



## DISCLOSURE OF INFORMATION

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## I INTRODUCTION

Bank M2M Europe AS (further - Bank) under the provisions the Financial and Capital Market Commission (further – FCMC) Regulations No.61 „On Information Disclosure and Institution Transparency” discloses information about inherent risks and their management methods and policies, compliance with capital requirements and internal capital adequacy assessment, Banks remuneration policy and practices.

## II RISK MANAGEMENT

### 1. ORGANIZATION OF RISK MANAGEMENT

Risk management is a part of Bank’s system of internal control that is established in accordance with the best practice principles and FCMC Regulations No.233 „On Establishment of the Internal Control System” regarding organization of risk control function and its synergy with compliance and internal audit functions.

The Risk Management Strategy guidelines are set out in the Bank's internal documents, that determines inherent risks, respective risk management mechanisms and approaches, capital adequacy assessment process; organizational structure or risk management and capital adequacy management; allocation of responsibilities for risk management.

The Bank performs risk and capital management in order to ensure achievement of the objectives with clear and acceptable level of risk, reducing the risk of adverse effects on the Bank's financial position, at the same time providing the necessary cost-efficiency taking into account capital adequacy and capital requirements set by the FCMC.

The Bank has set up a management information system to ensure Bank’s management with possibility to understand and timely assess the risk profile of the Bank, take effective decisions and evaluate their effects.

All units of the Bank are involved in Risk management process, but the Bank ensures an independent risk assessment, control and monitoring.

The Bank's Council determines risk strategy, monitors its implementation, as well as determines and approves respective risk management policies.

The Board ensures fulfillment of respective risk management policies and risk management process in the Bank.

Comprehensive risk control function's management is performed by the Risk Director, who sets up the Bank's risk management system, ensures the monitoring and necessary improvements.

The internal audit department performs independent monitoring of risk management system, as well as evaluation of its adequacy and effectiveness.

Risk control units provide development of a risk management process, determine risk identification methods, analyze the transaction volumes and report about significant risks.

## 2. SIGNIFICANT RISKS

### 2.1. The significant risk management

The Bank considers that the material risks inherent in the activities of the Bank are as follows:

- Credit Risk, including Concentration Risk;
- Market Risks, including:
  - Currency Risk;
  - Interest Rate Risk;
  - Financial Instruments Price Risk.
- Liquidity Risk;
- Operational Risk;
- MLTF Risk;
- Other risks: Compliance and Reputation Risk, Strategic Risk.

Below the Bank discloses information about each above mentioned significant risks - definition, management strategies and/or policies, control functions and organizational structure, measurement, evaluation, reporting systems, control and mitigation techniques.

The results of all risk assessment are given in the section on the internal capital adequacy assessment.

### 2.2. Credit Risk, including Concentration Risk

Credit risk is the risk of incurring losses in the event that the Bank's business partner is unable or refuses to fulfil its obligations towards the Bank in accordance with provisions of the relevant agreement.

The Bank has approved "Credit risk management policy" whose aim is to create effective credit risk management system in the overall risk management system, by choosing credit risk management strategy that lowers credit risk losses to the acceptable level.

Bank's lending core principles rely on clear Bank's practice and related regulatory rules, suit to Bank's operating profile and complexity and are defined taking into account Bank's employees, IT and technical resources. These principles are defined in Bank's internal document "Lending policy".

Lending is not the primary product of the Bank and the Bank does not create a big loan portfolio. For reduction of the credit risk, the Bank will ensure permanent supervision of the credit risk concentration; methodology of evaluation of counterparties; regular assessment of the credit risk

of a borrower/counterparty, stress testing. In order to mitigate credit risk arisen from crediting operations the Bank uses different types of collaterals and routinely assesses the value of the collaterals.

Bank's departments prepare and settle deals (operations) with respect to Bank's internal procedures and rules in credit risk management. Bank's accounting and back-office departments ensure accounting of deals exposed to credit risk. Separate department in the Bank performs independent credit risk assessment at the deals' preparation and monitoring stages, independently evaluates assets credit quality and necessary credit risk losses provisions calculation, as also ensures constant credit risk control process.

The credit risk management system of the Bank consists of the following elements:

- Analysis of balance and off-balance sheet items of the Bank in order to identify positions exposed to credit risk;
- Assessment of financial standing and solvency of each and every counterparty (banks, issuers of securities, borrowers) and regular review and actualization of assessment;
- Setting of different restrictions for risk deals with counterparty, based on assessment of financial standing and solvency of it;
- Setting of different credit risk indication limits and restrictions for portfolios of financial instruments;
- Regular and independent control of credit risk indication limits and restrictions;
- Assessment of value of credit risk, based on available data on probability of default;
- Stress - testing of credit risk, using different scenarios, in order to assess the potential losses resulted from adverse effect of various events.

