Information Disclosure Statement

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General Information on the Group

AS PrivatBank (hereinafter referred to as “the Bank”) is a joint stock company established in the Republic of Latvia, which received a banking licence on 31 July 1992 (reregistered on 17 September 1998).

The Information Disclosure Statement includes the information on the Bank and its subsidiaries (jointly referred to as “the Group”) for the year ended 31 December 2016.

The Bank has the following subsidiaries:

Name	Country of registration	Type of activity
SIA PrivatLīzings - in the process of merging with the Bank	Latvia	Financial and operating lease
SIA PrivatConsulting	Latvia	Consulting and tourism services
SIA Amber Real	Latvia	Real estate transactions
SIA PrivatInvestment	Latvia	Maintenance and servicing of the Bank’s real estate

Subsidiaries are companies controlled by the Bank. Control is exercised if the Bank directly or indirectly influences the company’s financial and business policy aimed at benefiting from the activities of the company.

The Bank discloses information on a consolidated basis (int. al., the subsidiaries) since according to Article 13 of Regulation (EU) No. 575/2013 there is no need to disclose information on an individual or sub-consolidated basis (subsidiaries of the Bank are of no material significance to the Latvian market).
All subsidiaries of the Bank are included in the consolidation group.
The Bank applies equal consolidation principles for accounting and prudential requirements.

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Key Activities

The Bank`s current and targeted activity is related with offering a wide range of products and services:

- payments, wire transactions (settlement accounts for legal entities, domestic payments (euros), international payments, cash payments);
- cash and non-cash transactions in different currencies;
- remote services: online banking, electronic settlement system;
- deposits and investments: savings accounts, term deposits;
- securities transactions;
- leasing and factoring;
- trust transactions;
- lending (long-term and short-term loans, overdraft, consumer loans, mortgage loans);
- electronic commerce services.

The Bank`s Financial Performance summary

The Consolidated and Separate Financial Statement (assets)

ASSETS	Group 2016 EUR '000 (Audited)	Bank 2016 EUR '000 (Audited)	Group 2015 EUR '000 (Audited)	Bank 2015 EUR '000 (Audited)
Demand sash and balances due from the Bank of Latvia	105 591	105 591	184 378	184 378
Financial instruments at fair value through profit or loss	-	-	9 275	9 275
Loans and receivables from credit institutions	14 191	14 191	69 498	69 498
Loans and receivables from customers	72 696	96 535	239 746	265 986
Available-for-sale assets	3 322	3 322	12 451	12 451
Held-to-maturity assets	20 807	20 807	38 175	38 175
Investment in subsidiaries	-	418	-	418
Fixed assets	33 462	33 412	35 256	35 142
Intangible assets	736	729	589	564
Investment property	2 793	2 793	2 846	2 846
Overpaid corporate income tax	176	173	94	92
Other assets	25 141	5 542	26 797	4 509
Total Assets	**278 915**	**283 513**	**619 105**	**623 334**

The Consolidated and Separate Financial Statement (liabilities, equity and reserves)

LIABILITIES, EQUITY AND RESERVES	Group 2016 EUR '000 (Audited)	Bank 2016 EUR '000 (Audited)	Group 2015 EUR '000 (Audited)	Bank 2015 EUR '000 (Audited)
Financial instruments at fair value through profit or loss	-	-	25	25
Balances due to credit institutions	6 445	6 445	7 380	7 380
Current accounts and deposits from customers	194 080	194 701	526 087	526 163

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Provisions	1 243	1 204	1 608	1 529
Subordinated loans	20 138	20 138	20 195	20 195
Other liabilities	9 142	8 982	19 701	19 565
Total Liabilities	**231 048**	**231 470**	**574 996**	**574 857**
Share capital	86 350	86 350	80 350	80 350
Other reserves	5 398	5 397	5 400	5 397
Revaluation reserve for available for sales assets	78	78	5 513	5 513
Accumulated losses	(43 959)	(39 782)	(47 154)	(42 783)
Total Equity, Reserves and Liabilities	**47 867**	**52 043**	**44 109**	**48 477**
Total Liabilities	**278 915**	**283 513**	**619 105**	**623 334**
Off-balance sheet items				
Trust assets	27 208	27 208	651 022	651 022
Contingent liabilities	3 829	3 833	4 740	4 744

The Consolidated and Separate Profit or Loss Account

PROFIT OR LOSS ACCOUNT	Group 2016 EUR '000 (Audited)	Bank 2016 EUR '000 (Audited)	Group 2015 EUR '000 (Audited)	Bank 2015 EUR '000 (Audited)
Interest income	9 662	9 872	16 192	16 415
Interest expense	(4 562)	(4 562)	(6 246)	(6 247)
Net interest income / loss	**5 100**	**5 310**	**9 946**	**10 168**
Fee and commission income	11 435	11 412	13 432	13 391
Fee and commission expense	(1 776)	(1 745)	(2 637)	(2 626)
Net fee and commission income	**9 659**	**9 667**	**10 795**	**10 765**
Net gain on financial instruments at fair value through profit or loss	7 453	7 453	460	460
Net foreign exchange and revaluation income	2 178	2 178	2 452	2 408
Other income	7 438	4 060	4 158	1 424
Other expense	(3 606)	(766)	(2 926)	(675)
Operating income	**28 222**	**27 902**	**24 885**	**24 550**
Impairment losses	(7 675)	(7 914)	(10 601)	(10 172)
Administrative expenses	(17 153)	(16 793)	(13 987)	(13 601)
Profit / loss before income tax	**3 394**	**3 195**	**297**	**777**
Corporate income tax expense	(199)	(194)	(284)	(284)
Profit for the year	**3 195**	**3 001**	**13**	**493**
Other comprehensive income items that may be reclassified subsequently to profit or loss				
Available-for-sale financial assets – net change in fair value	1 929	1 929	5 434	5 434
Available for sale financial assets – reclassified to profit or loss	(7 364)	(7 364)	-	-
Total comprehensive income / loss for the year	**(2 240)**	**(2 434)**	**5 447**	**5 927**

AS PrivatBank Group ended the year 2016 at a profit of EUR 3.195 million.

The Bank`s consolidated minimum capital adequacy ratio and liquidity ratio as at 31 December 2016 exceeded the individual regulatory requirements of 11.60% for capital adequacy and 50% for liquidity ratio. As at 31.12.2016, the liquidity rate was 103.06% and the capital adequacy ratio – 31.25% (before corrections).

Description of Risk Management System

Description of significant risks inherent in the Bank`s current and planned activity (risk profile)

The Bank`s risk management system has been developed according to the regulatory requirements of the Financial and Capital Market Commission (hereinafter – FCMC) and the guidelines for efficient risk management set up by the Basel Committee on Banking Supervision.

The Bank considers the following risks as significant to its activities according to *Significant Risk Identification Policy*:

- credit risk and business partner credit risk;
- operational risk;
- market risk (market price risk and foreign exchange risk);
- country risk;
- interest rate risk in the non-commercial portfolio;
- liquidity risk;
- concentration risk;
- risk of money laundering and terrorism financing (hereinafter – AML risk);
- reputation risk;
- strategic and business risk;
- excessive leverage risk.

Risk profile chart according to the Bank Strategy for 2017-2019:

Risk category / % of the consolidated own funds	Low	Average	Considerable	High
	<1%	1%-3%	3%-7%	>7%
Credit risk				
Concentration risk				
Interest rate risk				
Country risk				
Market risk				
AML risk				
Operational risk				
Reputation risk				
Strategy and business risk				

For the measurement of inherent risks the Bank applies analytical methods consistent with the specific features and complexity of its activity, int. al. stress tests.

The Bank regularly, at least once a year, revises and improves risk identification and management policies and procedures according to changes in the Bank activities and external factors affecting the activity of the Bank.

If significant changes in the Bank activities and the external factors affecting the activity of the Bank have taken place in the period between two strategic planning periods the Risk Control Department shall do a recurrent risk profile assessment and submit to the Board and the Council.

The Risk Control Department at least once a year according to *Procedure for Assessment of Significant Risk Management Efficiency and Analysis of Compliance of Bank's Operations with the Risk Strategy* shall submit the Board and the Council a report on the significant risks and the compliance thereof with the Bank Strategy.

