RISK MANAGEMENT
AND CAPITAL
ADEQUACY REPORT
PILLAR 3
2022
Building
future
together
finora bank
finorabank.eu

CONTENTS

1. INTRODUCTION 3
2. APPROVAL OF BANK'S MANAGEMENT 4
3. SCOPE OF DISCLOSURE 4
4. CAPITAL ADEQUACY 5
5. CREDIT RISK 9
6. OPERATIONAL RISK 13
7. INTEREST RATE RISK IN THE BANKING BOOK (IRRBB) AND CURRENCY RISK 14
8. LIQUIDITY COVERAGE RATIO (LCR) 15
9. NET STABLE FUNDING RATIO (NSFR) 16
10. UNENCUMBERED ASSETS 18

1. INTRODUCTION

Background of the Risk Management and Capital Adequacy report

The Risk Management and Capital Adequacy (Pillar III) report, hereinafter – Pillar III report or Report, of Finora Bank UAB, hereinafter – the Bank, is prepared according to the Capital Requirements Directive IV (CRD IV, European Parliament and Council Directive 2013/36/EU), the Capital Requirements Regulation (CRR, European Parliament and Council Regulation (EU) No 575/2013) as well as European Banking Institution's regulatory technical standards and implementing technical standards (ITS/RTS).

Pillar III report complements the set of the Bank's annual financial reports with additional information and is intended to be read in conjunction with these annual Bank's financial reports, which combined give a sufficient and accurate description of the risk profile of the Bank.

Pillar III report contains information on risk management, risk measurement and capital adequacy in accordance with the abovementioned requirements. The objective of Pillar III report is to inform shareholders and other stakeholders of the Bank's risk management, including policies, methodologies, and practices.

Finora bank in brief

The Bank is a specialized bank, whom a license was issued on 29 April 2022, focusing on small and medium sized enterprises (SME-s) in Lithuania and Estonia.

The Bank's vision, mission and main values: **professionalism, street smart responsibility**.

Professionalism entails being methodical, objective, and able to explain the behaviour and outlook of the economy and businesses to best identify opportunities and threats.

Being **street smart** means that profound professional expertise is complemented by a diverse background of hands-on experience.

Responsibility means, that we are committed to the society and economy around us achieving sustained, balanced fossil free growth (i.e., ecological responsibility) as well as promoting in-depth financial literacy both on the individual as well as the enterprise level (i.e., economic responsibility).

2. APPROVAL OF BANK'S MANAGEMENT

The Bank's management confirms that the Bank's system of internal control and risk management measures are adequate and sufficient in relation to the nature of the Bank's business and strategy.

3. SCOPE OF DISCLOSURE

The table below presents disclosed information in the Pillar III report in conjunction with the set of annual financial reports:

Table No. 1

Disclosure requirements with reference to the CRR Article	Disclosure in the Pillar III report	Disclosure in the set of annual financial reports
Article 435: Risk Management objectives and policies	p. 5, 9, 13, 14	p. 11
Article 436: Scope of application	p. 3	p. 9
Article 437: Own Funds	p. 6	p. 19
Article 438: Capital requirements	p. 6	p. 12
Article 439: Exposure to counterparty credit risk	not applicable	not applicable
Article 440: Capital buffers	p. 6	not applicable
Article 441: Indicators of global systemic importance	not applicable	not applicable
Article 442: Credit risk adjustments	p. 11-12	not applicable
Article 443: Unencumbered assets	p. 18	p. 12
Article 444: Use of ECAIs	not applicable	not applicable
Article 445: Exposures to market risk	p. 14	p. 46
Article 446: Operational risk	p. 13	p. 12
Article 447: Exposures in equities not included in the trading book	not applicable	not applicable
Article 448: Exposures to interest rate risk on positions not included in the trading book	p. 14	not applicable
Article 449: Exposures to securitization positions	not applicable	not applicable
Article 451: Leverage	p. 5	p. 12
Article 452: Use of IRB approach to the credit risk	not applicable	not applicable
Article 453: Use of credit risk mitigation techniques	not applicable	not applicable
Article 454: Use of the Advanced Measurement Approaches to operational risk	not applicable	not applicable
Article 455: Use of Internal Market Risk models	not applicable	not applicable

4. CAPITAL ADEQUACY

The Bank aims to stand out of the competitors by offering its customers flexible lending solutions, which could satisfy their specific needs, but at the same not to lose simplicity, cost efficiency and avoiding adverse risk outcomes. In terms of capital adequacy, the Bank's goals – medium risk, stable earnings, balanced return on equity.