To mitigate credit risk Bank uses collateral as one of the tools. In order to determine an appropriateness of collateral, criteria are set on different types of collateral, and the collateral is accepted, using the conservative approach, as well, ensuring low credit to collateral ratio. The value of collateral for credit risk assessment is modeled by using stress scenarios as well.

Concentration in credit portfolio and in risk deals with counterparties and other banks is analyzed and limited in the credit risk management process. Analysis is performed for different types of concentration: single name, groups of interrelated clients, industry groups, geography regions, collateral, income currency and other.

Capital requirements for credit risk are calculated using standardized approach from FCMC "Rules for calculating minimal capital requirements" Nr.60 (further - RCMCR).

### 2.3. Market Risk

Market risk is the risk of incurring losses or decreasing of Bank's future income due to changes in the interest rates, currency rates and financial instruments prices. To achieve moderate market risk levels, the internal limits of the Bank for open positions in one currency and total open positions are determined and controlled. To assess the investment portfolio risk, Bank applies indicators of sensitivity, Value-at-Risk and Expected Shortfall methodologies and stress – testing methodology as well; different risk restriction limits (regarding securities' prices sensitivity toward changes of risk factors, different limits on concentration) are set to portfolios of securities and some securities' positions. To reduce the interest rate risk, Bank maintains the structure of assets and liabilities that are sensitive to fluctuations of interest rates in accordance with the level of the interest rate risk acceptable for the Bank; Bank may use derivative instruments to hedge the risks as well.

The market risks management system of the Bank consists of the following elements:

- Identification of Bank's balance sheet positions and off-balance positions that are exposed to market risks, analysis of market data to identify market risks factors;
- Definitions of the Bank's financial results and ratios exposure to changes in market risks factors;
- Modeling of Market risks factors using internal methodologies to evaluate possible Market risks factors variations and its' impact on Bank's financial results and ratios. Evaluation of Market risks with parametrical methods;
- Modeling of Market risks factors using stress scenarios. Hypothetical and historical drastic changes in Market risks factors and their impact on Bank's financial results and ratios are evaluated;
- Setting limits and restrictions for market risks minimization – limits for currency positions, limits for size of securities portfolios, limits for bonds duration, portfolio duration, market risks losses etc.;
- Independent and regular market risks limits control;
- Hedging of market risks with financial instruments and Bank's positions management activities.

Capital requirements for market risk are calculated using RCMCR simplified approaches.

#### 2.4. Liquidity Risk

Liquidity risk is the risk that the Bank will not be able to satisfy legally relevant liabilities promptly and without considerable losses, and will not be able to overcome unplanned changes of the resources of the Bank and/or market circumstances as well because of a lack of sufficient amount of liquid assets.

Bank's internal regulations determine Liquidity Management qualitative and quantitative objectives (Bank's allowable level of liquidity risk); Liquidity risk assessments; funding structure (gaps) management, including identifying, measuring and control frameworks; preparation of guidelines for action plan for the for potential liquidity crisis; creation of a management information system of liquidity and liquidity risk management; principles of preparation of reviews and submission for monitoring purposes; duties and responsibilities in the field of Bank's liquidity and liquidity risk management.

The liquidity risk management system of the Bank consists of the following elements:

- Analysis of Bank's assets and liabilities by maturity, stability and liquidity levels;
- Definition of Banks's liquid assets and calculation of required liquid assets amount to match liabilities;
- Definition of Banks's liquidity ratios, including early warning risk indicators. Regular evaluation and control of liquidity ratios and defined limits;
- Cash flow planning;
- Evaluation of possible liquidity risk losses under stress scenarios' assumptions;

In order to identify adverse trends affecting liquidity, analyze and assess its Liquidity risk mitigation measures, the Bank establishes an early warning indicator (quantitative and qualitative)

system that can help identify the vulnerabilities of the Bank's liquidity position and the necessity to attract additional financing.

Early warning indicators are set and are a part of the Bank's Liquidity Crisis Management Action Plan.

The Bank maintains a high level of liquidity, providing liquidity ratio (FCMC methodology) above 60%. As part of Liquidity risk reduction the Bank performs cash flow planning; ensure sufficient liquid funds to ensure the ability to meet financial obligations; develop a liquidity crisis management action plan for the proper management of liquidity in case of market problems.

## 2.5. Operational risk

Operational risk is the risk of incurring losses resulting from inadequate or failed internal processes, which do not comply with the requirements of the external and internal legal regulations, the Banks's employees' and system activities, defects of internal processes, third parties' activities or from other external events as well, including legal risk, but excluding strategic and reputation risk.

