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 2019 (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	-11 177 181	-11 247 839
Loss for the current year	-3 440 257	-3 161 397
Intangible assets	-4 152 043	-4 152 043
Additional deductions of CET1 Capital	-3 807 359	-3 433 053
Financial instruments revaluation reserve (positive)	79 065	79 065
Value adjustments due to the requirements for prudent valuation	-16 060	-16 060
Other transitional adjustments to CET1 Capital	102 702	102 702
Tier 1 capital	**12 050 414**	**12 632 922**
Tier 2 capital elements		
Subordinated liabilities	6 411 232	6 411 232
Tier 2 capital	**6 411 232**	**6 411 232**
Total capital	**18 461 646**	**19 044 154**
Capital charge for credit risk inherent in the Bank's book, including the breakdown of exposures by categories:	**8 081 654**	**8 136 260**
Exposures to central governments or central banks	*251 447*	*251 447*
Exposures to public sector entities	*301 060*	*301 044*
Exposures to corporates	*1 965 743*	*1 835 408*
Exposures secured by mortgages on immovable property	*24 029*	*24 029*
Exposures in the form of covered bonds	*14 247*	*14 247*
Exposures in default	*1 785 660*	*1 800 098*
Exposures associated with particularly high risk	*1 272 238*	*1 374 649*
Equity exposures;	*197 853*	*444 834*
Other items	*2 269 378*	*2 090 505*
Capital charge for market risks	0	0
Capital charge for operational risk	2 135 667	2 131 225
Capital charge for credit valuation adjustment	2 104	2 104
Total capital charge	**10 219 425**	**10 269 590**
Tier 1 capital ratio	**9.43%**	**9.84%**
Total capital ratio	**14.45%**	**14.84%**

The Bank (the Group) must comply with the FCMC requirements for CET1 capital ratio (7.41%), T1 Capital ratio (9.90%) and Total capital ratio (13.20%). In addition to the requirements set by the FCMC, the Bank has to comply with the requirement of total capital buffers set forth in the Law on Credit Institutions. Compliance with the Common Equity Capital Requirement must be ensured by CET1 capital. As of December 31, 2019, the Bank's (Group) actual ratios were: CET1 (T1) capital ratio 9.84% (9.43%) and Total capital ratio 14.84 (14.45%).

As at 31 December 2019, the Bank (the Group) did not comply with the FCMC's requirement for a single indicator, i.e. T1 Capital ratio by 0.06 (0.47) percentage points. As of March 31, 2020, the Bank's (Group) capital ratios significantly exceed the requirements set by the FCMC as a result of the capital strengthening measures taken in the first quarter of 2020, and the Bank's capital is sufficient to comply with the CET1 Capital ratio was 14.32% (13.94%) the T1 Capital ratio was 14.32% (13.94%) and the total capital ratio was 17.31% (16.97%).

As at 21 April 2020, the FCMC mandated the Bank (the Group) to maintain the following regulatory capital ratios starting from the aforementioned date:

- CET1 Capital ratio of 6.18%,
- T1 Capital ratio of 8.25%,
- Total capital ratio of11.00%.

To comply with the requirement for total capital buffers set forth in the Credit Institutions Act of the Republic of Latvia, the Bank (the Group) must maintain the following regulatory capital ratios:

- CET1 Capital ratio of 8.93%,
- T1 Capital ratio of 11.00%,
- Total capital ratio of 13.75%.

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 2019, banks were not required to maintain the leverage ratio at a certain level.

Items	Group	Bank
Off-balance sheet items	3 227 800	3 277 295
Assets	222 405 685	222 579 157
Regulatory adjustments – tier 1 capital – after a fully implemented definition	-7 975 462	-7 601 156
Total exposure measure	217 658 023	218 255 296
Tier 1 capital	11 947 712	12 530 220
Leverage ratio	**5.49%**	**5.74%**

Encumbered and unencumbered assets as at 31 December 2019

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	23 025 900	X	203 356 098	X
30	including equity instruments	0		26 950	
40	including debt securities	18 788 049		15 989 728	
120	including other assets	0	X	50 808 471	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	1 329 347	2 422 760
150	including equity instruments		0
160	including debt securities		2 422 760
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	1 658 768	24 355 247