Risk Definitions Used by the Bank:

- *credit risk* means the risk of loss if a business partner (counterparty/borrower) fails to perform their contractual obligations to the Bank, or performs them unduly, or partially. Exposure to credit risk is retained throughout the credit period;
- *operational risk* means a possibility of incurring loss due to inappropriate or incomplete internal processes, human or system errors or external circumstances, including legal risk, but excluding strategic risk and reputation risk;
- *market risk* means a possibility of incurring loss due to revaluation of balance-sheet and off-balance-sheet items related to changes in the market prices for financial tools, commodities and commodity derivatives resulting from changes in exchange rates, interest rates and other factors;
- *foreign currency risk* means a potential adverse impact of changes in foreign exchange rates (gold is treated as a foreign exchange) on the Bank income/expenses and own funds;
- *counterparty credit risk* means a possibility of incurring loss if a counterparty discontinues complying with their obligations before the last settlement payment is made;
- *country risk* means a risk of incurring loss from transactions with non-residents resulting from the impact of economic, social and political factors of a relevant country on the ability of its residents (int. al., government) to duly perform their obligations to the Bank, and the transfer risk, which is a component of the country risk and is related to a counterparty`s ability to ensure the availability of foreign exchange;
- *interest rate risk* means a potential adverse impact of changes in the interest rates on the Bank income and economic value;
- *liquidity risk* means a probability that the Bank will be unable to cover its liabilities by loans and receivables, as well as potential losses that occur due to failure to comply with the FCMC regulations and non-material losses caused to the image of the Bank. The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is significant to the management of financial institutions including the Bank. Complete match is unusual for financial institutions since the business transacted is often of uncertain periods and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of loss;
- *concentration risk* means any risk exposure or group of risk exposures, which may cause such losses to the Bank that may lead to the Bank's insolvency or threaten the ability to

conduct further business. Concentration risk arises from high volume risk exposures to the clients or groups of connected clients or risk exposures to clients, whose creditworthiness is dependent on one joint risk factor (for example, on economic sector, geographical region, currency, credit risk mitigation instrument (homogeneous collateral or one guarantee provider, etc.));

- *risk of money laundering and terrorism financing (AML risk)* means a risk that the Bank may be involved into money laundering or financing of terrorism;
- *reputation risk* means a risk that the Bank customers, its counterparties, shareholders, supervisory institutions or other stakeholders may form a negative opinion about the Bank that may affect the Bank`s ability to maintain the current business relations with customers and other counterparties, or create new ones, as well as adversely affect the availability of financing. Due to reputation risk events, other risks inherent in the Bank`s activities (credit risk, liquidity risk, market risk, etc.) may increase that may adversely affect the Bank`s profit, capital and liquidity;
- *strategic and business risk* means a risk that changes in business environment and the Bank's lack of responsiveness to those changes or inadequate or inappropriately chosen business strategy, or inability of the Bank to ensure the necessary resources to implement the strategy may cause negative effect on the Bank's profit, capital and liquidity;
- *excessive leverage risk* means a risk the Bank may be exposed to upon the increase of borrowed funds (actual or possible) in the financing structure, requesting for unscheduled corrective measures in relation to the business plan, among them compulsory sales, that may incur loss or adjustment of the value of remaining assets.

Information about Risks Inherent in the Bank`s Operations. Risk Management System Overview

The Bank`s risk management system has been described in the financial statements for the year ended 31.12.2016. A short review of the Bank`s risk management system is given below.

Credit Risk

Credit risk of the credit portfolio is identified determining borrower`s creditworthiness prior to and after granting loans according to the *Procedure on Credit Risk Management when Performing Credit Operations.*

Before introducing a new financial service or significant changes to the current financial services the Bank shall assess the possible credit risk according to the *Procedure on Elaborating and Implementing New Products*, as well as assess the impact thereof on the credit risk capital requirement.

To reduce credit risk, the Bank performs the following credit risk minimisation measures:

- diversification – distribution of risk by types of credits and borrowers, credit terms, etc.;
- setting up limits – to borrowers (groups of connected customers), economic sectors, countries, etc.;
- stress testing – assessment of the amount of capital required to cover the credit risk and identification of critical situations that may significantly increase the amount of loss related to credit risk;

- credit (portfolio) quality control – regular credit portfolio quality control, calculation of impairment losses and creating of capital buffer.

To identify credit risk of the credit portfolio and assess credit quality, the Bank divides loans into two groups: individually assessed loans and loans grouped according to similar credit risk parameters, which are assessed according to *Assets and Off-Balance Liabilities Assessment Procedure*.

The Bank assesses credit portfolio concentration risk which occurs when a substantial loan amount is directly or indirectly granted to one customer, a group of connected customers or invested into one industry or sector, geographical region or country, as well as in cases when loans have homogeneous collateral or one guarantee provider, or loan currency is different from the customer income currency.

The reporting and information exchange procedure, distribution of risk management powers and responsibilities, as well as the procedure of decision making are set in *Credit Risk Management Policy*.

Loans and receivables from credit institutions and issuers consist of loans and receivables from other banks and issuers of securities purchased for investment portfolio of the Bank, as well as off-balance liabilities of credit institutions and issuers.

Loans and receivables from credit institutions and issuers are assessed individually. The Bank assesses the credit risk of loans and receivables from credit institutions and the necessity of provisioning according to *Assets and Off-Balance Liabilities Assessment Procedure*.

Individual concentration risk of loans and receivables from credit institutions / issuers is included in the concentration risk stress tests according to *Credit Risk Stress Tests Procedure*.

The Bank regularly (at least once a quarter) performs stress tests of credit risk exposers according to *Credit Risk Stress Tests Procedure*.

The Bank foresees two stress test scenarios – changes within a year and in two years, and develops the basic scenario and pessimistic scenario.

For the purposes of **credit portfolio stress testing** the Bank develops several scenarios of credit portfolio quality changes to identify the amount of capital required to cover the expected loss (EL) and the unexpected loss (UL). The scenarios take into account the deterioration in the borrowers` creditworthiness in light of decline in the macroeconomic indicators in the short-term and long-term perspective (publicly available on the Internet) and the probability of default (PD), which is determined according to the Bank`s historical data on the increase of non-performing loans[1] and the loss given default (LGD). Stress testing takes into account the planned credit portfolio for one year and two years, as well as possible migration of undue loans to overdue loans in view of macroeconomic forecast of economic indicators and forecasted changes in the immovable property value.

Within the framework of credit risk stress testing the Bank additionally performs stress testing of receivables (collection of receivables).

The Bank also assesses loans and receivables from credit institutions and issuers within the framework of credit risk stress testing.

When performing stress tests of loans and receivables from credit institutions / issuers, the amount of potential expected loss upon possible decrease in ratings is assessed.

[1] Non-performing loans mean loans overdue for more than 90 days.

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The key parameters for stress testing of loans and receivables from credit institutions/issuers are the probability of default (PD) and loss given default (LGD) provided by Moody`s international credit ratings agency within the framework of annual report *Annual Default Study: Corporate Default and Recovery Rates*.

Operational Risk

The Bank manages operational risk according to *Operational Risk Management Policy*, which is revised at least once a year according to changes in the Bank activities and external factors affecting the activity of the Bank.

The Bank manages operational risk according to the guidelines for efficient operational risk management set up by the Basel Committee on Banking Supervision and *International Convergence of Capital Measurement and Capital Standards,* the Financial and Capital Market Commission regulations and recommendations, as well as other international normative acts, which the Bank applies according to the scope, types and complexity of its operations.

The process of operational risk management consists of the following key elements:

- **identification** – summarising and classification of information on operational risk events and the losses thereof aimed at identifying the spheres of activity, products and structural units most exposed to operational risk;
- **assessment** – quantity and quality assessment (measurement) of operational risk aimed at identifying the level of operational risk and assessing the possible loss upon occurrence of adverse operational risk events;
- **mitigation** – development of measures for mitigation of operational risk to reduce the possibility of loss or the possible amount of loss;
- **control (monitoring)** – control of operational risk level, timely disclosure of the spheres of activity, products and structural units of the Bank whose level of operational risk becomes unacceptable; preparation of reports to the Board and heads of structural units about the identified operational risk events and the general risk level.

To manage operational risk, the Bank`s historical data on operational risk events (both internal events identified within the Bank, and external events – identified in other banks) are aggregated in the operational risk database according to *Procedure on Reporting about Operational Risk Events and Operational Risk Database.*

Market Risk

The Bank manages market risk according to *Financial Instrument Price Risk Management Procedure*, which is revised at least once a year according to changes in the Bank activities and external factors affecting the activity of the Bank.

Market risk management is aimed at supervision and control of the risk, providing for acceptable risk level and optimising the risk return.

To reduce the market risk, the Bank performs the following risk minimisation measures:

- diversification – division of risk by types of issuers, terms of issue, etc.;
- setting of limits – to individual issuers (groups of connected customers), sectors, countries, etc.;
- stress testing – assessment of the amount of capital required to cover the market risk and identification of critical situations that may significantly increase the amount of loss related to market risk.

Foreign Exchange Risk

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The Bank manages foreign exchange risk according to *Foreign Exchange Risk Management Procedure*, which is revised at least once a year according to changes in the Bank activities and external factors affecting the activity of the Bank.

To manage foreign exchange risk, the Bank:

- ✓ every day controls compliance with the limits of open foreign exchange positions (int. al., gold positions), using financial derivatives, for example, currency swap transactions, to reduce foreign exchange positions, if necessary;
- ✓ determines the foreign exchange risk level, applying the value at risk method (VaR) to open foreign exchange positions.

Country Risk

The Bank manages country risk according to *Country Risk Management Procedure*, which is revised at least once a year according to changes in the Bank activities and external factors affecting the activity of the Bank.

To assess and manage country risk, the Bank:

- ✓ implements regular measures to manage country risk, int. al., transfer risk;
- ✓ approves internal country limits in terms of asset categories (country limits for interbank transactions, credit portfolio and securities portfolio) and exercises daily control of the compliance thereof;
- ✓ regularly (each quarter) analyses economic and political situation of non-investment grade countries;
- ✓ develops stress test scenarios for country risk management of the countries with non-investment grade ratings, where the Bank has deposited funds, and each quarter provides stress testing of country risk of the relevant countries.

The country risk limit system is based on the ratings assigned by the world`s leading credit rating agencies (*Moody's, Standard and Poor`s, Fitch*).
The Bank regularly maintains a list of countries, where the Bank has deposited funds, together with the current ratings of the countries and development forecasts.

Country limits on asset transactions are determined according to the methodology prescribed by *Procedure on Setting Country Limits.*

Country limits on asset transactions for non-investment grade countries may be adjusted in view of stress test results according to *Country Risk Stress Tests Procedure*.

Interest Rate Risk in Non-Trading Portfolio

The Bank manages interest rate risk according to *Interest Rate Risk Management Policy*, which is revised at least once a year according to changes in the Bank activities and external factors affecting the activity of the Bank.

