625	24 277	16 538

The description of assets pledged to the bank as of the 31st of December 2017 can be found on page 48 of the annual report.

The data presented here reflects the fact that in accordance with Minutes No. 54 as of the 30th of October 2017 the bank's management approved a new repayment schedule for a loan whose balance for the reporting period amounted to 7 536 thous. EUR. The modified schedule was signed and came into force on the 18th of January 2018. The gap between the date of the approval and the date of the signing of the modified schedule was due to technical reasons, namely, due to implementing a technically complex project within the framework of a complex business model. That is why the delay of the payment was of technical nature without having any negative impact on the ability of the client to fulfill his obligations under the signed agreement. As a result, the data is presented in accordance with the newly signed repayment schedule.

Operational Risk

Operational risk is a risk to incur losses due to inadequate or failing internal processes of the Bank, activity of people and system, or due to effect of external conditions. The operational risk means that the Bank's income may decrease/additional expenditure may occur to the Bank (and, as a result, the equity capital might decrease) due to errors in transaction with customers/business partners, information processing, making of inefficient decisions, insufficient human resources, or insufficient planning of external conditions effects.

For the evaluation of the operational risk, self-evaluation process of the operational risk is used during which the Bank assesses performed operations against the types of the operational risk; the Bank's strong and weak sides regarding the management of the operational risk are identified.
The Bank has developed and maintains the Operation Risk Events and Losses Data Base in which the internal data on operational risk events and related losses is collected, summarized and classified.

The basic elements of the operational risk management:

- operational risk monitoring;

- operational risk control and minimisation:
- development of internal normative documents which exclude/minimise the possibility of operational events;
- compliance with the principle of division of duties;
- control of execution of internal limits;
- compliance with the defined procedure when using IT and other Bank's resources;
- appropriate training of employees;
- regular checks of transactions and account documents;
- ensuring the continuity of operation;
- stress testing.

Market Risk

The Bank's activity is exposed to market risk through the Bank's investments in the interest rates and currency product positions. All these products are exposed to systematic and specific market fluctuations. The Bank controls market risks by diversifying its financial instruments portfolio, setting restrictions for different types of financial instruments and carrying out sensitivity analysis which reflects the effect of the respective risks on the Bank's assets and equity capital.
Position Risk
Position risk – possibility to incur losses due to revaluation of position of debt securities or capital securities, when the price of the respective securities changes. The position risk can be categorised as specific and systematic risk:

- specific risk – possibility to incur losses if the debt securities' or capital securities' price will change due to factors related to the securities issuer;
- systematic risk – possibility to incur losses if the securities' price will change due to factors related to interest rate changes (in case of debt securities) or with significant changes in the capital market (in case of capital securities), which are not related to the specific securities issuer.
- Basic elements of position risk management:
- evaluation and analysis of securities' portfolio;
- analysis and monitoring of issuers' financial position;
- setting of internal limits on exposures/diversification (stop-loss; issuers, countries, regions, terms, credit rating groups etc.);
- control of execution of the internal limits.

Market Risk

The Bank's activity is exposed to market risk through the Bank's investments in the interest rates and currency product positions. All these products are exposed to systematic and specific market fluctuations. The Bank controls market risks by diversifying its financial instruments portfolio, setting restrictions for different types of financial instruments and carrying out sensitivity analysis which reflects the effect of the respective risks on the Bank's assets and equity capital.

Position Risk

Position risk – possibility to incur losses due to revaluation of position of debt securities or capital securities, when the price of the respective securities changes. The position risk can be categorised as specific and systematic risk:

- specific risk – possibility to incur losses if the debt securities' or capital securities' price will change due to factors related to the securities issuer;
- systematic risk – possibility to incur losses if the securities' price will change due to factors related to interest rate changes (in case of debt securities) or with significant changes in the capital market (in case of capital securities), which are not related to the specific securities issuer.

Basic elements of position risk management:

- evaluation and analysis of securities' portfolio;
- analysis and monitoring of issuers' financial position;

- setting of internal limits on exposures/diversification (stop-loss; issuers, countries, regions, terms, credit rating groups etc.);
- control of execution of the internal limits.

Interest Rate Risk

The interest rate risk is characterized by the influence of the market rate changes on the Bank's financial results. The Bank's everyday activity depends on the interest rate risk, which is influenced by the terms of repayment of assets and liabilities related to the interest income and expenditures or interest rate review dates. This risk is controlled by the Bank's Assets and Liabilities Committee by defining the limits of the interest rate coordination and evaluating the interest rate risk undertaken by the Bank.
For the evaluation of interest rate risk, the effect of interest rate changes on the Bank's economic value is assessed, incl. the evaluation of interest rate risk from the perspective of income and the evaluation of interest rate risk from the perspective of economic value. The evaluation of the interest rate risk is carried out once per month. Furthermore, at least 2 times per year, the stress tests of the interest rate risk are applied.
For monthly evaluation of the interest rate risk, for all balance sheet positions interest rate changes of +/-100 basis points are applied; for stress testing of interest rate risk – +/-200 basis points. Division of assets, liabilities and off-balance positions by term in the groups of term structures is carried out on the basis of:

- shortest term from the outstanding repayment/settlement/clearance term – for financial instruments with fixed interest rate;
- term until the next interest rate changes date or interest rate re-evaluation term – for financial instruments with a floating interest rate.

Basic elements of interest rate risk management:

- sensitivity analysis of interest rate risk;
- setting of internal limits (limit for decrease in economic value and for duration of securities' portfolio);
- control of compliance to the internal limits;
- carrying out of interest rate stress tests and analysis of their results;
- carrying out of hedging operations, if necessary.

Currency Risk

The Bank's activity is exposed to the risk of exchange of the main currencies involved in it, which influences both the Bank's financial result and cash flow. The Bank controls the foreign currency assets and liabilities in order to avoid inadequate currency risk. The Board determines the limits for the open positions of foreign currencies, and these limits are being supervised every day. The legislation of Latvia states that no individual foreign currency open position of the credit institution shall exceed 10% of the equity capital of the credit institution, and the total foreign currency open position shall not exceed 20% of the equity capital. During 2017, the Bank did not exceed these limits.
The Bank's foreign currency risk evaluation is based on the following basic principles:

- evaluation with respect to how the Bank's assets, liabilities and off-balance sheet items value changes due to changes in currency rates;
- how the Bank's income/expenditure changes due to changes in currency rates;
- the currency risk stress testing is performed.

