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* or, if it does not exist, Fitch or Standard & Poor's (worse of the two) assigned credit ratings.

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;
- 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 2018 (EUR)

Items	Group	Bank
Tier 1 capital elements		
Paid-in share capital	33 626 395	33 626 395
Reserve capital and other reserves	835 152	835 152
Retained earnings	-9 034 127	-9 297 900
Loss for the current year	-2 143 054	-1 949 939
Intangible assets	-4 180 835	-4 180 835
Additional deductions of CET1 Capital	-4 013 969	-4 013 969
Financial instruments revaluation reserve (positive)	8 367	8 367
Value adjustments due to the requirements for prudent valuation	-29 308	-29 308
Other transitional adjustments to CET1 Capital	505 950	505 950
Tier 1 capital	**15 574 571**	**15 503 913**
Tier 2 capital elements		
Subordinated liabilities	7 249 585	7 249 585
Tier 2 capital	**7 249 585**	**7 249 585**
Total capital	**22 824 156**	**22 753 498**
Capital charge for credit risk inherent in the Bank's book, including the breakdown of exposures by categories:	**11 279 211**	**11 326 381**
Exposures to central governments or central banks	*308 903*	*308 902*
Exposures to public sector entities	*419 262*	*419 260*
Exposures to corporates	*4 886 110*	*4 633 874*
Exposures secured by mortgages on immovable property	*25 450*	*25 450*
Exposures in the form of covered bonds	*13 927*	*13 927*
Exposures in default	*2 028 695*	*2 026 077*
Exposures associated with particularly high risk	*2 077 922*	*2 208 680*
Equity exposures;	*172 226*	*343 502*
Other items	*1 346 716*	*1 346 709*
Capital charge for market risks	84 997	84 997
Capital charge for operational risk	2 700 365	2 695 768
Capital charge for credit valuation adjustment	23	23
Total capital charge	**14 064 596**	**14 107 169**
Tier 1 capital ratio	**8.86%**	**8.79%**
Total capital ratio	**12.98%**	**12.90%**

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 2018, the Bank's individual capital adequacy ratio was set at 12,9%. In addition, banks have to hold capital buffers in accordance with Credit Institution Law. This means that the Bank, as of 31 December 2018, had to maintain the capital adequacy ratio of 15,65%. The Bank has approved capital preservation measures directed as well to restoring capital. The Bank expects to replenish its capital by EUR 9 million during 2019.

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 2018, banks were not required to maintain the leverage ratio at a certain level.

Items	Group	Bank
Off-balance sheet items	5 109 051	5 175 766
Assets	281 989 894	281 994 946
Regulatory adjustments – tier 1 capital – after a fully implemented definition	-8 224 112	-8 224 112
Total exposure measure	278 874 833	278 946 600
Tier 1 capital	15 068 621	14 997 963
Leverage ratio	**5.40%**	**5.38%**

Encumbered and unencumbered assets as at 31 December 2018

Assets

		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	25 454 511	X	260 152 763	X
30	including equity instruments	0		206 663	
40	including debt securities	19 530 710		20 071 132	
120	including other assets	0	X	51 518 463	X

Collateral received

		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	1 471 347	5 056 878
150	including equity instruments		0
160	including debt securities		5 056 878
230	including other collateral received		
240	Own debt securities issued other than own covered bonds or ABSs		0

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

		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	1 707 087	26 925 859