The Bank manages interest rate risk to prevent the possible adverse impact of interest rate risk on the Bank`s income and economic value, namely:

- ✓ assesses interest rate risk of all rate-sensitive assets, liabilities and off-balance liabilities;
- ✓ assesses interest rate risk of all assets, liabilities and off-balance liabilities in each currency, where the assets or liabilities exceed 5% of the total balance value, as well as the total amount in all currencies;
- ✓ assesses the potential interest rate risk inherent to new products and services;
- ✓ uses gap analysis and duration method to measure the interest rate risk level.

Liquidity Risk

The Bank manages liquidity rate risk according to *Liquidity Risk Management Policy*, which is revised at least once a year according to changes in the Bank activities and external factors affecting the activity of the Bank.

The Bank manages liquidity risk to provide for timely and proper execution of its liabilities.

To manage liquidity risk, the Bank:

- ✓ determines and regularly reviews internal net position limits for maturity structure of assets and liabilities in euros and each foreign currency in which the Bank has significant transaction amount, source of financing and liquidity limits, as well as determines necessary measures in case internal limits are violated;
- ✓ determines the Bank`s need for liquid assets taking into account the structure of the customer base;
- ✓ performs the analysis of financing concentration, assessing raising of funds from one person / entity (group of connected persons / entities);
- ✓ performs stress tests including the analysis of possible scenarios, i. e. critical situations on the level of the Bank, Latvian financial system and global financial system, with due regard to the influence of credit risk and reputation risk on liquidity risk;
- ✓ calculates and analyses the Liquidity Coverage Ratio (LCR) in accordance with EU Regulation 575/2013;
- ✓ develops action plans in order to solve significant liquidity problems or overcome a liquidity crisis (for example, dropping in deposits amounts, the outflow of significant Bank customers, etc.);
- ✓ regularly forecasts liquidity taking into account expected incoming and outgoing payments of the Bank and customers;
- ✓ strives to maintain the foreign customers` loan portfolio to foreign customers` deposit portfolio ratio in 1:3 (i. e. ensure that foreign customers` deposit portfolio is three times larger than the loan portfolio);
- ✓ maintains a liquidity buffer by holding a portfolio of bonds qualified as eligible collateral by the ECB.

The acceptable risk level is determined in accordance with internal net position limits for maturity structure of assets and liabilities (in euros and each foreign currency in which the Bank has significant transaction amount), as well as the acceptable level of the Bank`s liquidity ratio K (the ratio shall be determined according to *Procedure on Liquidity Condition Calculation and Liquidity Management Process*) and required liquidity ratio.

1. Levels of K liquidity ratio:

K	Liquidity level
>5%	increased liquidity
>-5%<5%	normal liquidity
>-10%<-5%	reduced liquidity
<-10%	liquidity crisis

2. Liquid assets to total assets:
   - ✓ > 20%

3. Required liquidity ratio:
   - ✓ > 50%

4. Lliquidity coverage ratio:
   - ✓
   - ✓ > 70% from January 1, 2016;
   - ✓ > 80% from January 1, 2017;
   - ✓ > 100% from January 1, 2018.

Concentration Risk

Taking into account that a major portion of concentration risk originates in the credit portfolio, the Bank assesses concentration of credit portfolio risk exposures, i. e.:

- concentration of risk exposures to groups of connected customers and individual customers not involved in groups of connected customers (hereinafter – individual concentration risk);
- concentration of risk exposures to customers – representatives of one sector (hereinafter – sectoral concentration risk);
- concentration of risk exposures where the transaction currency is different from the customer income currency (hereinafter – currency mismatch concentration risk);
- concentration of indirect risk exposures originating from transactions secured by homogeneous collateral or risk exposures where credit risk has been mitigated applying the collateral of one guarantor (hereinafter – collateral concentration risk).

Within the framework of concentration risk exposure the Bank regularly performs:
- ✓ analysis of individual concentration risk (total risk exposures to heavy borrowers or connected groups of borrowers);
- ✓ analysis of sectoral concentration risk by the borrower`s sector and concentration risk by the type of collateral;
- ✓ analysis of currency mismatch concentration risk;
- ✓ analysis of concentration risk between credit risk and foreign exchange risk, credit risk and operational risk.

The Bank assesses concentration risk of of loans and receivables from credit institutions and issuers according to *Concentration Risk Management Procedure and Calculation Methods*, which is revised at least once a year according to changes in the Bank activities and external factors affecting the activity of the Bank.

Risk of Money Laundering and Terrorism Financing

To mitigate the risk of money laundering and terrorism financing, the Bank has established internal control system, which comprises actions and measures aimed at meeting the requirements of the law *On the Prevention of Money Laundering and Terrorism Financing*, i. e. risk assessment, control and mitigation measures, providing relevant resources for the purpose.

The Bank has approved its AML Strategy, which, together with the AML Policy, are the Bank's central internal documents for managing its AML risk. A number of other internal policies and procedures have been revised or are in the process of being revised.

The Bank has overhauled its AML compliance structure to set up three lines of defence. Namely, client-servicing departments and support units, as a first line of defence, are responsible for the adherence to the Know-Your-Client principle; the Financial Monitoring Department and Risk Control

Department forms the second line of defence and is responsible for the design of AML processes, quality and limit control and reporting; and the Internal Audit Department forms the third line of defence by providing an independent opinion on the effectiveness of the Bank’s AML programme.

The Bank has decreased its inherent AML risk by de-derisking (pro-actively closing accounts for those clients that are considered to pose too high a risk to the Bank) and the decision to close the Bank’s branch in Italy.

In terms of AML controls, the Bank has introduced a new transaction monitoring system and is finalising its new client AML risk scoring solution. These will help the Bank analyse and mitigate its AML risks.

The Bank is enhance its AML training programme by differentiating trainings for different groups of employees, communicating its new risk appetite and increasing the level of competence.

Given the scale of the changes to the Bank’s AML programme, at the end of 2016 an independent reviewer concluded that the effectiveness of the Bank’s new and planned AML controls cold not yet be assessed due to the lack of historical data.

The Bank`s internal control system includes the following basic elements and measures:

- commencement and termination of business relations with customers;
- customer identification;
- assessment of customer`s risk of money laundering and terrorism financing;
- identification and initial due diligence of customer`s beneficiary;
- monitoring and enhanced due diligence of customer`s transactions;
- disclosure of unusual or suspicious transactions and reporting to the Control Service;
- refraining from suspicious transactions;
- storage of information and documents obtained in the process of customer identification and due diligence, investigation results and reports thereof;
- training of the staff.

The Bank applies a due diligence method that is based on customers` risk assessment to prevent as much as possible cooperation with persons involved in money laundering and terrorism financing.

The Bank does not establish business relations with customers prior to performing customer identification and identification of their true beneficiaries according to the reguirements of regulatory enactments and the Bank`s internal documents. The Bank does not open anonymous accounts.

Financial Monitoring Department ensures management of risk of money laundering and terrorism financing according to *Anti-Money Laundering Policy*.

Reputation Risk

The Bank manages reputation risk according to *Reputation Risk Management Policy*, which is revised at least once a year according to changes in the Bank activities and external factors affecting the activity of the Bank.

According to *Procedure on Reputation Risk Assessment and Management Methods* the responsible employee of Financial Monitoring Department for objective assessment of reputation risk and identification of the true source thereof may request additional information from any Bank employee.

In turn, all employees (structural units) are obliged to provide all relevant information about each particular reputation risk event that is at their disposal.

Reputation risk management consists of:

- control and analysis of reputation risk indicators;
- assessment of reputation risk;
- identification of factors causing increase of reputation risk, whenever possible;
- elimination of factors causing increase of reputation risk, whenever possible;
- elimination or minimisation of consequences;
- monitoring of situation after the elimination or minimisation of consequences.

Methods for the prevention or minimisation of reputation risk are selected according to the impact of risk factors on the Bank`s operations and financial situation, as well as each particular reason of the risk, the measurement thereof and the impact on the Bank`s reputation.

The head of Risk Control Department/Risk Director regularly (once a month) informs the Board of the reputation risk level and the development trends, submitting a relevant report.

Strategic and Business Risk

The Bank manages strategic and business risk according to *Strategic Risk Management Policy*, which is revised at least once a year according to changes in the Bank activities and external factors affecting the activity of the Bank.

According to *Strategic Risk Assessment and Management Procedure* the responsible employee of Risk Control Department for objective assessment of strategic risk and identification of the true source thereof may request additional information from any Bank employee. In turn, all employees (structural units) are obliged to provide the responsible employee of Risk Control Department all relevant information about each particular strategic risk event that is at their disposal.

Strategic risk management consists of:

- control and analysis of strategic risk indicators;
- assessment of strategic risk;
- identification of factors causing increase of strategic risk, whenever possible;
- elimination or minimisation of consequences of strategic risk;
- monitoring of situation after the elimination or minimisation of consequences.

Methods for the prevention or minimisation of strategic risk are selected according to the impact of risk factors on the Bank`s operations and financial situation, as well each particular reason of the risk, the measurement thereof and the impact on the implementation of the Bank`s strategy.

Excessive Leverage Risk

The Bank manages excessive leverage risk according to *Leverage Risk Management Policy*, which is revised at least once a year according to changes in the Bank activities and external factors affecting the activity of the Bank.