Basic elements of currency risk management:

- evaluation of currency risk;
- setting of limits and restrictions;
- control of execution of these limits;
- currency risk stress testing and analysis of the results;
- carrying out of hedging operations, if necessary.

Liquidity Risk

The Bank is subject to the daily risk that it might need to use the available funds and short-term liquid assets for the fulfillment of its short-term liabilities. The term relation of assets and liabilities, as well as off-balance items, is related to liquidity risk and reflects to what extent funds would be necessary to fulfill the existing liabilities.

Terms and capabilities of the assets and liabilities to replace the liabilities, which inflict interest and have a due payout term, at acceptable costs are significant factors for determination of the Bank's liquidity and its exposure to the changes in the interest rates and currency rates.

Such coordination of assets and liabilities, and control of this coordination is one of the Bank's most important daily management tasks.

The Bank is subject to the daily risk that it might need to use the available funds and short-term liquid assets for the fulfillment of its short-term liabilities. The term relation of assets and liabilities, as well as off-balance items, is related to liquidity risk and reflects to what extent funds would be necessary to fulfill the existing liabilities.
Terms and capabilities of the assets and liabilities to replace the liabilities, which inflict interest and have a due payout term, at acceptable costs are significant factors for determination of the Bank's liquidity and its exposure to the changes in the interest rates and currency rates.
Such coordination of assets and liabilities, and control of this coordination is one of the Bank's most important daily management tasks.
The Bank is using the following methods for the measurement of liquidity risk:

- evaluation of existing and planned assets, liabilities, and off-balance sheet liabilities term-structure broken down by financial instruments, various term intervals in all currencies together and individually, in which the Bank performs a significant amount of transactions (i.e. currency the proportion of which in the Bank's assets/liabilities exceeds 5%) or which has a non-liquid market;
- determining liquidity indicators used for liquidity risk analysis and control;
- determining internal limits:
  - assets and liabilities term structure net liquidity positions in euro and all foreign currencies in which the Bank performs a significant amount of transactions (i.e., currency the proportion of which in the Bank's assets/liabilities exceeds 5%) or which has a non-liquid market;
  - for deposit concentration;
  - for other liquidity indicators which the Bank has specified for the liquidity risk control;
  - stress testing.

By specifying the calculation procedure of liquidity indicators and by its determining limits, the Bank takes into account its operational targets and the acceptable risk level.
The Bank determines and regularly analyses the early warning indicator system which may help to identify the vulnerability of the Bank's liquidity position and the necessity to attract additional financing.
On the basis of data of the early warning indicator system, the Bank identifies the negative tendencies which affect liquidity, analyses them and evaluates the necessity to carry out measures reducing the liquidity risks.
The liquidity risk management methods (basic elements) are as follows:

- fulfillment of liquidity indicator limits;
- determining of net liquidity position limits;
- determining restriction on deposit concentration;
- control of compliance with the defined limits;
- liquidity stress testing and analysis of the results;
- proposals for solving liquidity problems;
- setting and monitoring of a set of indicators for liquidity evaluation;
- maintenance of an adequate liquidity buffer which covers the positive difference between the planned outgoing and incoming cash flows within the term interval of up to 7 days and 30 days.

In accordance with FCMC's requirements, the Bank maintains sufficient liquid assets for the fulfillment of its obligations.

Liquidity Coverage Ratio for 2017

The ratio was calculated in line with the Liquidity Coverage Ratio Disclosure Principles to comply with the European Banking Authority's (EBA) Regulation in addition to the European Union's Liquidity Risk Management Disclosure Regulation No. 575/2013, paragraph 435.

thous. EUR		Total Corrected Value			
		31.03.17	30. 06.17	30.09.17	31.12.17
21	Liquidity Reserves	229 754	192 996	154 233	155 280
22	Total Net Cash Outflow	72 300	64 804	46 772	53 265
23	Liquidity Coverage Ratio (%)	318%	298%	330%	292%

Assumptions and clarifications with respect to the calculation of the Liquidity Coverage Ratio.

The bank recognizes the following assets as the Level I ones:

- coins and banknotes;
- transactions with the central banks of the member countries;
- the bank's reserves placed with the central bank;
- assets issued or guaranteed by the governments of the member countries;
- assets issued or guaranteed by the governments of other countries given these are allocated to the 1st credit quality category within the credit assessment process in accordance with the EU Regulation 575/2013.

The bank applies a 0% discount rate for those assets.

The bank recognizes the following assets as the Level II ones:

- 2.A assets: The bank does not possess such assets at the moment.
- 2.B assets: Corporate debt securities which comply with the EU Regulation 2015/61's requirements.

The bank applies at least a 50% discount rate for the market value of those assets.

The bank classifies as the LSR Liquid assets (LSR liquidity reserves) those assets which comply with the EU Regulation 2015/61's general and operational requirements.

Net expected cash outflow.

The net expected cash outflow is calculated as a difference between the amount of expected cash outflows and the amount of expected cash inflows in accordance with the calculation procedure as set in Paragraph 20 of the EU Regulation 2015/61.
The cash outflows and the cash inflows are assessed during a 30-day stress period given the assumption of a combined institution-level and market-wide stress scenario as mentioned in Paragraph 5 of the EU Regulation 2015/61.

Assumptions with respect to the expected cash outflow.

The expected cash outflow is calculated as the balance value of the bank's obligations and off-balance-sheet obligations multiplied with respective rates reflecting the speed with which those positions are expected to decline during a stress period.
A 10% discount rate is applied to the deposits placed by natural persons and SMEs.
Enterprises are classified as commercial companies. A 20% discount rate is applied to the state-guaranteed share of a deposit while a 40% expected cash-outflow discount rate is applied to the non-guaranteed share.
A 15% discount rate and a 20% discount rate is applied to the deposits placed by natural persons and SMEs with an elevated probability of cash outflow.