Table No. 2 provides an overview of the Bank's capital adequacy and key ratios.

Table No. 2 Overview of the Bank's capital adequacy and key ratios

In thousands of Eur

Available capital (amounts)	31 Dec 2022
Common Equity Tier 1 (CET1)	1 984
Tier 1	1 984
Tier 2	1 000
Total capital	2 984
Risk-weighted assets (amounts)	
Total risk-weighted assets (RWA	5 632
Risk-based capital ratios as a percentage of RWA	
Common Equity Tier 1 ratio (%)	35.23%
Tier 1 ratio (%)	35.23%
Total capital ratio (%)	52.98%
Additional CET1 buffer requirements as a percentage of RWA	
Capital conservation buffer requirement (2.5%) (%)	2.50%
Countercyclical buffer requirement (%)	0.00%
Total of bank CET1 specific buffer requirements (%)	10.50%
Leverage ratio	
Leverage ratio (%)	19.50%
Liquidity Coverage Ratio (LCR)	
Total high-quality liquid assets (HQLA)	159
Total net cash outflow	0
Liquidity Coverage Ratio (LCR) (%)	Infinite
Net Stable Funding Ratio (NSFR)	
Total available stable funding	150 455
Total required stable funding	96 480
Net Stable Funding Ratio (NSFR) (%)	156%

The table below presents data on Bank's own funds, capital adequacy ratios and buffers.

Table No. 3 (CC1) Own Funds items and Capital adequacy ratios and buffers

In thousands of Eur

Common Equity Tier 1 capital: instruments and buffers	31 Dec 2022
Capital instruments and the related share premium accounts	3 000
Retained earnings	(496)
Common Equity Tier 1 (CET1) capital before regulatory adjustments	2 504
Common Equity Tier 1 (CET1) capital: regulatory adjustments	
Intangible assets (net of related tax liability) (negative amount)	(523)
Other buffers	3
Total regulatory adjustments to Common Equity Tier 1 capital	(520)
Common Equity Tier 1 capital (CET1)	1 984
Additional Tier 1 capital (AT1)	-
Tier 1 capital (T1 = CET1 + AT1)	1 984
Tier 2 capital	1 000
Total regulatory capital (= Tier 1 + Tier2)	2 984
Total risk-weighted assets	5 632
Capital adequacy ratios and buffers	
Common Equity Tier 1 capital (as a percentage of risk-weighted assets)	35.23%
Tier 1 capital (as a percentage of risk-weighted assets)	35.23%
Total capital (as a percentage of risk-weighted assets)	52.98%
Buffer requirement (capital conservation buffer plus countercyclical buffer requirements plus higher loss absorbency requirement, expressed as a percentage of risk-weighted assets)	2.50%
Of which: capital conservation buffers requirement	2.50%
Of which: bank-specific countercyclical buffers requirement	0.00%
Of which: higher loss absorbency requirement	-

The table below provides data on total risk-weighted assets (RWA) and the minimum capital requirements.

Table No. 4 (COV1) Risk-weighted assets (RWA) and the minimum capital requirements

In thousands of Eur

Risk exposure amount	31 Dec 2022
Credit risk according to the standardized approach	4 907
Market risk according to the standardized approach	-
Operational risk according to basic indicator approach	725
Total risk exposure amount	**5 632**
Exposure amount for credit risk according to the standardized approach	
Central bank exposure	-
Institutional exposure	611
Corporates	-
Retail	3 756
Exposures in default	473
Other exposures	67
Total credit risk according to the standardized approach	**4 907**
Exposure amount for market risk according to the standardized approach	
Foreign exchange risk	-
Total market risk according to the standardized approach	**-**

The table No. 5 provides data on a reconciliation of regulatory capital to the balance sheet items.