To assess and manage excessive leverage risk, the Bank:

- determines, assesses and controls the level of excessive leverage risk;

- analyses the positions of balance assets, which have an impact on the sources of excessive leverage risk;
- determines the level of excessive leverage risk according to *Leverage Risk Management Procedure*;
- upon non-compliance with the limit, develops recommendations to reduce the level of excessive leverage risk;
- performs stress testing of excessive leverage risk, develops recommendations to reduce the risk level, if necessary;
- sets internal limits the compliance whereof allows to confine the impact of changes in the level of excessive leverage risk on the Bank`s economic value and income/expenses.

Risk Control Department regularly:

- controls compliance with excessive leverage risk limits determined according to *Leverage Risk Management Procedure* (daily);
- in detail analyses the level of excessive leverage risk for the previous month (monthly).

The value of excessive leverage risk and stress test results are assessed according to the table below.

Excessive leverage risk indicator	Assessment	Measures
≥5%	Excessive leverage risk complies with the Bank business model and strategic objectives	Not needed; monitoring within the standard procedures
≥4%	Excessive leverage risk complies with the Bank business model	According to the Bank strategy a special monitoring procedure shall be commenced to investigate the trends
<4%	Excessive leverage risk does not comply with the Bank business model	Develop, approve and implement action plan to reduce excessive leverage risk
<3%	Inadmissible infringement	Activate contingency plan

The head of Risk Control Department/Risk Director regularly (once a month) informs the Board of the level of excessive leverage risk and the development trends, submitting a relevant report.

Leverage ratio calculated as the simple arithmetic mean of the monthly leverage ratio over a quarter		
	2016	2015
Leverage Ratio -using a fully phased-in definition of Tier 1	14%	7%
Leverage Ratio -using a transitional definition of Tier 1	14%	7%

Information to the Board and Council about Risk Management Process Flow

As mentioned before, risk management and control processes employ different reports, which are submitted to the Board, Council and heads of structural units involved in risk management processes at the following periodicity: daily, weekly, monthly, quarterly, semi-annually and annually.
The Board and Council are reported the implementation of strategic objectives and performance results; the report comprises quantitative indicators and capital requirements to cover credit risk set by Risk Management Strategy, foreign exchange risk, market risk, interest rate risk, liquidity risk, operational risk, reputation risk, country risk, concentration risk and strategic risk.

The Bank performs stress tests and reports the results to the Board and Council. Stress tests of all significant risks are performed quarterly.

The Board is submitted daily and monthly reports on compliance with the limits and restrictions of risk exposures, liquidity risk, foreign exchange risk and country risk.

To ensure day-to-day control and decision making, the reports are submitted to all structural units involved in risk management and the Board members in charge.

Duties, Authorisations and Responsibilities for Risk Management and Risk Adequacy Assessment

The Council:

- determines the Bank`s corporate strategy, i. e. the objectives, capital management strategy and risk strategy;
- supervises the risk management process, i. e. approves risk identification and management policies; requests (receives) information about the level of significant risks inherent in the Bank activities and the management thereof (int. al., macroeconomic risks and economic cycle risks); provides sufficient financing for risk management; at least once a year assesses the efficiency of risk management;
- determines the approach to capital management and capital adequacy assessment – definition of capital, applicable methods and objectives, i. e. approves Capital Assessment Policy and Capital Assessment Procedure;
- at least once a year examines the results of capital adequacy assessment and makes decisions regarding capital adequacy;
- supervises the assessment of assets related to the significant risks inherent in the Bank activities, application of ratings assigned by credit rating agencies and the use of internal models;
- supervises the activity of the Board for the implementation of Capital Assessment Policy and Capital Assessment Procedure to provide for prompt and efficient solution of capital and risk management issues;
- supervises compliance of the Bank activity, provisions of risk management and capital adequacy assessment policy with the provisions of normative enactments of the Republic of Latvia, international regulatory framework for banks and standards of good practice, the Bank`s articles of association and decisions of shareholder meetings.

The Board:

- ensures identification and management of risks inherent in the activities of the Bank, i. e. risk measurement, assessment, control and reporting, while implementing the Council determined capital assessment policies and procedures, and approves the relevant procedures;
- provides for regular risk assessment, capital adequacy assessment and maintenance of capital requirements;

- examines draft capital adequacy assessment policy and submits to the Council for approval; approves other internal normative documents that govern capital management and capital adequacy assessment process;
- examines the Report on Capital Adequacy Assessment;
- at least once a year evaluates the efficiency of capital management and adequacy assessment; if necessary, initiates measures to improve the efficiency thereof according to changes in the Bank activities and external factors affecting the activity of the Bank;
- is responsible for establishing a comprehensive internal control system, the implementation, management and improvement thereof, as well as the implementation and improvement of Capital Management Policy and risk management policies; ensures and monitors compliance with the requirements thereof.

Head of Risk Control Department / Risk Director:

- manages comprehensive risk control function;
- ensures the risk management system of the Bank is established and upgraded, exercises its control;
- ensures regular assessment of the Bank strategy (including activity types), separate services (including recently elaborated services and changes in the current services), structure, general risk profile, as well as compliance of set restrictions and limits with the risk strategy of the Bank; should there be any incompliance, ensures informing the Council, Board and heads of corresponding structural units thereof;
- ensures the Council, Board and heads of corresponding structural units regularly receive comprehensive and accurate information about the general risk profile of the Bank, all most important risks and their compliance with the risk strategy of the Bank;
- is responsible for developing, updating, amending a capital adequacy assessment methodology, as well as exercises control over the process;
- provides heads of Bank structural units, the Board, and Council with comprehensive and accurate information on capital adequacy, level of the capital, and its compliance with the development strategy of the Bank;
- reconciles *Report on Capital Adequacy Assessment*;
- provides consultations to the Board and Council regarding capital adequacy, capital assessment process, as well as provides support during decision making concerning capital adequacy.

Risk Control Department:

- identifies, measures all important risks inherent in Bank activities and their interaction, as well as develops the risk management policy and procedures, actively participates in the development of the risk strategy of the Bank and decision making regarding risk management;
- exercises regular control over the implementation of the risk management policy and procedures, including compliance with the set limits and restrictions;
- regularly (at least once a year) revises and amends the risk management policy and procedures in order to insure their applicability and compliance with changes in Bank activities and external factors affecting the activity of the Bank;
- at least once a year develops and updates *Capital Adequacy Assessment Policy* and related procedures;
- assesses the amount of the capital necessary to cover Bank risks and the amount of capital buffer;
- prepares *Report on Capital Adequacy Assessment* and every three months submits it to the Board (for consideration) and the Council (for approval);
- follows amendments to international legal enactments and standards, laws and legal acts of the Republic of Latvia, requirements regulating Bank activities in the fields of risk exposures,

capital adequacy, finance risk management and operational risk management, as well as assesses the impact of such amendments on Bank activities;

- performs capital planning; within the scope of capital planning develops a capital adequacy maintenance plan for cases of emergency (defines the activities aimed at compliance with individual minimum capital requirements established by the FCMC in cases of emergency, as well as develops a corresponding plan of actions).

Internal Audit Department:

- regularly performs a capital adequacy assessment audit according to the work plan approved by the Council.

Risk Committee:

The Bank does not need to establish a risk committee as Article 38 of the Regulations for Establishing Internal Control System of the FCMC defines the obligation to establish a risk committee for those institutions only which are “of significant importance based on their volume of operations, activity type, complexity and profile, as well as organisation structure”.

According to Article 16 of the Regulations on Internal Capital Adequacy Assessment Process (hereinafter referred to as “the Regulations”) of the FCMC, AS PrivatBank is a small-sized bank that provides traditional and simple services to its customers. As per Article 16.1 of the Regulations, the Bank falls within the first group (a bank whose assets individually or at the level of consolidated group or consolidated sub-group are less than 1.3 billion euros and which are not part of the third group according to Article 16.3 of these Regulations).

According to Article 17.1 of the Regulations, “the bank that belongs to the first group in accordance with Article 16.1 of these Regulations can use simplified methods to determine the capital needed to cover risks not covered by minimum regulatory capital requirements and shall not justify the suitability of these methods to the operations of the bank.”

The number of Bank employees is rather small (less than 300 employees); the Bank has a transparent line-and-staff structure.

The Board of the Bank consists of four members whose duties are assigned with due regard to the organisational structure of the Bank and cover all fields of Bank activities.

The Council of the Bank consists of three members whose duties are assigned taking into consideration all fields of Bank activities.

Risk Strategy

Aim: to ensure the balance between risks and profit, and minimise a potential negative impact of risks on the financial standing of the Bank.

Key principles:

✓ the risk management system is integrated into the internal control system of the Bank according to the requirements of the FCMC and Basel Committee. Within the scope of the risk management process, the functions of risk assessment, risk analysis and risk control are separated from the functions of structural units of the Bank;

✓ the Bank develops, documents and implements corresponding policies and procedures regarding all identified significant risks inherent in Bank activities, as well as manages them, i. e. defines exposures, assesses the risks and exercises control over them, as well as prepares relevant reports;

✓ risk management policies are revised at least once a year according to changes in Bank activities and external factors affecting the activity of the Bank;

- ✓ the Bank assesses potential risks inherent in new products and services, as well as approves risk management procedures and control procedures prior to introducing the above-mentioned new products or services.

The Bank considers the following risks inherent in its activities as **significant risks**:

- ✓ credit risk,
- ✓ liquidity risk,
- ✓ market risk (including foreign exchange risk),
- ✓ interest rate risk,
- ✓ country risk,
- ✓ operational risk,
- ✓ concentration risk,
- ✓ money laundering and terrorist financing risk,
- ✓ reputation risk,
- ✓ strategic risk,
- ✓ excessive leverage risk
- ✓ model risk.