A 10% cash-outflow discount rate is applied to such off-balance-sheet obligations as credit lines and overdrafts.
A 5% cash-outflow discount rate is applied to such off-balance-sheet obligations as trade transactions.
A 100% cash-outflow discount rate is applied to the following instruments:

- Derivative-related cash outflows.
- Obligations towards monetary financial institutions and other financial institutions.
- Other obligations.

Assumptions with respect to the expected cash inflow.

The expected cash inflow should be assessed during a 30-calendar-day period. It is comprised of cash inflows, as stipulated by respective contracts, resulting only from those high-risk transactions which are not classified as being delayed as well as there is no basis for the bank to expect them to get delayed within a 30-calendar-day period.

The bank sets operational deposits as being equal to 15% of the balance value of correspondent accounts and applies a 5% cash-inflow rate to this share of correspondent accounts.

When calculating the LSR the bank sets a limit amounting to 75% of the total expected cash inflow.

The planned revenue from the loan principal repayments being made by non-financial clients are reduced by 50% from the size of the repayment.

A 100% rate is applied to the following instruments:

- cash claims towards monetary financial institutions;
- securities with the maturity of up to 30 calendar days which are not classified as highly liquid ones;
- net derivative-related cash inflows.

Transaction Concentration Risk

Transaction concentration risk is a risk that occurs from transaction concentration. In order to restrict the transaction concentration risk, the Bank determines limits for investments in various assets, instruments, markets etc. One of the most significant transaction concentration risks is the concentration of geographic regions (country risk).

Country Risk

Country risk – country partner risk – the possibility to incur losses if the Bank's assets are invested in a country whose changing economic and political factors may create problems for the Bank to retrieve its assets in the planned time and extent. A partner's and issuer's default occurs mainly due to currency devaluation, unfavorable changes in legislation, creation of new restrictions and barriers and other conditions, including force majeure factors.

For the country risk analysis, information of the international rating agencies (incl. credit ratings, their dynamics), economic indicators of countries and other related information is used.

Fundamental elements of risk control:

- setting of internal limits by regions, countries and transaction types in individual countries;
- control of execution of the internal limits;
- country risk analysis and monitoring;
- review of internal limits.

Assets, liabilities and off-balance sheet country risk is attributable to a country which may be considered the customer's main country of entrepreneurship. If the loan is granted to a resident of another country against a pledge, and this pledge is physically located in another country which is not the legal person's country of residence, the country risk is transferred to the country where the loan's pledge is actually located.

Compliance and reputational risk

Compliance risk is a risk that the bank may incur losses, or certain legal obligations may be imposed on it, or it may face certain sanctions, or its reputation may be damaged due to non-compliance with or violation of certain legislative acts, regulations and standards.

Reputational risk is a risk that the bank's clients, partners, shareholders, regulatory institutions and other stakeholders may form a negative opinion with respect to the bank. As a result, it may have a negative impact on the bank's ability to maintain existing or establish new business relationships with its clients and other business partners as well as having a potential negative impact on the bank's access to financing. Reputational risk incidents may also raise the level of risks stemming from other areas of the bank's activities (credit risk, liquidity risk, market risk etc.), thus having a negative impact on the bank's profitability, size of the capital base and liquidity.

In accordance with legislative acts the bank establishes and maintains an effective compliance and reputational risk management framework which ensures the bank's compliance with legislative acts, regulations and standards and in doing so preventing possible losses from happening, the imposition of legal obligations, the application of sanctions or the worsening of the bank's reputational profile. The bank's compliance control function stems from a risk-based approach, thus ensuiring that the focus of compliance oversight and consultation activities is reasonable and up-to-date.

The primary tasks of the bank's compliance control function is as follows:

- identifying, assessing and managing compliance and reputational risk which, among other things, provides for a regular monitoring of applicable legislative requirements and an assessment of related risks, controlling the incorporation of applicable legislative requirements into the bank's processes and documents, compliance oversight audits in accordance with Council-approved work plans etc.
- implementing preventive activities with the aim to timely and fully define, document and assess bank-related compliance and reputational risks at an initial phase, including, among other things, developing adequate internal regulations before introducing new products and services or making significant changes in their design, training employees and providing guidance on compliance-related topics etc.
- creating the bank's business reputation by ensuring compliance with the bank-related regulatory requirements as well as complying with professional ethics standards, including preventing conflicts of interests and corruption while conducting the bank's activities as well as proper oversight over the complaint process.

The bank has developed and approved a Compliance and Reputational Risk Management Policy which provides for compliance and reputational risk management objectives, tasks and major principles, bank management and business units' tasks and responsibilities in the field of compliance and reputational risk as well as procedures regulating the report preparation and information provision process.

The bank has established a structural unit whose responsibility is to manage compliance and reputational risks, to ensure an independent control as well as to regularly and comprehensively assess respective risks and to submit reports to the Board and the Council.

Prevention of money laundering and terrorism financing (AML/CFT) risk

AML/CFT risk definition and AML/CFT risk management system description

The AML/CFT risk refers to the possibility of using a credit institution in the process of legalizing criminally acquired funds or financing terrorist activities in the context of providing financial services, a credit institution's client base, a geographical profile of clients' activities as well as in the context of an institution's distribution channels to deliver its products and services.

In order not to be involved into money laundering and terrorism financing the bank has developed an internal AML/CFT risk management control system. It is based on a clear understanding of possible

AML/CFT risks and necessary, relevant, proportionate and sufficient measures aimed at the prevention of such risks.

The bank has developed control policies, procedures and mechanisms based on the KYC-Know-Your-Customer principles. The risk-based approach ensures that one applies sufficient and proportionate measures with respect to each client in accordance with his/her risk profile.

The bank complies with Latvian and international legislative requirements which regulate anti-laundering and terrorism financing prevention, ensures compliance with sanctions imposed in accordance with EU regulations, UN and OFAC acts as well as compliance with professional and ethical standards.