Table No. 5 (CC2 and LI1) Reconciliation of balance sheet items

In thousands of Eur

Assets	31 Dec 2022			
	Carrying values as reported in the financial statements	Deduction from capital under regulatory framework	Carrying values under regulatory framework	Subject to credit risk framework
Cash balances at central banks	-		-	-
Cash balances at commercial banks	3 057	-	3 057	3 057
Loans and advances to customers	6 904	-	6 904	6 904
Intangible assets	523	(523)	-	-
Tangible assets	23	-	23	23
Investments in debt securities held to maturity	159	-	159	159
Deferred tax assets	-	-	-	-
Other assets	44	-	44	44
Total assets	**10 710**	**(523)**	**10 187**	**10 187**
Liabilities				
Deposits from retail customers	3 246	-	3 246	-
Other deposits with agreed maturity	2 880	-	2 880	-
Subordinated loan	1 000	-	1 000	-
Other liabilities	1 077	-	1 077	-
Total liabilities	**8 203**	**-**	**8 203**	**-**
Equity				
Paid-in share Capital	3 000	-	3 000	-
Other reserves	3	-	3	-
Retained earnings	(496)	-	(496)	-
Total equity	**2 507**	**-**	**2 507**	**-**
Off-balance sheet items				
Off-balance sheet items	**214**	**-**	**214**	**-**

5. CREDIT RISK

A credit risk is the risk of financial loss if the Bank's customers fail to meet their contractual obligations to the Bank. It is the most important risk in the Bank, which arises from lending activities (credits, leasing, factoring and guarantees, hereinafter – exposures or loans) to customers – small and medium-sized companies. Currently, the Bank does not have credit facilities with large non-financial companies and exposures to financial institutions. Counterparty credit risk, settlement risk and concentration risks are considered to be part of the credit risk.

The Bank aims to maintain a well-diversified loan portfolio with acceptable risk, thus the Bank provides its services only if the customer's creditworthiness satisfies the Bank's requirements as laid out in the Bank's internal regulation, as well as external prudential requirements. The credit risk management process goal is that credit risks would be identified, controlled and communicated to management on a timely manner. The Bank uses loan customer rating model in making credit decisions for selected customers. The Bank manages the credit risk of the entire loan portfolio and individual loans. Credit risk management also takes into account the relationship between this risk and other significant risks (AML, Operational and other) too.

The main credit risk mitigation measures are collateral (mortgage, pledge), like real estate, equipment, inventories and trade receivables, as well as guarantees provided INVEGA, a financial entity incorporated by the State.

Besides, the Bank's organizational and operational structure ensures that incompatible activities is being performed by different employees. The Bank's ensures that the business units, which initiates credit transactions is separated from risk units, which presents independent risk opinion on the financing transaction.

The Bank operates in a classic three lines of defence governance structure:

- the Bank's business units comprise the First Line of Defence and all employees are responsible for understanding and managing the risks for which they are accountable. Business management owns the risks within their respective area of responsibility and is responsible for ensuring that there are appropriate processes and internal control structures in place that aim to ensure that risks are identified, assessed, managed, monitored, reported and kept within the boundaries of the Bank's risk appetite;

- the Second Line of Defence comprises independent risk and compliance functions which are responsible for the design and management of the risk and control framework. The Second Line of Defence refers to the independent control functions – risk control organization and compliance organization. The Second Line of Defence is organizationally independent from the First Line of Defence and does not carry out operational activities in the business or the unit they monitor and control;
- the Third Line of Defence comprises the internal audit function. The Third Line of Defence is organizationally independent from the First and Second Lines and does not carry out operational activities or other functions.

Credit impairment provisions are measured according to an expected credit loss model in a line with **International Financial Reporting Standards IFRS 9**. All loans, performing as well as non-performing, will carry a credit impairment provision (loss allowance) depending on their stage allocation. The exposures are allocated to one of three stages:

- Stage 1 – Performing exposures where the credit risk has not increased significantly since initial recognition;
- Stage 2 – Performing exposures where the risk of default has increased significantly since initial recognition, but the asset is still not classified as credit-impaired;
- Stage 3 – Credit-impaired exposures.