The Bank identifies significant risks according to *Significant Risk Identification Policy*.

Credit Risk

A **credit risk** means a risk of loss if a business partner (counterparty / borrower) fails to perform their contractual obligations to the Bank, or performs them unduly, or partially. Exposure to the credit risk is retained throughout the credit period.

The Bank considers the risk to be **significant and assesses its exposure as high.**

The Bank keeps following the economic situation in Latvia and other countries where the Bank plans to offer lending services in order to timely revise its lending policy should the situation get worse.

The Bank will continue to operate with the existing credit portfolio, especially with non-performing loans.

In years 2017-2019 the Bank expects the following credit portfolio structure with regard to local and foreign customers:

Type of loans	2017		2018		2019	
	Local customers	Foreign customers	Local customers	Foreign customers	Local customers	Foreign customers
Loans on mortgage	22.13%	0.09%	24.22%	0.10%	26.94%	0.12%
Loans to replenish current assets	3.75%	24.03%	2.96%	16.91%	2.36%	7.61%
Loans / Leases to purchase vehicles / equipment	25.22%	0.06%	30.40%	0.05%	35.92%	0.04%
Consumer loans	2.53%	0.09%	3.49%	0.12%	4.63%	0.16%

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Industrial loans	0.53%	8.65%	0.42%	6.81%	0.33%	5.39%
Overdrafts	0.13%	0.13%	0.10%	0.14%	0.08%	0.16%
Reverse repo transactions	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Others	12.61%	0.07%	14.19%	0.08%	16.17%	0.10%

Currency	2017		2018		2019	
	Local customers	Foreign customers	Local customers	Foreign customers	Local customers	Foreign customers
EUR	66.09%	1.90%	74.90%	1.69%	85.44%	1.57%
USD	0.80%	31.21%	0.88%	22.53%	0.99%	12.01%

Region	2017		2018		2019	
	Local customers	Foreign customers	Local customers	Foreign customers	Local customers	Foreign customers
Latvia	66.89%	0.00%	75.78%	0.00%	86.42%	0.00%
EU countries	0.00%	26.79%	0.00%	21.28%	0.00%	11.16%
Third countries	0.00%	6.32%	0.00%	2.94%	0.00%	2.41%

Areas	2017		2018		2019	
	Local customers	Foreign customers	Local customers	Foreign customers	Local customers	Foreign customers
Agriculture, forestry and fish industry	2.81%	0.00%	3.20%	0.00%	4.03%	0.00%
Mining industry and quarry operations	1.14%	0.12%	1.14%	0.11%	1.26%	0.11%
Manufacturing industry	4.86%	5.21%	6.10%	0.00%	8.32%	0.00%
Electricity supply, gas and steam supply, conditioning	-	-	-	-	-	-
Water supply, sewage system, gathering and	0.05%	0.00%	0.06%	0.00%	0.07%	0.00%

distribution control						
Construction	1.83%	0.00%	2.41%	0.00%	3.41%	0.00%
Wholesale and retail trade and repair of motor vehicles	7.41%	5.09%	9.63%	4.99%	13.46%	5.34%
Transport and storage	9.82%	0.00%	14.29%	0.00%	21.49%	0.00%
Hotel and catering services	0.92%	0.00%	0.97%	0.00%	1.14%	0.00%
Information and communication	0.01%	0.00%	0.01%	0.00%	0.01%	0.00%
Finances and insurance	0.22%	20.69%	0.21%	19.04%	0.22%	2.13%
Real estate operations	3.28%	0.23%	3.24%	0.21%	3.52%	0.21%
Professional, scientific and technical activity	0.65%	0.00%	0.84%	0.00%	1.17%	0.00%
Administrative activities and additional services in this field	1.45%	32.62%	1.77%	30.02%	2.37%	29.65%
Public administration and defence, mandatory social insurance	-	-				
Education	0.23%	0.00%	0.24%	0.00%	0.29%	0.00%
Public health and social services	0.18%	0.00%	0.26%	0.00%	0.40%	0.00%
Art, entertainment and relaxation	0.04%	0.00%	0.04%	0.00%	0.04%	0.00%
Other services	1.15%	0.00%	1.20%	0.00%	1.38%	0.00%

Maturity structure	2017		2018		2019	
	Local customers	Foreign customers	Local customers	Foreign customers	Local customers	Foreign customers
Ilgtermiņa kredīti	16.66%	14.69%	27.28%	10.49%	33.78%	2.85%
Īstermiņa kredīti	50.23%	18.42%	48.50%	13.73%	52.64%	10.73%

Collateral on Loans

In order to mitigate the credit risk the Bank may accept a collateral, which is considered to be a secondary source of loan repayment as the decision on loan granting is generally taken based on borrower's ability to repay the loan.

The Bank considers and accepts the following collateral types:

- ✓ assets (for example, customer's funds on a deposit account, securities, savings, immovable property, movable property, etc.);
- ✓ third persons' guarantees.

When accepting a collateral, the Bank gives priority to assets.

In order to accept a collateral as valid, the Bank verifies its legal provisions, for example, the possibility to alienate (take over, sell) the collateral, obtain insurance, and other provisions.

When accepting third persons' guarantees as a collateral, Bank employees responsible for loan granting should perform the analysis of guarantors' financial and economic standing (creditworthiness) prior to granting a loan. The results of such analysis should be documented and stored in customer's credit file.

Should several persons registered in different jurisdictions take part in a transaction, the Bank shall have a legal opinion on the possibility of claims and liabilities netting.

Should a loan be secured with a deposit placed with the Bank, the Bank shall verify there are no encumbrances for claims and liabilities netting even in cases when security provider's bankruptcy or insolvency proceedings are initiated.

All collateral objects should be insured in favour of the Bank, except for real estate which is impossible to insure, for example, land plots. The Bank may offer an insurance company or a borrower may choose it independently by negotiating their choice with the Bank prior to acquiring an insurance policy. All expenses related to collateral object insurance shall be covered by the borrower (collateral provider).

Should the borrower fail to insure a collateral object during the credit period, the Bank shall insure it at its own expense and later require the borrower to compensate the Bank for such expenses.

Limits of loan to collateral ratio are set in accordance with procedures for processing and granting Bank loan products.

The management of collateral on loans is performed according to *Procedure on Loan Monitoring*, *Mortgage Assessment and Monitoring Regulations*, *Procedure on Declaring Loan Dependent on Pledge*, *Procedure on Assessment and Monitoring of Securities Used as Loan Collateral*, as well as *Procedure on Monitoring Bank Leasing Transactions*.

In 2017 the Bank is not going to make significant changes in the structure of the credit portfolio.

The acceptable risk of non-bank credit portfolio cannot exceed the maximum possible and acceptable losses in the consolidated credit portfolio and shall be set with due regard to the results of a stress scenario (a basic short-term stress scenario) for the credit portfolio. Moreover, the following principle shall be obeyed: the amount of Bank's own funds shall always exceed the capital necessary to cover the risks (the necessary amount is computed during the capital adequacy assessment), as well as the amount of capital buffer.

The acceptable risk of non-bank credit portfolio is set at 19% of Bank's consolidated own funds.

The acceptable risk of loans and receivables from counterparties with due regard to the security purchase strategy is set at 11% of Bank's consolidated own funds.

The ratio of money market transactions with counterparties having non-investment grade ratings should not exceed 30% of the total amount of funds placed with the credit institution.

To reduce the credit risk the Bank performs the following credit risk mitigation activities:

- diversification, i. e. distribution of risk by types of loans and borrowers, loan terms, etc.;
- setting of limits to borrowers (groups of connected customers), industries, countries, etc.;
- stress testing, i. e. assessment of the amount of capital required to cover the credit risk and identification of critical situations that may significantly increase the amount of loss related to the credit risk;
- loan (credit portfolio) quality control, i. e. regular credit portfolio quality control, calculation of impairment losses and creating of capital buffer.

To identify the credit risk of the credit portfolio and assess the quality of loans, the Bank divides loans into two groups: individually assessed loans and loans grouped according to similar credit risk parameters; they are assessed according to *Assets and Off-Balance Liabilities Assessment Procedure*.

The Bank assesses credit portfolio concentration risk which occurs when a substantial loan amount is directly or indirectly granted to one customer, a group of connected customers or invested into one industry or sector, geographical region or country, as well as in cases when loans have one type of collateral or one collateral provider, or loan currency is different from the customer income currency.

The reporting and information exchange procedure, distribution of risk management powers and responsibilities, as well as the procedure of decision making are set in *Credit Risk Management Policy*.

Loans and receivables from credit institutions and issuers consist of loans and receivables from other banks and issuers of securities purchased for investment portfolio of the Bank, as well as off-balance liabilities of credit institutions and issuers.

Loans and receivables from credit institutions and issuers are assessed individually. The Bank assesses the credit risk of loans and receivables from credit institutions and the necessity of capital buffer according to *Assets and Off-Balance Liabilities Assessment Procedure*.

Individual concentration risk of loans and receivables from credit institutions / issuers is included in the concentration risk stress tests according to *Credit Risk Stress Testing Procedure*.

The Bank regularly (at least once a quarter) performs stress testing of credit risk exposures according to *Credit Risk Stress Testing Procedure*.

The Bank foresees two stress test event scenarios, i. e. changes within a year and two years, and develops the basic scenario and pessimistic scenario.

