Baltic International Bank

BALTIC INTERNATIONAL BANK CAPITAL ADEQUACY ASSESSMENT

The purpose of the Bank's internal capital adequacy assessment process (ICAAP) is to ensure that

- the Bank maintains, on an ongoing basis, an amount of internal capital sufficient to cover material risks inherent in the Bank's activities
- the Bank's capital is sufficient to absorb losses during periods of possible economic downturn.

The Bank's definition of the term capital corresponds to the definition given in 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, amending Regulation (EU) No. 648/2012 (hereinafter referred to as the Regulation).

In determining the required capital charges for various risk profiles, the Bank identifies and evaluates the following material risks to which the Bank is exposed:

- risks referred to in Section 92 of the Regulation (hereinafter referred to as risks of Pillar 1);
- other risks (hereinafter referred to as risks of Pillar 2);
- impact of possible adverse events on Bank's capital.

To determine the size of capital necessary for addressing risks under Pillar 1, the Bank assesses whether the adherence to the minimum regulatory capital requirements ensures that the Bank's capital is adequate for covering all contingent losses associated with these risks. To this end, the Bank measures the following risks:

- credit risk;
- market risk;
- credit value adjustment risk (hereinafter referred to as CVA risk);
- operational risk.

When calculating the required capital level based on the minimum regulatory capital requirements, the Bank applies the following methods:

- capital requirements for credit risk– standardised approach;
- capital requirements for market risk – standardised approach;
- capital requirements for credit value adjustment risk (CVA) – standardised approach.
- capital requirements for operational risk – the basic indicators approach.

To determine the amount of risk, Bank relies on credit ratings assigned by *Moody's Investors Service*.

Bank uses two techniques of credit risk mitigation: funded credit protection and unfunded credit protection.
In the case of *funded credit* protection, Bank uses:

- the on-balance sheet netting of mutual claims between Bank and its counterparty, where eligibility is limited to reciprocal cash balances between Bank and the counterparty (i.e. loans and deposits);
- the Financial Collateral Simple Method.

To determine the size of capital necessary for addressing risks under Pillar 2, the Bank measures the probability of loss to be incurred as a result of inherent material risks. The Bank, therefore, analyses:

- concentration risk;

- interest rate risk in the non-trading (banking) book (the Bank measures the risk each half-year);
- liquidity risk;
- ML/TF risk;
- other material risks inherent in Bank's business.

To assess the impact of possible adverse events on Bank's capital, the Bank applies scenario analysis, including stress testing. The Bank determines the size of recommended **capital buffer** in order to ensure that the Bank's capital is sufficient to support its activities upon the occurrence of any adverse circumstances, and to ensure that the Bank's capital is sufficient throughout the economic cycle.

The size of overall required capital, determined by the Bank as part of its capital adequacy assessment process, represents the sum of the capital charges for all risks plus the capital buffer. Within the scope of its business planning, the Bank conducts internal capital planning on a forward-looking basis, i.e., for at least the next three years.

Capital Adequacy Ratio as of 31 December 2016 (EUR)

Items	Group	Bank
Tier 1 capital elements		
Paid-in share capital	31 496 395	31 496 395
Reserve capital and other reserves	835 152	835 152
Retained earnings	-709 054	-301 937
Profit for the current year	325 492	135 351
Intangible assets	-4 107 870	-4 107 870
Deferred tax related to the intangible asset	509 939	509 939
Available for sale instruments revaluation reserve	-126 171	-126 171
Less revaluation of investment property	-258 348	-90 188
Specific decline in Tier 1 capital	-2 561 318	-2 561 318
Tier 1 Core Capital	**25 404 217**	**25 879 353**
Tier 2 capital elements		
Subordinated liabilities	10 445 893	10 445 893
Specific decline in Tier 2 capital	-2 561 318	-2 561 318
Tier 2 Supplementary Capital	**7 884 575**	**7 884 575**
TOTAL CAPITAL		
Capital charge for credit risk inherent in the Bank" s book, including the breakdown of exposures by categories:	13 001 558	12 924 507
Central governments or central banks	743 780	743 780
Multilateral development banks	0	0
Public entities	335 940	335 940
Commercial companies	3 145 097	3 145 097
Overdue (delinquent) exposures	2 012 909	1 842 556
High-risk exposures	3 186 159	3 383 843
Shares and other variable income securities	415 107	580 326
Other items	3 162 566	2 892 965
The total capital charge for market risks	435 044	435 044
Capital charge for operational risk	2 999 432	2 990 271
Total capital charge	**16 436 034**	**16 349 822**
CET1 capital ratio	**12,37%**	**12,62%**
Capital adequacy ratio	**16,20%**	**16,48%**