The Bank uses both individual and collectively assessed provisioning methods. The individually assessed calculation method is being applied when exposure of the customer or exposures related to the group of connected customers exceeds material benchmark and when exposure is being accounted in Stage 3. For the remaining exposures the Bank uses collectively assessed method. For collectively assessed method PD is being used as weighted average PD of the Banks exposures portfolio for the reporting date, LGD is being used as the last available statistical exposure weighted average LGD (**www.eba.europa.eu/risk-analysis-and-data/risk-dashboard**).

Table No. 6 provides data on the effect of credit risk mitigation (CRM) and Table No. 7 provides a breakdown of credit risk exposures by asset class and risk weight using the standardised approach.

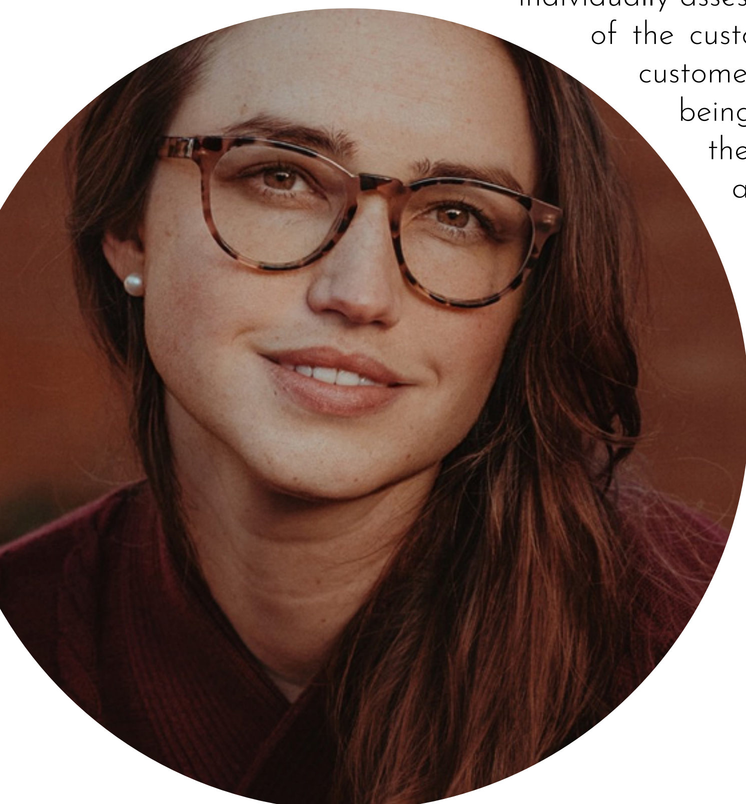

Table No. 6 (CR4) The effect of credit risk mitigation (CRM)

In thousands of Eur

	31 Dec 2022					
	Exposure before applying recalcu-lation ratio	Exposures at default	Specific credit risk adjust-ments	Exposure	Risk-weighted exposures before applying of the support coefficient	Risk-weighted exposures after applying of the support coefficient
Central governments or central banks	159	-	-	159	-	-
Regional government or local institutions	-	-	-	-	-	-
Public sector entities	-	-	-	-	-	-
Multilateral development banks	-	-	-	-	-	-
International organisations	-	-	-	-	-	-
Institutions	3 057	-	-	3 057	611	611
Corporates	-	-	-	-	-	-
Of which SME	-	-	-	-	-	-
Retail	6 639	510	50	6 589	4 942	3 756
Of which SME	6 639	510	50	6 589	4 942	3 756
Secured by real estate mortgage	-	-	-	-	-	-
Of which SME	-	-	-	-	-	-
Exposures at default	510	-	195	315	473	473
Related with the particularly high-risk items	-	-	-	-	-	-
Covered bonds	-	-	-	-	-	-
Requirements for institutions and entities with a short-term credit risk assessment	-	-	-	-	-	-
Subjects of collective investment	-	-	-	-	-	-
Equity exposures	-	-	-	-	-	-
Other positions	67	-	-	67	67	67
Total	**10 432**	**510**	**245**	**10 187**	**6 093**	**4 907**