For the purposes of **credit portfolio stress testing** the Bank elaborates several scenarios of credit portfolio quality changes to compute the amount of capital required to cover the expected loss (EL) and unexpected loss (UL). The scenarios take into account the deterioration in the borrowers' creditworthiness in light of decline in the macroeconomic indicators in the short-term and long-term perspective (publicly available on the Internet) and the probability of default (PD), which is calculated

according to the Bank's historical data on the increase of non-performing loans[1] and the loss given default (LGD). Stress testing takes into account the expected credit portfolio for one year and two years, as well as possible migration of undue loans to overdue loans in view of macroeconomic forecast of economic indicators and forecasted changes in the immovable property value.

Within the framework of credit risk stress testing the Bank additionally performs stress testing of receivables (accounts receivable due to debt collection).

Within the framework of credit risk stress testing the Bank also assesses loans and receivables from credit institutions and issuers.

When performing stress testing of loans and receivables from credit institutions / issuers, the amount of potential expected losses upon possible decrease of ratings is assessed.

The key parameters for stress testing of loans and receivables from credit institutions/issuers are the probability of default (PD) and loss given default (LGD) provided by Moody's international credit ratings agency within the framework of annual report *Annual Default Study: Corporate Default and Recovery Rates*

Counterparty Credit Risk Exposures

The limits for transactions exposed to the credit risk of counterparties are set according to *Procedure on Establishing Limits for Partner Banks and Compliance Control*.

The credit risk assessment method elaborated by the Bank is based on the calculation of financial stability index of each counterparty taking into account different financial indicators of the corresponding counterparty.

Foreign Exchange Risk

A **foreign exchange risk** means a potential adverse impact of changes in foreign exchange rates (gold is treated as a foreign currency) on the Bank's income / expenses and own funds.

The Bank considers the risk to be **significant and assesses its exposure as low.**
The source of foreign exchange risk is foreign exchange positions opened by order of a customer and in Bank's interests in the result of currency exchange transactions, decrease of foreign exchange-denominated financial and non-financial assets, as well as when making payments or receiving profit in foreign currencies.

The acceptable risk level is set in the amount of EUR 80 000 (the limit is based on the historical data on possible losses from the foreign exchange risk).

The Bank complies with the following open foreign exchange position limits laid down in the Credit Institution Law:

- ✓ the open foreign exchange position of a credit institution in a single foreign currency may not exceed 10 per cent of own funds, and
- ✓ the open foreign exchange position of a credit institution in all foreign currencies altogether may not exceed 20 per cent of own funds.

[1] Non-performing loans mean loans overdue for more than 90 days.

Foreign Exchange Risk Mitigation Activities

The Bank manages the foreign exchange risk in the following ways:

- ✓ each day controls compliance with open foreign exchange position limits (including gold position); uses financial derivatives, for example, swap transactions, in order to reduce foreign exchange positions;
- ✓ each day calculates the foreign exchange risk by applying the value-at-risk (VaR) method to opened foreign exchange positions.

The Bank manages the foreign exchange risk in accordance with *Foreign Exchange Risk Management Policy*, which is revised at least once a year according to changes in Bank activities and external factors affecting the activity of the Bank.

Liquidity Risk

A **liquidity risk** means a probability that the Bank will be unable to cover its liabilities by loans and receivables, as well as potential losses that occur due to failure to comply with the FCMC regulations and non-material losses caused to the Bank's image.

The Bank considers the risk to be **significant and assesses its exposure as high.**

The acceptable risk level is determined in accordance with internal net position limits for maturity structure of assets and liabilities (in euros and each foreign currency in which the Bank has significant transaction amount), as well as acceptable level of Bank's K liquidity ratio (the ratio shall be calculated according to the *Procedure on Liquidity Ratio Calculation and Liquidity Management*) and required liquidity ratio.

Levels of K liquidity ratio:

K	Liquidity level
>5%	increased liquidity
>-5%<5%	normal liquidity
>-10%<-5%	reduced liquidity
<-10%	liquidity crisis

Liquid assets to total assets:
- ✓ > 20%

Required liquidity ratio:
- ✓ > 50%

Liquidity coverage ratio means the ratio set in Regulation (EU) 2015/61 and Regulation (EU) 575/2013:
- ✓ > 70% as of 1st January 2016;
- ✓ > 80% as of 1st January 2017;
- ✓ > 100% as of 1st January 2018.

The Bank constantly maintains the required liquidity ratio **higher** than the individual required liquidity ratio established by the FCMC.

The consolidated LCR of the Group as at December 31, 2016 was 474%.

The Bank also considers the impact of other risks (credit risk, market risk, operational risk and reputation risk) on the level of liquidity and liquidity risk.

Liquidity Risk Mitigation Activities

During liquidity risk management the Bank performs the following actions:

- ✓ calculates and regularly reviews internal net position limits for the maturity structure of assets and liabilities in euros and each foreign currency in which the Bank has significant transaction amount, source of financing and liquidity limits, as well as determines necessary measures in case internal limits are violated;
- ✓ calculates Bank's possible needs for liquid assets taking into account the structure of the customer base;
- ✓ performs the analysis of financing concentration by assessing raising of funds from one person / entity (group of connected individuals / entities);
- ✓ performs stress tests including the analysis of possible scenarios, i. e. critical situations on the level of the Bank, Latvian financial system and global financial system, with due regard to the impact of the credit risk and reputation risk on the liquidity risk;
- ✓ develops plans of actions in order to solve significant liquidity problems or pass through a liquidity crisis (for example, dropping in deposits amounts, the outflow of significant Bank customers, etc.);
- ✓ regularly forecasts liquidity taking into account expected incoming and outgoing payments of the Bank and customers;
- ✓ implements the following measures if necessary to re-establish a normal liquidity level:
  - performs necessary actions in order to reduce the amount of demand liabilities and regroups liabilities according to their maturity date;
  - conducts negotiations with customers in order to extend deadlines for obligations towards the customers;
  - performs necessary actions in order to increase the amount of liquid assets, for example, sells the credit portfolio in part;
  - stops granting new loans;
  - conducts negotiations with business partners in order to receive new loans on the interbank market;
  - raises other short-term liquid assets (for example, from the Bank of Latvia);
  - performs other actions according to *Business Continuity Plan in Case of Liquidity Crisis*.

The Bank manages the liquidity risk according to *Liquidity Risk Management Policy*, which is revised at least once a year according to changes in Bank activities and external factors affecting the activity of the Bank.

Liquidity coverage ratio: as of year 2015 the Bank calculates the liquidity coverage requirement, exercises its control and introduces it into the general risk management system according to Implementing Technical Standards elaborated by the European Bank Authority and requirements of Regulation (EU) 2015/61 dated 10th October 2014.

Interest Rate Risk

An **interest rate risk** means a potential adverse impact of changes in the interest rates on the Bank's income and economic value.

The Bank considers the risk to be **significant and assesses its exposure as considerable.**

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The acceptable risk level: possible losses on net interest income in the amount of **8% of Bank's own funds** and losses due to changes of RSA / RSL net economic value in the amount of **8% of Bank's own funds**.

Interest Rate Risk Mitigation Activities

The Bank manages the interest rate risk in order to minimise its possible negative impact on Bank profit and Bank economic value in the following ways:

- ✓ assesses the level of the interest rate risk for all interest rate sensitive assets, liabilities and off-balance liabilities;
- ✓ assesses the level of the interest rate risk for all assets, liabilities and off-balance liabilities in each currency where the amount of assets or liabilities excesses 5% of the balance total, as well as in all currencies together;
- ✓ assesses the potential level of the interest rate risk for new products and services;
- ✓ uses gap analysis and duration method in order to assess the level of the interest rate risk.

The Bank manages the interest rate risk in accordance with *Interest Rate Risk Management Policy*, which is revised at least once a year according to changes in Bank activities and external factors affecting the activity of the Bank.

Country Risk

A **country risk** means a risk of incurring losses while performing transactions with non-residents resulting from the impact of economic, social and political circumstances of a relevant country on its residents' (int. al., government's) ability to duly perform their obligations to the Bank, and the transfer risk, which is a component of the country risk and is related to a business partner's ability to ensure the availability of foreign currency, management policy.

The Bank considers the risk to be **significant and assesses its exposure as considerable**.

The acceptable risk level according to the country limits established by the Bank shall not exceed 5% of Bank's own funds.

Country Risk Mitigation Activities

In order to assess and manage the country risk, the Bank performs the following:

- ✓ regularly manages the country risk, including the transfer risk;
- ✓ approves internal country limits and divides them into asset categories (country limits for interbank transactions, credit portfolio, and securities portfolio), as well as controls them on a daily basis;
- ✓ every three months analyses the economic and political situation of countries with non-investment grade ratings;
- ✓ within the scope of country risk management develops stress test scenarios for countries with non-investment grade ratings, as well as every three months performs country risk stress tests concerning a particular country.

The Bank manages the country risk according to *Country Risk Management Policy*, which is revised at least once a year according to changes in Bank activities and external factors affecting the activity of the Bank.

Operational Risk

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An **operational risk** means a possibility of incurring loss due to inappropriate or incomplete internal processes, human or system errors or external circumstances, including the legal risk, but excluding the strategic risk and reputation risk.

The operational risk includes the following operational risk events due to which the Bank may incur losses:
- ✓ internal fraudulent transactions;
- ✓ external fraudulent transactions;
- ✓ inappropriate employment practice and workplace safety;
- ✓ incorrect attitude towards customers, inappropriate products and business practice;
- ✓ damage to physical assets;
- ✓ business disruptions and system failures (defects);
- ✓ execution, delivery and process management faults; and
- ✓ other operational risk events.

The Bank considers the risk to be **significant and assesses its exposure as considerable**.