In accordance with the capital adequacy requirements set by the Financial and Capital Market Commission, banks with a business model focusing on non-resident customer service, are required to maintain their individual capital adequacy ratios. As of 31 December 2016, the Bank's individual capital adequacy ratio was set at 10,2%. In addition, banks have to hold a capital conservation buffer of 2,5% of their total exposure value. This means that the Bank, as of 31 December 2016, had to maintain the capital adequacy ratio of 12,7%. The Bank and the Group satisfied the above requirements.

As part of the capital adequacy assessment process, the Bank, on an annual basis, assesses the capital that is necessary for covering of risks. The results of the assessment are presented in the table below:

A Summary of the Results of the Capital Adequacy Assessment

Items	Item code	Group	Bank
Pillar 1 risks [1.1.+1.2.+1.3.+1.4.]	**1.**	**16 629 702**	**16 543 489**
Credit risk	1.1.	13 077 580	13 000 528
Credit value adjustment risk (CVA risk)	1.2.	0	0
Market risks	1.3.	552 690	552 690
Operational risk	1.4.	2 999 432	2 990 271
Pillar 2 risks [2.1.+2.2.+2.3.+2.4.+2.5+2.6.]	**2.**	**7 814 511**	**7 855 782**
Interest rate risk in the non-trading (banking) book	2.1.	2 397 042	2 416 656
Credit portfolio concentration risk	2.2.	1 063 961	1 068 334
ML/TF risk	2.3.	3 279 455	3 280 807
Liquidity risk	2.4.	87 891	87 891
Other risks	2.5.	986 162	1 002 094
Additional capital requirement, related to the individually set capital adequacy ratio	2.6.	0	0
Diversification effects	**3.**	-	-
Total capital reserve requirement	**4.**	**5 136 261**	**5 109 320**
Recommended capital reserve	**5.**	0	0
Total capital required for covering risks	**6.**	**29 580 475**	**29 508 592**
The amount of capital held by the Group (Bank)	**7.**	**33 288 792**	**33 673 928**
Capital surplus	**8.**	**3 708 317**	**4 165 336**

According to the results of the ICAAP as of 31 December 2016, the **Bank's capital is sufficient to support all material risks inherent in the Bank's activities.**

Leverage Ratio

The risk of excessive leverage is defined as the risk resulting from Bank's vulnerability due to leverage or contingent leverage in its funding structure that may require unintended corrective measures to its business plans, including distressed selling of assets which might result in losses or in valuation adjustments to its remaining assets. The leverage ratio is the ratio representing the percentage of Tier 1 capital to the total amount of non-risk weighted exposures (including off-balance sheet business). As at the end of 2016, banks were required to maintain the leverage ratio at a certain level. It is expected

that the minimum requirement for a leverage ratio will be determined on the basis of data obtained during the observation period and will take effect on 01 January 2018.

Items	Group	Bank
Off-balance sheet items	11 267 131	11 353 025
Assets	304 381 482	304 681 116
Regulatory adjustments— tier 1 capital — after a fully implemented definition	-6 159 249	-6 159 249
Total exposure measure	309 489 364	309 874 892
Tier 1 capital	25 662 565	25 879 541
Leverage ratio	**8,29%**	**8,35%**

Encumbered and unencumbered assets as at 31 December 2016

Annex No. 1
Finance and Capital Market Commission 25.02.2015 regulations No. 24

Assets

	EUR	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
		10	40	60	90
10	Total assets	31 930 392	X	276 159 553	X
30	including equity instruments	0		4 718 400	
40	including debt securities	19 202 143		79 145 733	
120	including other assets	0	X	50 301 284	X

Annex No.2
Finance and Capital Market Commission 25.02.2015 regulations No. 24

Collateral received

	EUR	Fair value of encumbered collateral received or own debt securities issued	Fair value of collateral received or own debt securities issued available for encumbrance
		10	40
130	Total collateral received	2 310 335	12 548 977
150	including equity instruments		363 982
160	including debt securities		12 184 996
230	including other collateral received		
240	Own debt securities issued other than own covered bonds or ABSs		234 323

Encumbered assets and collateral received that serve for securing of bank's liabilities

	EUR	Liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
		10	30
10	Carrying amount of financial liabilities	6 190 533	34 240 727