The bank has developed internal regulations which define the responsibility of its executive officers and employees in the field of AML/CFT risk management, describe the framework for a timely and rigorous identification of AML/CFT risks in the context of the bank's services, products and internal processes.

In order to manage the AML/CFT risk there is a permanent risk monitoring. Its major objective is to ensure a timely identification and elimination of shortcomings in the bank's internal documentation and daily work processes and a proper function of the AML/CFT risk management process under changing circumstances in order not to allow a weakening of the internal control mechanism. There is a regular assessment of AML/CFT risks and a preparation of relevant reports as well as a regular update of the risk management strategy and processes.

The bank's Council and the Board bear responsibility to manage the AML/CFT risks in an efficient way. The bank's Council approves an AML/CFT policy and appoints Board members responsible for managing the AML/CFT risks.

The bank's Board:

- approves the bank's regulations which provides for an internal control mechanism in the field of AML/CFT;
- considers and approves submitted reports and notifications on a regular basis;
- ensures that there are sufficient financial, technical and human resources to manage the AML/CFT risks;
- ensures that there is a permanent compliance with high ethical standards while managing the AFT/CFT risks, including the prevention of conflicts of interests which increase or may increase the bank's AML/CFT risk exposure.

There is a decision-making entity within the bank in the form of a AML/CFT risk management committee which ensures that there is an efficient client oversight and a daily AML/CFT risk management.

The bank has established a Client Activities' Oversight Department which:

- ensures the identification, assessment and management of AML/CFT risks (including the oversight with respect to the assignment of a client to a relevant risk group); organizes and controls the preparation of quarterly reports containing information on meeting the bank's AML/CFT risk management requirements, AML/CFT risk exposure and its dynamics as well as assesses the accuracy of data submitted in the reports.
- oversees measures required to ensure the quantity and quality of human resources (personnel), the level of training and substitutability in order to conduct tasks in the field of AML/CFT risks;
- submits proposals to the Board and AML/CFT Risk Management Committee on measures required for a AML/CFT risk reduction;
- ensures an analytical support in the field of AML/CFT risks such as the business-unit maintenance of required IT technical tools, the preparation of analytical data to identify and prevent the AML/CFT risks, the regular submission of AML/CFT risk information to the Board as well as the exchange of information with regulatory and control institutions.

In order to reduce the AML/CFT risk the bank employs the following methods:

- The identification of the AML/CFT risks by clearly determining existing and residual risks and by introducing relevant and efficient procedures to reduce these risks.

- Procedures define processes of client identification, approval and monitoring, instructions for client inquiries and extended inquiries, a course of action when providing a new product to a client, cooperation with correspondent banks and partners and other processes;
- A relevant oversight/monitoring system to cover a client's activities and transactions which comprises specialized IT tools to automatically scan and map transactions with reference lists, comparison with previously defined scenarios and limit controls in order to ensure the identification of unusual and suspicious transactions;
- A client oversight is conducted in accordance with automatically assigned client risk groups (low, moderate, high, very high), thus ensuring the automated maintenance and usage of a limit and restriction system to oversee a client's activities based on risk factors such as a client type, residence, expected/existing transaction size, a politically exposed person status, expected/existing types of services to be used etc.
- An extended client examination for high-risk clients, including a course of action to follow when initiating and maintaining relationships with politically exposed persons;
- Procedures to initiate relationships with correspondent banks and partners, including a course of action to folow when assessing, examining and monitoring relevant risks;
- Information flow management, namely, the storage of information obtained when conducting the control and examination processes as well as the maintenance of required processes to ensure regular client information updates;
- A course of action to follow when discovering and reporting unusual and suspicious transactions.

The bank follows a Three-Defense-Line principle while managing the AML/CFT risks. Client relationship units have a primary role to play in the process of a client identification and verification as well as a unusual and suspicious transactions identification and further reporting. AML/CFT risk management units form a second line of defense, thus ensuring daily control activities. The Internal Audit unit forms a third line by conducting, not less than once in 18 months, the efficiency assessment of the AML/CFT risk management functions.

The bank also provides for an independent assessment of the AML/CFT internal control system not less than once in 18 months by hiring independent and professional outside assessors, thus ensuring that the bank's AML/CFT program is independently assessed not less than once in 9 months with further reporting of audit results to the bank's Council.

The bank has defined a course of action to follow for submitting reports. At least once a quarter AML/CFT risk management units submits to the Board and Risk Director its assessment of AML/CFT risks, assessment of effectiveness of the AML/CFT internal control system and related issues as well as its assessment of desirable and currently implemented measures to prevent those issues in accordance with the bank's internal regulations, thus reflecting parameter dynamics/trends, comparisons with work plans and conclusions as well as submitting an operational AML/CFT information to relevant Council and Board members in emergency situations;

In 2017 there was a series of improvements in the IT area which simplified and optimized the bank's internal and external IT processes as well as ensured compliance with legislative acts. In 2017 the bank introduced new programs and refined existing ones with the aim to improve the analysis and oversight of a client and his/her activities as well as to ensure an electronic documentation, storage and availability of the data obtained during the process of the extended client examination, decisions taken following the client examination and information which reflects a rationale of transactions in accordance with the IT system's user authorization level.

In 2017 there were certain activities with the aim to improve sanctions risk management. This involved the improvement of regulations, including a 2017-2019 New Money Laundering and Terrorist Financing Risk Management Strategy, the introduction of a 2017-2019 Sanction Program and an action plan. Starting with September 2017 the bank established a Sanction Officer position whose primary task is to regularly refresh the bank's filters in order to keep up-to-date with revisions / amendments / updates in various sanction programs, thus ensuring the distribution of sanction information materials, training, consulting and decision making with respect to client-conducted transactions as well as developing criteria for further implementation into the bank's internal control system.

All leading AML/CFT employees acquired ICA and ACAMS international certificates in 2017.

Business model risk

Business model risk refers to a risk that certain changes in the bank's business environment and its inability to react to these changes in due time or the bank's inappropriate or incorrectly selected development strategy, or the bank's inability to provide for sufficient resources to implement a strtategy may have an adverse effect on the bank's profitability, capital size and liquidity.