The aim of the management of the operational risk is to keep the operational risk on the economic reasonable minimum level, to ensure stability of the Bank's activities and commercial profit in the long term. The management of the operational risk goes through all the Banks's organizational structure and is realized in each unit of the Bank and its subsidiaries, that is why the management of the risk is based on overall comprehension of each employee of the Bank on processes he conducts and the risks inherent in these processes (high risk awareness), and on sound risk culture as well.

In order to mitigate operational risk, Bank uses the expert method and self-assessment; implementation of quantitative indicators of operational risk; usage of database of risk events; stress – testing and scenario analysis.

Identifying any operational risk, the Bank takes a decision on whether such risk is to be accepted, necessary and reasonable steps are taken to limit or cease to perform the operational risk-related activities.

Such decisions are taken in respect of the Bank specified risk appetite levels. The Bank provides regular monitoring of the identified operational risk and operational risk loss.

The operational risk management system of the Bank consists of the following elements:

- Operational risk is evaluated before implementing new business projects or making changes in current businesses, for example, in new outsourcing projects or in development of new products, services and technologies;
- Regular operational risk self-assessment in all Bank's processes, products and/or departments – this is identification and evaluation of possible operational risk events, evaluation of control systems and analysis of required risk limiting measures. Self-assessment queries and/or specific surveys and discussions with responsible employees are used;
- Definition of operational risk indicators – statistical, financial and other indicators that describes different operational risk types and levels and its' changes;
- Limits for losses acceptable levels – defining risk appetite and ensuring limits' control;
- Evaluation of operational risk, using registered and analyzed operational risk events, losses, risk sources and other relevant information;

- Business continuity plan – management of operational risk that arises from events such as disasters or catastrophes that the Bank can't control and that affect the Bank directly or indirectly. Special attention is drawn to events that harm or limit access to Bank's material or financial assets, information systems or telecommunication infrastructure – that is, events that can stop employees from work process, cause Bank's work process interruption and significant financial losses.

Main elements of Operational risk mitigation include:

- Separation of duties;
- Documented levels of authority;
- Separation of duties in business decisions making;
- "Four eyes" principle in deals execution process (final execution of a deal should be approved at least by two independent employees or departments);
- Not allowing possibilities to make a deal single-handedly for unlimited amounts (errors or fraud);
- Insurance (with analysis of additional risks that can arise from insurance – juridical or counterparty risks);
- Investments in data processing and IT security technologies etc.

Capital requirements for Operational risk are calculated using RCMCR simplified approaches

## 2.6. Money laundering and terrorism financing risk

Money laundering and terrorism financing risk is the risk that the Bank can be involved into money laundering or terrorism financing (MLTF).

The Bank has developed and approved "Money Laundering and Terrorism Financing Prevention Policy", which aims to identify the key principles and elements of internal control system, that are focused on ensuring compliance with external legislation and to minimize the usage of Bank's financial services for MLTF purposes, providing for that adequate resources and performing employee training. The Bank has established an internal control system for anti-money laundering and counter-terrorist financing in full compliance with relevant requirements of legislation, taking into account international best practices.

Bank performs each client's identification and due diligence in accordance with the respective level of MLTF risk. Depending on the level of MLTF risk the Bank gather necessary information about nature of client's personal or economic activity, planned volumes of activity in the accounts, the source of funds and the nature of the transactions. The Bank has established client monitoring unit, which performs: each Bank's potential client's research and risk assessment prior establishment of the business relationships, transaction monitoring during course of the business relationship, as well as performs accurate and timely execution of statutory obligations with the competent authorities of the Republic of Latvia. Each client has its relationship manager who is directly responsible for customer identification, due diligence measures, reporting to the client monitoring unit on suspicious or unusual transactions. Client monitoring unit is supervised by the board member responsible for the efficiency of the Bank's anti-money laundering and terrorism financing activities.

The MLTF risk management system of the Bank consists of the following elements:

- Client identification and due diligence measures, including process of performance of identification, due diligence, enhanced due diligence, establishment and maintenance of business relationships with politically exposed persons, termination of business relationships;
- document and information retention;

- reporting to FIU;
- establishment of business relationships with respondent banks;
- employee training and testing.

Main elements of MLTF risk mitigation include:

- analyze of fulfillment of the requirements prescribed in internal regulations to identify gaps in the existing system or employee performance;
- regular employee anti money laundering and terrorism financing training ;
- improvement of the Bank's internal regulatory documents and training or responsible employees for the Banks MLTF risk management according to national legislation, international requirements, as well as examples of good practice MLTF risk management and, where appropriate, evaluate the professional competence and quality of work results

## 2.8. Compliance and Reputation Risk

Compliance and reputation risk is the risk that the Bank is not subject to or in violation of the compliance legislation, losses may occur or may be imposed on the legal obligations or penalties may be applied or may degrade the reputation.