Table No. 7 (CR5) The breakdown of credit risk exposures

In thousands of Eur

Risk weight	31 Dec 2022									Total
Asset classes	0%	10%	20%	35%	40%	75%	100%	150%	Kita	Credit exposures amount (post CCF and post-CRM)
Central governments or central banks	159	-	-	-	-	-	-	-	-	-
Non-central government public sector entities	-	-	-	-	-	-	-	-	-	-
Multilateral development banks	-	-	-	-	-	-	-	-	-	-
Institutions	-	-	3 057	-	-	-	-	-	-	611
Securities trade companies	-	-	-	-	-	-	-	-	-	-
Corporates	-	-	-	-	-	-	-	-	-	-
Retail	-	-	-	-	-	6 639	-	-	-	3 756
Equity exposures	-	-	-	-	-	-	-	-	-	-
Exposures at default	-	-	-	-	-	-	-	510	-	473
Related with the particularly high-risk items	-	-	-	-	-	-	-	-	-	-
Other positions	-	-	-	-	-	-	67	-	-	67
Total	**159**	**-**	**3 057**	**-**	**-**	**6 639**	**67**	**510**	**-**	**4 907**

Table No. 8 provides data on overdue exposures breakdown.

Table No. 8 (CR5) Breakdown of overdue exposures

In thousands of Eur

31 Dec 2022		Expected credit losses (ECL)				
Distribution of loans by overdue days	Total loans amount	Stage 1	Stage 2	Stage 3	Net loan amount	Impairment coverage, %
No overdue	5 546	-38			5 508	0.69%
0-30 days	768	-9			759	1.17%
90 and more days	835		-3	-195	637	23.71%
Total loans to customers	**7 149**	**-47**	**-3**	**-195**	**6904**	**3.43%**

6. OPERATIONAL RISK

Operational risk is the potential loss resulting from the failure or inefficiency of people, processes or information systems. These risks include reputational and legal risks, but not strategic and business risks, which are assessed separately. Legal risk is the risk that an obligated party will default on its obligations. Reputation risk is a negative public focus on the Bank and its business, regardless of its reality, which reduces the customer base, reduces revenue and increases legal costs. To reduce operational risk, the Bank defines and documents all important business processes, defining tasks and responsibilities in accordance with strict rules, and continuously improving information systems.

The main principle for organizing workflows is 1) to follow the "four-eyes principle" and 2) to segregate the business-generating functions from the recording and monitoring functions.

The Bank uses the Basic Indicator Approach to calculate the minimum required capital need for operational risk. The capital requirement for operational risk is equal to 15% of the average over three last year annual revenue of the Bank.

Anti Money Laundering and Terrorist Financing risk, as a part of Operational risk, is the risk that the Bank's products will be used for money laundering or terrorist financing, which may include reputational and/or compliance risks. Reputational risk is the risk that actual or suspected involvement in money laundering or terrorist financing will have a material effect on the Bank's financial performance, which will also give rise to compliance risk. Compliance risk is the risk that the Bank will not be able to comply with the rules established for the prevention of money laundering and terrorist financing. To prevent this, the Bank's management monitors the compliance of economic activities, customers profiles with the established rules and the adequacy of internal procedures and control systems. The Bank's business model is also based on principles that mitigate this risk.

7. INTEREST RATE RISK IN THE BANKING BOOK (IRRBB) AND CURRENCY RISK

The Bank's interest rate risk is related to the changes of interest rates on a banking book portfolio (IRRBB). Interest rate risk is the mismatch between assets and liabilities due to changes in interest rates, as well as the probability that the current value of financial instruments will change in a negative direction due to ongoing changes. The purpose of monitoring and managing interest rate risk is to assess the profitability of the Bank's interest-enhancing products, to forecast future profits and to avoid a significant decrease in profitability due to changes in interest rates. Loans granted by the Bank have a fixed or variable interest rate, and financial liabilities are usually with a fixed interest rate, for long-term period variable interest rate for loan usually is being applied and based on EURIBOR, for short term period fixed interest rate could be applied. The Bank's management analyses the market situation and avoids a possible pricing situation for loan products, where an increase in interest expenses would have a decisive impact on the financial results.

The Bank has limited foreign currency risk, because it does not offer products in other currencies.

8. LIQUIDITY COVERAGE RATIO (LCR)

Table No. 9 provides Liquidity Coverage Ratio (LCR) calculation.