In late 2017 the bank's management reviewed and approved a 5-year strategy in accordance with which lending is one the bank's priority activities.

To manage business model risk the bank undertakes the following activities:

- strategic planning for the period of 5 years;
- developing a current financial plan;
- capital planning;
- stress testing.

Information disclosure with respect to encumbered and unencumbered assets

Information disclosure is prepared in accordance with the Commission-delegated Regulation 2017/2295's requirements.

Asset encumbrance in the context of the bank's balance sheet is quantitavely insignificant, given that the bank's encumbered assets primarily serve the purpose of ensuring its ability to provide services. The bank places its assets in such a way as to maintain a high level of liquidity and to be able to meet its current obligations towards clients at any time.

In its calculations of the risk value of encumbered assets for the year 2017 the bank used the median of the sums of four quarterly end-of-period values over the previous 12 months.

There are no transactions involving asset encumbrance between the bank and its subsidiaries.

The bank's assets are primarily encumbered when conducting trade finance transactions and when placing required collateral in transactions involving service provision to the bank's clients.

The bank's assets are primarily encumbered when conducting trade finance transactions and the value located at the intersection of row 120 and column 010 of Table 1 consists of the assets which serve as collateral in client transactions involving payment cards.

The value located at the intersection of row 060 and column 040 of Table 1 is available to the bank for asset encumbrance. The most significant percentage of this value is comprised of government-issued debt securities.

The bank would not consider the assets located at the intersection of row 060 and column 120 of Table 1 as available for possible encumbrance while undertaking ordinary commercial activities. The most significant percentage of these assets consists of fixed assets and equity participations in subsidiaries.

Encumbered and unencumbered assets, thous. EUR

Encumbered and unencumbered assets		Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
		010	040	060	090
010	Assets of the reporting institution	1 337		100 380	
030	Equity instruments			197	8
040	Debt securities			71 875	71 875
050	of which: covered bonds				
060	of which: asset-backed securities				
070	of which: issued by financial corporations			67 418	67 418
080	of which: issued by financial corporations			2 339	2 339

090	of which: issued by non-financial corporations			2 280	2 280
120	Other assets	1 337		28 308	
121	of which: collateral in payment-card transactions	1 337			
121	of which: fixed assets and intangibles			15 412	
121	of which: equity participations in subsidiaries			6 600	

Collateral received, thous. EUR

Collateral received		Fair value of encumbered collateral received or own debt securities issued	Unencumbered
			Fair value of collateral received or own debt securities issued available for encumbrance
		010	040
130	Collateral received by the reporting institution		
140	Loans on demand		
150	Equity instruments		
160	Debt securities		
170	of which: covered bonds		
180	of which: asset-backed securities		
190	of which: issued by financial corporations		
200	of which: issued by non-financial corporations		
210	of which: issued by non-financial corporations		
220	Loans and advances other than loans on demand		
230	Other collateral received		
231	of which: …		
240	Own debt securities issued other than own covered bonds or asset-backed securities		
241	Own covered bonds and asset-backed securities issued and not yet pledged		
250	TOTAL ASSETS, COLLATERAL RECEIVED AND OWN DEBT SECURITIES ISSUED	1 337	

Sources of encumbrance, thous. EUR

	Sources of encumbrance	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
		010	030
010	Carrying amount of selected financial liabilities	974	
011	of which: Over-The-Counter	974	

Capital Adequacy

Capital adequacy reflects the Bank's capital resources necessary to secure itself against risks related to assets and off-balance sheet items.

The Bank has the Capital Adequacy Assessment Process Policy, the aim of which is to ensure that the amount, elements and proportion of the Bank's equity capital are adequate to cover the substantial risks inherent to the Bank's current and planned operation.

For Pillar I risks, the capital requirement is calculated using the following approaches or methods:

- the credit risk requirement is calculated in accordance with a standardized approach;
- for the credit risk mitigation, simple method is used for financial collateral;
- capital requirements to cover a CVA risk in accordance with a standardized approach;

- the foreign currency risk capital requirements, debt securities' and capital securities' position risk, the payment/settlement risk capital requirements are calculated by using the standardized approach;
- debt securities' systematic risk capital requirement is determined by using the term method;
- the operational risk minimum capital requirement is calculated in accordance with the basic indicator approach.

For the calculation of the minimum capital requirements for the purpose of determining the transaction risk degree, the Bank applies the FCMC's recognized ECRA (rating agency) evaluations/ratings. ECRA are nominated for each risk transaction category, into which the Bank's risk transactions are divided into. If the Bank has no transactions, which can be included into any of the risk transaction categories, then, for this category, ECRA is nominated, when the actual risk transaction/-s of this category appears.

The following ECRA are nominated for the risk transaction categories:

Risk transaction category	Nominated ECRA
Claims against the central governments and central banks (CG and CB)	FitchRatings; Standard & Poor's Ratings Services; Moody's Investors Service.
Claims against the institutions with the exception of such institutions, for which the short-term rating is available	FitchRatings; Standard & Poor's Ratings Services; Moody's Investors Service.
Claims against the commercial companies with the exception of such institutions, for which the short-term rating is available	FitchRatings; Standard & Poor's Ratings Services; Moody's Investors Service.
The overdue risk transactions	FitchRatings; Standard & Poor's Ratings Services; Moody's Investors Service.
Claims against the institutions and commercial companies with the short-term ratings	FitchRatings; Standard & Poor's Ratings Services; Moody's Investors Service.
Other claims	FitchRatings; Standard & Poor's Ratings Services; Moody's Investors Service.

The Bank examines whether the fulfillment of the minimum capital requirements ensures that the Bank's capital is adequate to cover all potential losses related with the risks mentioned above.

In order to calculate the capital requirements to cover Pillar II risks the bank assesses its likely losses that may arise as a result of bank-specific risks, including the assessment of likely losses resulting from risks for which there is no generally accepted unified quantitative risk measuring approach. For this purpose the bank conducts a business-specific evaluation of at least:

- a non-trading portfolio's interest rate risk;
- concentration risk;
- anti-money laundering and counterterrorism financing risk;
- liquidity risk;
- other substantial bank-specific risks, including reputation risk, business model risk and others.