The acceptable risk level is determined by taking into account the results of the basic stress test scenarios at the end of the previous period (quarter), but not exceeding the minimal requirements for operational risk capital adequacy. The Bank calculates the capital requirements for the operational risk using the basic indicator approach.

The acceptable risk level is set at 6% of the Bank's consolidated own funds.

Operational Risk Mitigation Activities

To manage the operational risk, the Bank:
- ✓ collects and classifies information on operational risk events in the Bank;
- ✓ performs qualitative and quantitative operational risk assessment (measurement);
- ✓ ensures continuous monitoring of the operational risk level and develops measures for its reduction;
- ✓ establishes internal operational risk limits and monitors compliance with these limits on a monthly basis;
- ✓ evaluates potential operational risk associated with new products and services;
- ✓ evaluates the probability of occurrence of adverse operational risk events, including performing operational risk stress testing quarterly;
- ✓ develops and regularly updates its business continuity plan.

The Bank manages the operational risk in compliance with *Operational Risk Management Policy*, which is revised at least once a year according to the changes in Bank activities and external factors affecting the activity of the Bank.

Concentration Risk

A **concentration risk** means any risk exposure or group of risk exposures, which may cause such losses to the bank, that may lead to the bank's insolvency or threaten the ability to conduct further business. Concentration risk arises from high volume risk exposures to the clients or groups of connected clients or risk exposures to clients, whose creditworthiness is dependent on one joint risk factor (for example, one economic sector, geographical region, currency, credit risk mitigation instrument (homogeneous collateral or one guarantee provider etc.)).

The Bank considers the risk to be **significant and assesses its exposure as considerable.**

Within the framework of managing the concentration risk the Bank regularly performs the following:

- ✓ analyses individual concentration risk (total amount of risk exposures due to large borrowers or mutually connected groups of borrowers);
- ✓ analyses borrowers' sector concentration risk and collateral concentration risk;
- ✓ analyses the currency mismatch concentration risk;
- ✓ analyses the concentration risk of interactions between the credit risk and the foreign exchange risk, the credit risk and the operational risk.

According to the expected amount of the credit portfolio for years 2017–2019, the Bank plans the following concentration limits on the credit portfolio:

	Concentration limits
Types of loans	45% per loan type
Sectors	45% per sector
Collateral	30% per collateral type

The acceptable risk level is determined by calculating the concentration risk in Bank's expected credit portfolio, as well as portfolio of loans and receivables from counterparties according to the internal capital adequacy assessment methods of the Bank and *Concentration Risk Management Procedure and Calculation Methods,* which is revised at least once a year according to changes in Bank activities and external factors affecting the activity of the Bank.

The acceptable risk level is set at 4% of the Bank's consolidated own funds.

Concentration	Acceptable level (credit portfolio)	Acceptable level (loans and receivables from counterparties)
Individual	1% of the consolidated capital of the Bank	2% of the consolidated capital of the Bank
Industry	1% of the consolidated capital of the Bank	As there is one (financial) industry, assessment of this concentration risk is not carried out.
Collateral	-	As risk exposures to counterparties are not secured, assessment of this concentration risk is not carried out.
Currency discrepancies	-	As the risk of discrepancy in the currencies of business partners is assessed during definition of the credit rating in foreign currency, assessment of this concentration risk is not carried out.
Total	**2% of Bank's consolidated own funds**	**2% of Bank's consolidated own funds**
Total	**4% of Bank's consolidated own funds**	

Concentration Risk Mitigation Activities

To manage the concentration risk, the Bank performs the following:

- ✓ sets limits for one counterparty or group of connected counterparties and controls compliance with these limits on a daily basis;
- ✓ sets limits on borrowers' sectors, types of collateral and currencies, and controls compliance with these limits on a daily basis;
- ✓ quarterly conducts stress testing of the concentration risk of the credit portfolio and loans and receivables from counterparties;
- ✓ controls concentrations of those risk exposures where the currency of loans is different from the customers' income currency (the currency mismatch concentration risk);
- ✓ controls indirect concentrations of risk exposures involving one type of collateral or collateral provided by one giver (collateral concentration risk).

PrivatBank

Risk of Money Laundering and Terrorism Financing

A **risk of money laundering and terrorism financing (AML risk)** means a risk that the Bank may be involved in money laundering or financing of terrorism.

The Bank considers the risk to be **significant and assesses its exposure as considerable.**

The acceptable risk level of money laundering and terrorism financing is set at **4% of the Bank's consolidated own funds.**

To reduce the risk of money laundering and terrorism financing:

- ✓ the Bank establishes the internal control system compliant with the appropriate legislative and regulatory requirements in the field of preventing money laundering and terrorism financing, and regularly assesses the effectiveness of the system and improves it. The Bank develops and regularly reviews policies and procedures for preventing money laundering and terrorism financing;
- ✓ the Bank regularly monitors amendments to laws, regulations and standards in the field of preventing money laundering and terrorism financing (including legal acts of the countries where the Bank has its branches), and amends internal procedures accordingly and in a timely manner;
- ✓ the Bank provides regular training for the staff to improve their skills to identify unusual and suspicious transactions, as well as perform actions envisaged in the internal control system;
- ✓ during collaboration with customers (partners), the Bank applies Know Your Customer principle in order to prevent cooperation with persons involved in money laundering and terrorism financing. The Bank starts cooperation with a particular customer, if the latter is identified and a true beneficiary is specified;
- ✓ before establishing collaboration with a customer (partner), as well as during business relations, the Bank assesses and regularly reviews the AML risk of every single customer (partner) paying a special attention to customers of high and very high AML risk group (performs enhanced due diligence);
- ✓ the Bank regularly calculates and assesses the following indicators:
  - the ratio of foreign customers' deposits to the total deposit amount;
  - the ratio of deposits of customers subject to enhanced due diligence to the total deposit amount;
  - change in the amount of foreign customers' deposits during the last calendar year (percentage ratio over the previous period);
  - the percentage ratio of liabilities under management to the total balance amount.

The Bank manages the money laundering and terrorism financing risk according to *Anti-Money Laundering and Terrorism Financing Policy* and assesses it in accordance with *Procedure on Money Laundering and Terrorism Financing Risk and Assessment Methods,* which is revised once a year according to the changes in Bank activities and external factors affecting the activity of the Bank.

Reputation Risk

A **reputation risk** means a risk that the Bank customers, its counterparties, shareholders, supervisory institutions or other stakeholders may form a negative opinion about the Bank that may affect the Bank's ability to maintain the existing business relations with customers and other counterparties, or create new ones, as well as adversely affect the availability of financing. Due to reputation risk events, other risks inherent in the Bank's activities (credit risk, liquidity risk, market risk, etc.) may increase that may adversely affect the Bank's profit, capital amount and liquidity.
The Bank considers the risk to be **significant and assesses its exposure as high.**

The acceptable risk level is set in the amount of 7% of Bank's consolidated own funds.

Reputation Risk Mitigation Activities

The Bank makes the following actions in order to maintain the reputation risk on the acceptable level:

- ✓ performs qualitative and quantitative assessment of the reputation risk;
- ✓ regularly controls compliance with laws and regulations of regulatory and supervisory authorities, as well as amendments thereof. A special attention is paid to the establishment of an effective internal control system;
- ✓ follows the principles of professional ethics and standards of corporative culture;
- ✓ ensures effective management of significant risks inherent in its activities;
- ✓ timely arranges settlements with customers and business partners, for example, pays deposits, deposit interest in due time, as well as makes settlements for other transactions;
- ✓ introduces a management information system which allows to be aware of and timely assess the financial standing of the Bank, make decisions in an effective way and evaluate the consequences thereof, as well as identify the cases of non-compliance with control procedures;
- ✓ follows the information about the Bank and connected individuals / legal entities published in the mass media;
- ✓ develops a plan of actions in order to overcome critical situations, int. al., identifies possible events which can generate the increased reputation risk, examines the causes and possible consequences of such events, determines measures aimed at protection of business reputation in a critical situation, as well as sets the manner in which the crisis communication with the society should be carried out;
- ✓ provides qualitative responses to customers' complaints, as well as assesses and analyses the reasons thereof.

The Bank manages the reputation risk according to *Reputation Risk Management Policy,* which is revised once a year according to the changes in Bank activities and external factors affecting the activity of the Bank.

Strategic and Business Risk

Strategic and business risk means a risk that changes in business environment and the bank's lack of responsiveness to those changes or inadequate or inappropriately chosen business strategy, or inability of the bank to ensure the necessary resources to implement the strategy may cause negative effect on the bank's profit, capital and liquidity.

The Bank considers the risk to be **significant and assesses its exposure as average.**

The acceptable risk level is set in the amount of 3% of Bank's consolidated own funds.

Strategic and Business Risk Mitigation Activities

During the process of strategic and business risk management the Bank performs the following:

- ✓ establishes an appropriate strategic planning system;
- ✓ informs employees about strategic objectives and tasks of the Bank;
- ✓ assesses capital adequacy for the achievement of the strategic objectives and tasks;
- ✓ regularly analyses external factors and identifies such possible events and changes in market conditions that may have a negative impact on Bank's activities and delay the achievement of Bank's objectives;
- ✓ ensures regular improvement of Bank employees' skills in order to identify and eliminate the strategic and business risk;
- ✓ ensures the safety of information in order to prevent information leaks due to unfair competition or negligence;

- ✓ establishes a risk management system appropriate for the nature and scope of Bank's activities.

The Bank manages the strategic and business risk according to *Strategic Risk Management Policy*, which is revised once a year according to the changes in Bank activities and external factors affecting the activity of the Bank.