Table No. 9 (CR5) (LIQ1) Liquidity Coverage Ratio (LCR) calculation

In thousands of Eur

High-quality liquid assets	31 Dec 2022	
	Total unweighted value	Total weighted value
Total HQLA		159
Cash outflows		
Retail deposits of which:	3 246	-
Deposits that are not included in the calculation of the cash flow outflow	3 246	-
Other retail deposits		
Unsecured wholesale funding:		
Operational deposits (all counterparties) and deposits in cooperative networks		
Non-operational deposits (all counterparties)		
Unsecured debt		
Secured wholesale funding		
Additional requirements:		
Outflows related to derivative exposures and other collateral requirements		
Outflows related to loss of funding on debt products		
Credit and liquidity facilities		
Other contractual funding obligations	**1 310**	-
Other unforeseen/contingent funding commitments		
TOTAL CASH OUTFLOWS		-
Cash inflows		
Secured lending (e. g. reverse repos)		
Inflows from fully performing exposures		
Other cash inflows	3 414	3 236
TOTAL CASH INFLOWS	**3 414**	**3 236**
Total adjusted value		
Liquidity buffer		159
TOTAL NET AMOUNT OF CASH OUTFLOW		-
LIQUIDITY COVERAGE RATIO (%)		Infinite

9. NET STABLE FUNDING RATIO (NSFR)

Table No. 10 provides Net stable funding ratio (NSFR).

Table No. 10 (LIQ2) NSFR calculation

In thousands of Eur

Available Stable Funding (ASF) instruments	31 Dec 2022				
Equity:	**No maturity**	**< 6 months**	**6 months < 1 year**	**≥ 1 year**	**Weighted value**
Regulatory Capital				3 579 000	3 579 000
Other capital instruments					
Retail deposits and deposits from small business customers:					
Stable deposits					
Other retail deposits			699 000	2 547 000	112 177
Wholesale funding:					
Operational deposits					
Other wholesale funding				1 000 000	4 009
Liabilities with matching interdependent assets					
Other liabilities:					
NSFR derivative liabilities					
All other liabilities and equity not included in the above categories		359 000			
Total Available Stable Funding (ASF) instruments					150 455
Required stable funding (RSF) item					
Total NSFR high-quality liquid assets (HQLA)	159 00				
Deposits held at other financial institutions for operational purposes					
Performing loans and securities:					
Performing loans to financial institutions secured by Level 1 HQLA					
Performing loans to financial institutions secured by non-Level 1 HQLA and unsecured performing loans to financial institutions		5 991		2 003	2 602

Available Stable Funding (ASF) instruments	31 Dec 2022				
	No maturity	**< 6 months**	**6 months < 1 year**	**≥ 1 year**	**Weighted value**
Performing loans to non-financial corporate clients, loans to retail and small business customers, and loans to sovereigns, central banks and PSEs, of which:		889 000	1 326 000	4 690 000	26 198
With a risk weight of less than or equal to 35% under the Basel II standardised approach for credit risk					
Performing residential mortgages, of which:					
With a risk weight of less than or equal to 35% under the Basel II standardised approach for credit risk					
Equity securities that do not match liabilities					
Securities that are not in default and do not qualify as HQLA, including exchange-traded equities					
Assets with matching interdependent liabilities					
Other assets:					
Physical traded commodities, including gold					
Assets posted as initial margin for derivative contracts and contributions to default funds of central counterparties					
NSFR derivative assets					
SFR derivative liabilities before deduction of variation margin posted					
All other assets not included in the above categories				590 000	1 741
Off-balance sheet items					
		638 000	284 000	586 000	4 123
Total RSF					96 480
Net Stable Funding Ratio (%					**156%**

10. UNENCUMBERED ASSETS

Table No. 11 provides data on unencumbered assets.

Table No. 11 Unencumbered assets

	31 Dec 2022			
	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
Assets	**-**	**-**	**10 710**	**-**
Loans on demand	-	-	-	-
Equity instruments	-	-	-	-
Debt securities	-	-	159	-
Loans and advances other than loans on demand	-	-	6 904	-
Other assets	-	-	3 647	-

finorabank.eu