In order to assess the bank's capital adequacy to cover Pillar II risks the bank follows a simplified approach outlined in the FCMC Regulations on the Internal Capital and Liquidity Adequacy Assessment Process as well as conducts the assessment of their applicability to the bank's activities.

In order to calculate the capital requirements to cover additional risks the bank sets a recommended capital reserve to ensure that the bank's capital is adequate to cover losses in the event of likely adverse scenarios as well as to ensure that the size of the bank's existing capital is sufficient over the entire length of a business cycle. This implies that throughout periods of economic expansion the bank accumulates a capital reserve to cover losses that may arise during economic slowdowns.

In its calculations of the capital reserve size the bank evaluates, assesses and documents its likely development scenarios over the next three years subject to various macroeconomic development scenarios, events or changes in market conditions as well as assesses the impact of these scenarios, events

and changes in market conditions on the bank's overall financial situation, viability and sustainability of its business model, the size of the bank's existing own capital, capital requirements and capital adequacy by taking into account the interaction of bank-specific risks, particularly, credit risk, market risk and liquidity risk.

The recommended size of the capital reserve is calculated by incorporating the results of an annual stress test scenario with the severest adverse impact on the bank's activities given, following the results of that year's stress test scenario, there is a need for an additional capital to cover likely bank-specific risks above the size of the required capital to cover Pillar I and Pillar II risks and in compliance with the aggregate amount of the total capital reserve requirements stipulated in Paragraph IV of the Credit Institution Law.

Methods to ensure total size of the required capital are as follows:

- meeting the capital adequacy requirements;
- reviewing the compliance with the capital adequacy requirements;
- maintaining the capital adequacy target ratio;
- complying with the individual capital ratio within the time frame agreed upon with FCMC;
- calculating and planning the size of the required total capital to cover substantial existing and potential bank-specific risks;
- assessing and evaluating all substantial risks;
- developing stress test scenarios, conducting stress tests and reviewing obtained results;
- developing the capital adequacy maintenance plan.

On 31 December 2017, the Bank's calculated capital adequacy ratio was 30.12% (on 31 December 2016, it was 30.51%) which exceeds the minimum and the sum of capital conservation buffer minimum (10.5%) laid down in the European Parliament and Council Regulation (EU) No 575/2013 that own funds ratio against the risk weighted assets and off-balance sheet items must be at least 8% and the capital conservation buffer must be at least 2.5%. In the end of 2017, the Financial and Capital Market Commission recalculated the Bank's individual capital adequacy ratio and set it at 13.2%. The Bank observes and meets this individual capital adequacy requirement.

Capital adequacy evaluation results as of 31.12.2017

The capital required to cover risks, thous. EUR

	Minimum regulatory capital requirements	Bank's assessment of the required capital
Credit Risk	12 216	12 216
Market Risks	563	589
Currency Risk	54	54
Tradable Debt Instruments, securities	509	535
	9	9
Operational Risk	2 238	2 238
Other significant risks for which the minimum regulatory capital requirements have not been defined		7 321
Capital Reserve		7 086
Total	15 027	29 460*

*Taking into account the FCMC's individual capital requirements, Pillar II requirements and capital preservation requirements set at 2.5%.

The Bank's Existing capital, thous. EUR

Own Capital	Calculation of the Bank's capital
56 581	56 581
Capital deficit/surplus in accordance with the Bank's assessment	27 121

In the following table, the risk transaction category values before and after the credit risk mitigation are presented, as well as the total amount of the risk transactions, which have been concluded with the adequate collateral (thous. EUR):

Credit risk: the risk transaction categories	The risk transactions before the credit risk mitigations	Collateral (simple method)	The risk transactions after the credit risk mitigations	The risk weighted assets of the risk transactions
Claims against the central governments or central banks	**89 613**	**0**	**89 613**	**0**
0% risk degree	89 613	0	89 613	0
Claims against the institutions	**58 494**	**0**	**58 494**	**11 943**
20% risk degree	57 683	0	57 683	11 537
50% risk degree	811	0	811	406
Claims against the commercial societies	**127 983**	**31 642**	**96 341**	**104 017**
0% risk degree	0	0	0	0
20% risk degree	0	0	0	0
100% risk degree	89 065	8 074	80 991	80 991
150% risk degree	38 918	23 568	15 350	23 026
High risk transactions	**3 693**	**2 501**	**1 192**	**1 789**
0% risk degree	0	0	0	0
100% risk degree	0	0	0	0
150% risk degree	3 693	2 501	1 192	1 789
Overdue risk transactions	**8 387**	**0**	**8 387**	**9 416**
0% risk degree	0	0	0	0
100% risk degree	6 330	0	6 330	6 330
150% risk degree	2 057	0	2 057	3 086
Other claims	**21 727**	**0**	**55 716**	**18 706**
0% risk degree	2 214	0	36 203	0
20% risk degree	1 009	0	1 009	202
100% risk degree	18 504	0	18 504	18 504
Capital securities	**6 835**	**0**	**6 835**	**6 835**
100% risk degree	6 835	0	6 835	6 835
Total	**316 732**	**34 143**	**316 578**	**152 706**

Note: no CVA (credit value adjustment) risk is taken into account.