Excessive Leverage Risk

Taking into account the requirements of Regulation (EU) No 575 / 2013 of the European Parliament and the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, in 2014 the Bank introduced the excessive leverage risk management into the general risk management system.

An **excessive leverage risk** means a risk the Bank may be exposed to upon the increase of borrowed funds (actual or possible) in the financing structure, requesting for unscheduled corrective measures in relation to the business plan, among them compulsory sales, that may incur loss or adjustment of the value of remaining assets.

The leverage ratio shall limit the increase of the amount of non-risk weighted transactions against Tier 1 capital (back stop regime).

The Bank manages the excessive leverage risk in accordance with *Excessive Leverage Risk Management Policy*.

Excessive Leverage Risk, million EUR				
	2016	2017 (forecast)	2018 (forecast)	2019 (forecast)
Tier 1 capital	**59.1**	**58.6**	**62.0**	**66.1**
The amount of non-risk weighted assets + off-balance receivables	360.8	395.3	400.8	427.3
Financial leverage ratio	**16.37%**	**14.83%**	**15.47%**	**15.46%**

Model Risk

Model risk is the risk that mistakes have been made in the development, implementation or use of a risk model in assessing the value of risk assets or calculating capital requirements, and that decisions made on the basis of the results obtained with such a model may cause losses to the Bank.

The Bank considers the risk to be **significant and assesses its exposure as low.**

The Bank manages model risk according to *Model Risk Management Policy*, which is revised once a year according to the changes in Bank activities and external factors affecting the activity of the Bank.

Own Funds of the Group

In order to determine its own funds, the Group applies the own funds definition and own funds calculation methodology in accordance with the provisions of Part two of Regulation No. 575/2013 of the European Parliament and of the Council, and the FCMC Regulations on *Applying Options and Transitional Periods provided for by the Regulation (EU) No. 575/2013 of the European Parliament and*

of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012.

The Group and consolidation group own funds is the total of Tier 1 and Tier 2 capital elements according to Regulation (EU) No. 575/2013.

Capital elements, total of Tier 1 and Tier 2 capital as at 31 December 2016.

Tier 1 capital	(EUR `000)
Equity	86 350
Other provisions	5 397
Retained earnings	(35 921)
Intangible assets	(737)
Unrealised profit, estimated by fair value	47
Total Tier 1 capital	**55 136**
Tier 2 capital	
Subordinated capital	13 720
Total Tier 2 capital	**13 720**
Tier 1 and Tier 2 capital reduction as per legislation	(948)
Total equity	**67 908**

Capital Requirements
Compliance with minimum capital requirements

According to Regulation (EU) No. 575/2013, institutions ensure constant compliance with the following capital requirements: Tier 1 equity capital ratio at 4.5%, Tier 1 capital ratio at 6%, and total capital ratio at 8%. According to Financial and Capital Market Commission requirements effective as from 1 October 2016, the capital adequacy ratio set for the Bank and the Group is 11.6% (13.1% in 2015). The Group determines its capital ratios as follows:

- Tier 1 equity capital ratio is the Group's Tier 1 equity capital, expressed as a percentage of the total risk exposures;
- Tier 1 capital ratio is the Group's Tier 1 capital, expressed as a percentage of the total total risk exposures;
- total capital ratio is the Group's equity, expressed as a percentage of the total total risk exposures.

To determine the risk weighted exposure amount, the Bank uses a standardised approach described in Regulation (EU) No. 575/2013. To calculate the risk weighted exposure amount, the value of risk exposures is determined dividing all exposures into categories, on the basis of which the applicable risk level is determined; the risk weighted exposure amount is calculated in accordance with the risk level determined.

For assessment of credit risk the Bank uses ratings assigned by three external credit assessment institutions (ECAIs): Standard&Poor's Ratings Services, Moody`s Investors Service Ltd and Fitch Ratings, according to the correlation set by the European Banking Authority (EBA) between ECAIs external rating and rating tiers in accordance with Regulation (EU) No. 575/2013.

The Group determines the capital requirement for operational risk using the basic indicator approach, multiplying the capital requirement by 12.5.
The capital requirements for foreign exchange risk, commodity risk and counterparty`s risk are calculated using the standardised approach and multiplying the capital requirements by 12.5.
Capital adequacy as of 31.12.2016 (summary).

Total credit risk capital requirements			
Risk exposure categories	**Total risk exposure amount (EUR `000)**	**Average risk exposure amount (EUR `000)**	**Capital requirement (EUR `000)**
Central governments or central banks	124 506	177 496	0
Institutions	6 731	69 879	2 399
Commercial companies	78 362	96 383	71 435
Secured with real estate	18 258	18 184	15 359
Overdue risk transactions	14 630	16 865	9 647
Other items	76 637	82 551	74 680

The Group determines the foreign exchange risk capital requirement using the standartised approach.

Foreign exchange risk capital requirement (EUR `000) 0

The Group determines the operational risk capital requirement using the basic indicator approach.

Operational risk capital requirement (EUR `000) 43,795

Total capital requirements (EUR `000) – 217,313
Capital adequacy ratio (%) – 31.25

In the course of capital adequacy assessment the Bank regularly (every quarter) assesses minimum capital requirements, the capital required to cover the risks and capital provisions to ensure adequacy of capital for the current and targeted Bank activity upon occurrence of potential adverse scenarios, as well as within the entire economic cycle.

The planned increase in assets and increase of risks is carried out within the current and planned capital.

Use of Credit Risk Mitigation Methods

As from 2015, the Bank has entered into several credit transactions whereof it has received guarantees from the banks registered in the European Union member states or in the European Economic Area (EEA). They guarantee a full amount of receivables from relevant customers; guarantees are denominated in transaction currency and the warranty period exceeds the period of risk exposures.

Prior to acknowledging risk exposures as guarantor risk exposures, the Bank has taken all necessary measures as prescribed by Part three, Title II, Chapter 4, Articles 194, 213 and 215 of Regulation (EU) No. 575/2013, i. e. has included in the credit risk and concentration risk management system the management of risk exposures to which substitution approach is applied; has ascertained that the guarantees are legally effective and enforceable in all relevant jurisdictions; the extent of the credit protection is clearly defined and incontrovertible.

Risk exposure amount to which substitution approach is applied as at 31.12.2016 was 0 EUR, as at 31.12.2015 – 142 009 692 EUR.

Internal Capital Adequacy Assessment

In the process of assessing the adequacy of internal capital the Group determines the extent of own funds needed to cover the risks, to which regulatory requirements regarding the total minimum

amount of own funds have been set (credit risk, market risks and operational risk), and the risks to which the minimum capital requirements have not been set, however the Group considers them significant for its activity:

- credit risk,
- operational risk,
- country risk,
- interest rate risk in the non-commercial portfolio,
- market risk,
- foreign exchange risk,
- liquidity risk,
- concentration risk,
- risk of money-laundering and terrorism financing,
- reputation risk, and
- strategic and business risk.

The Group sets the amount of own funds needed to cover credit risk, market risks and operational risk according to the required minimum amount of own funds, and additionally assesses whether the compliance with the required minimum amount of own funds for the above-mentioned risks calculated according to the approaches chosen by the Group ensures sufficient own funds to cover the above-mentioned risks.

The Group sets the amount of own funds needed to cover all mentioned risks, estimating the potential loss connected with the mentioned risks. The total amount of capital required to cover risks is the sum of the amounts needed to cover each particular risk and the capital buffer.

Information about the total amount of capital required to cover risks as at 31.12.2016 is provided in the table below.

Type of risk	Capital requirements according to the Bank methodology or FCMC standardised method, EUR '000	Total estimate of the Bank, EUR '000
Credit risk	**6,614**	**12,052**
Market risks, i. e.:	**199**	**199**
foreign exchange risk	*37*	*37*
market price risk	*162*	*162*
Operational risk	**4,284**	**4,284**
Interest rate risk in the non-commercial portfolio	**1,487**	**1,487**
Concentration risk, i. e.:	**1,881**	**1,881**
individual concentration risk	*1,185*	*1,185*
sectoral concentration risk	*696*	*696*
currency mismatch concentration risk	-	-
collateral concentration risk	-	-
Risk of money laundering and terrorism financing	**3,000**	**3,000**
Other risks, i. e.:	**8,362**	**8,362**
reputation risk	*2,095*	*2,095*
Business model risk	*3,199*	*3,199*

Geographical concentration risk	*3,068*	*3,068*
Capital buffer	**5,215**	**5,215**
Diversification effects	-	-
Total capital required to cover risks	**31,042**	**36,480**

Measures to be carried out to ensure compliance with the individual capital adequacy requirements:

- ✓ analysis of exposure risk level and the impact thereof on capital adequacy prior to execution thereof;
- ✓ daily control of own funds, risk weighted assets and capital adequacy ratio;
- ✓ regular revision and improvement of methodology for determination of capital needed to cover each significant risk and for the total capital requirement;
- ✓ development of programs for raising subordinated capital.

Ensuring of capital adequacy in exceptional situations

- ✓ To ensure compliance with individual capital adequacy requirements in exceptional situations, the Bank carries out the following measures:
    - develops the assets allocation strategy to increase the proportion of low-risk assets, e. g. to allocate assets with counterparties whose risk transactions have 0% risk level;
    - reduces the volume of the credit portfolio by way of sales;
    - optimises the Bank`s organisational structure to cut general and administrative expenses, as well as optimises the expenses of maintaining the branch network;
    - raises additional capital – both own funds and the subordinated capital.