BALTIC INTERNATIONAL BANK CAPITAL ADEQUACY ASSESSMENT

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

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

The Bank's definition of the term capital corresponds to the definition given in Regulation (EU) No.575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, amending Regulation (EU) No. 648/2012 (hereinafter referred to as the Regulation).

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

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

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

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

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

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

To determine the amount of risk, Bank relies on credit ratings assigned by Moody's Investors Service or, if it does not exist, Fitch or Standard & Poor's (worse of the two) assigned credit ratings.

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

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

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

- concentration risk;

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

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

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

Capital Adequacy Ratio as of 31 December 2020 (EUR)

Items	Group	Bank
Tier 1 capital elements		
Paid-in share capital	36 399 229	36 399 229
Reserve capital and other reserves	835 152	835 152
Retained earnings	-14 617 438	-14 409 236
Loss for the current year	-3 104 427	-1 173 099
Intangible assets	-2 872 716	-2 872 716
Additional deductions of CET1 Capital	-1 161 946	-915 784
Financial instruments revaluation reserve (positive)	3 089 620	3 089 620
Value adjustments due to the requirements for prudent valuation	-12 570	-12 570
Other transitional adjustments to CET1 Capital	126 259	191 301
Minority interest given recognition in CET1 capital	68 878	0
Tier 1 capital	**18 750 041**	**21 131 897**
Tier 2 capital elements		
Subordinated liabilities	2 766 047	2 766 047
Tier 2 capital	**2 766 047**	**2 766 047**
Total capital	**21 516 088**	**23 897 944**
Capital charge for credit risk inherent in the Bank's book, including the breakdown of exposures by categories:	**9 274 750**	**9 354 207**
Exposures to central governments or central banks	*161 864*	*161 864*
Exposures to public sector entities	*59 420*	*59 381*
Exposures to corporates	*1 890 658*	*1 613 772*
Exposures secured by mortgages on immovable property	*40 101*	*40 101*
Exposures in the form of covered bonds	*0*	*0*
Exposures in default	*1 475 191*	*1 475 191*
Exposures associated with particularly high risk	*2 243 041*	*2 907 145*
Equity exposures;	*135 483*	*146 141*
Other items	*3 268 992*	*2 950 612*
Capital charge for market risks	226 083	226 083
Capital charge for operational risk	2 023 892	2 040 441
Capital charge for credit valuation adjustment	17 353	17 353
Total capital charge	**11 542 078**	**11 638 084**
Tier 1 capital ratio	**13.00%**	**14.53%**
Total capital ratio	**14.91%**	**16.43%**

The Bank (the Group) must comply with the FCMC requirements for CET1 capital ratio (6.18%), T1 Capital ratio (8.25%) and Total capital ratio (11.00%). In addition to the requirements set by the FCMC, the Bank has to comply with the requirement of total capital buffers set forth in the Law on Credit Institutions. Compliance with the Common Equity Capital Requirement must be ensured by CET1 capital. As of December 31, 2020, the Bank's (Group) actual ratios were: CET1 (T1) capital ratio 14.53% (13.00%) and Total capital ratio 16.43% (14.91%).

Leverage Ratio

The risk of excessive leverage is defined as the risk resulting from Bank's vulnerability due to leverage or contingent leverage in its funding structure that may require unintended corrective measures to its business plans, including distressed selling of assets which might result in losses or in valuation adjustments to its remaining assets. The leverage ratio is the ratio representing the percentage of Tier 1 capital to the total amount of non-risk weighted exposures (including off-balance sheet business). As at the end of 2020, banks were not required to maintain the leverage ratio at a certain level.

Items	Group	Bank
Off-balance sheet items	6 930 592	6 957 631
Assets	216 272 526	214 482 598
Regulatory adjustments – tier 1 capital – after a fully implemented definition	-4 047 232	-3 801 070
Total exposure measure	219 155 886	217 639 159
Tier 1 capital	18 623 782	20 940 596
Leverage ratio	**8.50%**	**9.62%**

Encumbered and unencumbered assets as at 31 December 2020

Assets

		Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
		10	40	60	90
10	Total assets	3 626 590	X	215 037 428	X
30	including equity instruments	0		28 525	
40	including debt securities	0		23 442 183	
120	including other assets	0	X	70 486 649	X

Collateral received

		Fair value of encumbered collateral received or own debt securities issued	Fair value of collateral received or own debt securities issued available for encumbrance
		10	40
130	Total collateral received	551 532	0
150	including equity instruments		0
160	including debt securities		0
230	including other collateral received		
240	Own debt securities issued other than own covered bonds or ABSs		0

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

		Liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
		10	30
10	Carrying amount of financial liabilities	1 506 106	4 178 122