The average net amount of the risk transactions within the reporting period, broken down into different risk transaction categories after the credit risk mitigation application (thous. EUR):

Credit risk: the risk transaction categories	The risk weighted assets of the risk transactions in 2017	Average risk weighted assets of the risk transactions in 2017	The risk weighted assets of the risk transactions in 2016	Average risk weighted assets of the risk transactions in 2016
Claims on central governments and central banks	**0**	**0**	**0**	**0**
0% risk weight	0	0	0	0
Claims on financial institutions	**11 943**	**11 184**	**14 520**	**13 967**
20% risk weight	11 537	9 074	12 650	11 708
50% risk weight	406	2 110	1 870	2 259
100% risk weight	0	0	0	0
Claims on companies	**104 017**	**108 069**	**99 350**	**90 565**
0% risk weight	0	0	0	0
20% risk weight	0	0	0	1
100% risk weight	80 991	81 561	92 214	80 379
150% risk weight	23 026	26 508	7 136	10 185
Speculative risk transactions	**1 789**	**6 163**	**11 352**	**12 050**
0% risk weight	0	0	0	0
150% risk weight	1 789	6 163	11 352	12 050

Overdue risk transactions	**9 416**	**9 944**	**9 132**	**8 295**
100% risk weight	6 330	8 419	8 749	6 817
150% risk weight	3 086	1 525	383	1 478
Equity securities	**6 835**	**6 819**	**189**	**372**
100% risk weight	6 835	6 819	189	372
Other claims	**18 706**	**19 728**	**26 273**	**23 581**
0% risk weight	0	0	0	0
20% risk weight	202	66	10	78
100% risk weight	18 504	19 662	26 263	23 503
Total	**152 703**	**161 908**	**160 816**	**148 830**

Note: no CVA risk is taken into account.

Leverage ratio

Leverage ratio calculation as on 31.12.2017:	EUR, thousand
Securities financing transactions (SFT) exposure according to Article 220 of the CRR	
SFT exposure according to Article 222 of the CRR	
Derivatives: market value	66
Derivatives: add-on mark-to-market method	568
Derivatives: original exposure method	0
Undrawn credit facilities, which may be cancelled unconditionally at any time without notice	0
Medium/ low risk trade related off-balance sheet items	0
Medium risk trade related off-balance sheet items and officially supported export finance related off-balance sheet items	0
Other off-balance sheet items	11 270
Other assets	366 935
Tier 1 capital – fully phased-in definition	38 714
Tier 1 capital – transitional definition	38 714
Amount to be added according to second subparagraph of Article 429 (4) of the CRR	0
Amount to be added according to second subparagraph of Article 429 (4) of the CRR – transitional definition	0
Regulatory adjustments — Tier 1 capital — fully passed-in definition; of which	0
Regulatory adjustments regarding own credit risk	0
Regulatory adjustments — Tier 1 capital — transitional definition	-573*
Leverage ratio using the fully phased-in definition of Tier 1 capital, %	10.23%
Leverage ratio using the transitional definition of Tier 1 capital, %	10.23%

* non-material assets

In order to manage the leverage risk, the Bank has revised and supplemented the Capital Adequacy and Liquidity Assessment Process Policy, and the strategic planning process is being implemented taking into account the leverage ratio requirements.

As compared to 2016, in 2017, the Bank's deposit portfolio has decreased by 30.7% and amounted to EUR 296.8 million at the end of the year, whereas the amount of assets decreased by 26.8% and amounted to EUR 367.4 million on 31 December 2017.

The Bank's loan portfolio was 98.8 million EUR as on 31 December 2017, thus registering just an insignificant drop of 0.7% compared to the end of 2016. As compared to 2016, the size of the bank's own capital fell amounting to 56.5 million EUR at the end of 2017 (62.4 million EUR as of the end of 2016). The reduction in the size of the bank's own capital was due to a Tier II capital amortization for the amount of 9 million EUR.

The banking group's ratios are not significantly different with the size of own capital funds amounting to 56.5 million EUR, including 38.6 million EUR of Tier I capital. The capital adequacy ratio is 29.74%, the Tier I capital ratio is 29.74%, while the leverage ratio is 10.22%

The geographical composition of the Bank's credit risk exposure for transactions that are significant in the calculation of the Bank's countercyclical capital buffers (EUR, thousand):

Valstis	Initial pre-adjustment risk exposure value	Specific credit-risk exposure adjustments (for provisioning purposes)	Risk exposure value	Risk exposure risk-weighted value
United Arab Emirates	612	0	612	49
Armenia	1	0	1	0
Austria	9 858	0	9 858	789
Bangladesh	78	0	0	0
Belgium	11	0	11	1
Bulgaria	1 150	0	375	30
Belarus	34	0	19	1
Kazakhstan	44	0	44	7
Canada	1 835	0	168	14
Switzerland	1	0	0	0
China	504	0	504	14
Czech Republic	0	0	0	0
Germany	4 974	585	2 857	222
Estonia	7 525	0	7 522	602
Great Britain	2 674	0	1 415	37
Georgia	1 354	0	1 354	108
Hong Kong	168	0	1	0
Israel	8	0	4	0
Luxemburg	0	0	0	0
Latvia	69 089	16 033	77 660	3 446
Monaco	7 758	0	7 725	618
Poland	0	0	0	0
Russia	21 912	0	18 611	1 566
Ukraine	85 932	9 544	39 283	3 680
USA	2 710	953	2 763	231
Other countries	0	0	0	0
Total	218 232	27 115	170 786	11 414

Information on Management Arrangements

In order to ensure diversity the composition of the bank's Council and Board is established by taking into consideration a very wide range of person-specific information and competences. The bank's policy on the assessment of the suitability of members of the management body provides for the criteria used to assess the suitability of the bank's Council and Board members which should be complied with when assessing the suitability of nominated or elected Council and Board members as well as provides for actions to be taken when these persons are considered unsuitable for a respective position. With respect to Council and Board members one takes into account the fact that Council and Board members should devote a considerable amount of time and effort in performing their duties. Council and Board members, both individually and as a group, should possess a required specific knowledge, experience, competence, understanding (including understanding the business and related risks of the bank's subsidiaries) and personal characteristics (including professionalism and integrity) to allow the proper performance of the duties which in the case of Council members cover the supervision over the bank's or its subsidiary's Board activities, while in the case of Board members these cover the management of the bank's or subsidiary's activities. Council and Board members should possess a relevant information with respect to the bank's or subsidiary's activities not only at a level sufficient to perform his / her duties, but also should have an understanding of activities for which they do not bear the direct responsibility, while still bearing the overall responsibility.

The bank shapes its internal organizational structure so that business units that ensure the performance of certain functions within the bank's activities report to a Board member who bears the respective responsibility for these functions and possesses the relevant competence.

Pursuant to the bank's Statutes:

- The Council is composed of five members. The Shareholders' Meeting elects the Council for a period not exceeding five years. Following the election of the Council the Shareholders' Meeting monitors the general competence of Council members to enable the Council to perform its duties in an efficient way. Council members elect a Council Chairman and at least one Deputy Chairman from their midst.
- The Board is composed of five members* A Board member is elected for a term not exceeding five years. Board members are elected by the Council. When electing Board members the Council monitors the general competence of Board members to enable the Board, as a whole, to perform its duties in an efficient way. The Council elects a Board Chairman from among the members of the Board.

*At this point the Board is composed of four members with one Board member position being vacant.

A remuneration policy and practice

The objective of a remuneration policy is to define the key principles of remuneration of the Bank's employees pursuant to the Bank's strategy, business direction and risk profile to recruit and retain best employees. The remuneration policy is binding for all employees in the bank and its subsidiaries as well as for those employees in the bank's representative offices in Ukraine to the extent it is not in contradiction with this country's specific legal requirements.

The bank's Council is the principal remuneration oversight body. In 2017 the bank's Council held 41 Council meetings. The Council defines and approves the key principles of the remuneration policy, is responsible for its implementation and compliance oversight, sets remuneration for Board members, head of the Internal Audit Department and for the positions whose remuneration is equal to or exceeds a lower level of the salary scale for Board members or similar positions, establishes a procedure for tracking the remuneration policy's implementation and compliance with the approved key principles, establishes a procedure for the submission of Council reports on the outcome of internally conducted audits as well as the policy's impact on the bank's risk profile and risk management quality, is responsible for the direct oversight of the remuneration of top level executive positions or employees performing risk control and compliance control functions.

The Board of the Bank is responsible for implementation of remuneration policy's basic principles, evaluates positions that influence risk profile of the Bank, determine remuneration for the employees of affiliated companies, is responsible for development of relevant internal documentation, its approval and implementation. Remuneration for the positions that insure internal control function in the Bank is assigned independently from the performance of the functions under their control .

The remuneration structure consists of 2 parts:

- fixed salary or invariable part;
- benefits (mobile phone bills, health care insurance, extra days off, grants, corporate events, gifts, extra payments for excellent results of work or variable part of remuneration that is dependent on performance results.

The fixed part of Remuneration is assigned individually for each employee on the basis of evaluation of his or her competence and experience.

Variable part or extra payments are set for achieved performance results during a reporting period (quarter, year) and are based on general financial performance of the Bank, indicators that describe activity volume of the Bank (e.g. income, profit) as well as on indicators that characterize risk assessment of existing and potential risks arising from such performance results.

When calculating and assigning an yearly extra payment for fulfillment of individual performance plan or fulfillment of a unit performance plan, a deferred part in the amount 30% of early extra payment is applied and this payment is postponed for the period of 12 months. Variable part of salary for positions that influence risk profile of the Bank for the year cannot exceed 100% of the fixed salary before taxes according to current legislation of Latvian Republic.

As concerns the risk profile positions, the objective of the Remuneration Policy is to establish the system of remuneration, which would:

- not cause undertaking risks above the level set in the Bank's Risk Strategy,
- not limit the Bank's ability to increase its equity,
- correspond to the standards of ethics as well as encourage prudent and effective risk strategy,
- be in line with the principles of customers' and investors' interest protection.

There were no significant changes in remuneration policy in 2017, except that the list of position categories whose professional activities can influence risk profile of the Bank was enlarged.

The tables specify the amounts of the gross remuneration paid by the Group (the Bank, the representative offices, affiliated company "Grunewald Residence" Ltd.), excluding the employer's obligatory state social security payments or other payments resulting from taxation system of other countries. In 2017, remuneration was not paid for launching employment relations.

1. Table Information on employees' remuneration in 2017 (EUR)

	Council	Board	Investment services	Providing services to private persons or small and medium companies	Asset management	Corporate support function	Internal control function	Other types of activity
The number of employees at the end of the year	5	6	3	6	1*	154	13	13
Total remuneration EUR	165 444	437 486	128 979	238 732		3 478 663	402 355	129 110
Including: variable part of remuneration		16 106	6 343	15 862		283 668	30 764	7 037

2. Table Information on employees influencing the Bank's risk profiles (EUR)

		Council	Board	Investment services	Providing services to private persons or small and medium companies	Asset management	Corporative support function	Internal control function	Other types of activity
	The number of employees influencing the institution's risk profile	5	6	3		1*	3	3	
	Including the number of employees influencing the risk profile in the highest management positions								
Remuneration invariable part	**Total invariable part**	165 444	437 486	122 637			119 777	126 745	
	Including money and other means of payment	165 444	437 486	122 637			119 777	126 745	

	Including shares and the related instruments								
	Including other instruments								
Remuneration variable part	**Total remuneration variable part**	16 106	6 342				22 985	14 158	
	Including money and other means of payment	16 106	6 342				22 985	14 158	
	Including shares and the related instruments								
	Including other instruments								
The related variable part of remuneration	**Total variable part of remuneration deferred at the end of the reporting year**								
	Including the deferred amount in the form of money and other means of payment								
	Including the deferred amount in the form of shares and related instruments								
	Including the deferred amount in the form of other instruments								
	Total unpaid part of the deferred remuneration allocated before the reporting year								
	Including the part, to which the irrevocable parts are obtained								
	Including the part, to which the irrevocable parts are not obtained								
	Total part of the deferred remuneration paid at the end								

	of the reporting year	
Adjustment of variable part of remuneration	*Adjustment of the variable part of remuneration during the reporting year that concerns the variable part of remuneration allocated in the previous years*	
Variable part of guaranteed remuneration	*Number of persons receiving the guaranteed variable part of remuneration (sign-on payments)*	
	The amount of the variable part of guaranteed remuneration (sign-on)	
Remuneration for termination of employment relations	*Number of employees that received a compensation for termination of legal employment relations*	
	Amount of compensation for termination of legal employment relations paid in the reporting year	
	Amount of the largest compensation for a single person for termination of legal employment relations	
Benefits related to retirement	*Number of employees that receive benefits related to retirement*	
	Amount of benefits related to retirement	