Bank has developed and implemented the "compliance policy" with the aim, of subject to compliance with the requirements in the legislation, to improve the Banks's capabilities and competitive position in the market; to strengthen confidence in the Bank; to protect Bank's reputation, to lower the cost of capital; to reduce litigation and sanctions enforcement risks.

The Bank has established a separate and independent, with business transactions unrelated structure unit that performs compliance function.

The management of Compliance and Reputation Risk includes:

- follow up on changes in external legislation and their timely implementation in to internal regulations and practices;
- active participation in task committees and discussions of Association of Latvian Commercial Banks and FCMC concerning compliance issues;
- evaluation of efficiency of internal regulations and their correspondence with performed practices and compliance with external regulations;
- analysis and evaluation of activity indicators for proactive actions on issues that can raise Compliance risks;
- evaluation of client's complains;
- employee training on Compliance risk management.

## 2.9. Strategic Risk

Strategic risk is the risk that the changes in the business environment and the Bank's failure to respond to these changes timely, or inappropriate/unsubstantiated activities of the Bank's long-term strategy, or if the Bank's inability to provide the necessary resources for the implementation of the strategy could adversely affect Bank's income/expense (and the amount of equity capital).

The main aim of the assessment of the Strategic risk is to evaluate the risks arising from the Bank's failure to determine business strategy appropriate for respective business environment; unconsidered / unreasonable strategy; Bank's failure to ensure the implementation of the Strategy.

The Bank has determined an operational development strategy, which is regularly reviewed and updated.

The Bank performs its business development planning for at least the next three years, taking into account the FCMC regulatory requirements and key strategic goals and objectives set by the Banks



Council, that are basis for the Banks Board to exercise planning (strategic, long-term and short term) process of the Bank. The Bank has established a special unit that controls the execution of the strategy and informs the Bank's Board about its execution.

Planning activities within the framework of development, Bank carries out analysis of the external environment, competitiveness of the Bank, its position in the financial market, macroeconomic circumstances, with the purpose to determine the likelihood that an event in a business environment, in which Bank carries out its activities and/or intends to take action in the future, will have a negative impact on Bank's ability to achieve its strategic objectives (to implement the strategy) and/or threaten Bank's future operations. Evaluating and predicting of Bank's asset and liability structure is based on results of analysis of selected indicators of development activities and the business environment.

The Bank prepares and analyzes various business development scenarios. As a result of their evaluation optimal scenarios are elected.

### III CAPITAL MANAGEMENT

#### 3.1. Overall information about capital adequacy assessment process

Capital adequacy assessment by FCMC rules is described in the Bank's annual report for year 2013.

<http://www.bankm2m.com/en/about-bank/in-reporting/>

#### 3.2. Internal capital adequacy assessment

In addition to the minimal capital requirements Bank constantly controls internal capital adequacy to ensure capital coverage for all significant risks.

Internal capital adequacy assessment is based on the calculation of the possible losses under the stress scenario assumptions. The results are compares with the minimal capital requirements. In addition capital required for planned future Bank's development is assessed.

Internal capital adequacy assessment for 31.12.2013., thsd. EUR:

|   |        |
|---|--------|
| Own funds   | 13 507 |
| Capital required under RCMCR                        | 2 010  |
| Internal capital requirement                        | 4 964  |
| Internal capital requirement and reserve of capital | 10 799 |

After evaluations conclusion was drawn that Bank's own funds are enough to cover possible risks.

#### 3.3 Planning of capital

Planning of capital is done under the budget planning process.

The Bank performs capital planning at least for the next three years and defines desirable level of equity (capital adequacy aim), including:

- planning of capital adequacy with respect to the approved by the Management Board next year financial plans and financial forecasts for the following two years;
- develops plan to achieve capital adequacy target, including sources of capital increase (paid-in capital increase with the new shares issue, subordinated debt, retained earnings for the previous period or, after the permission of the FCMC, audited current year profit) and expected costs of the additional capital increase;
- develops capital adequacy contingency plan for crisis situations (when exists threat of capital adequacy ratio fall judging by the early warnings indicators).

#### IV REMUNERATION POLICY AND PRACTICE

Information prepared in accordance with requirements of FCMC „On Principles of Remuneration Policy” Nr. 171 and „On Information Disclosure and Institution Transparency” Nr. 61, and in accordance with the principles of physical persons data security.

The principles of Bank’s remuneration policy are established and executed in accordance with the Bank’s development strategy and values that corresponds to the Bank’s business model and the risk profile.

The Supervisory Council takes decision and is responsible for setting the remuneration policy framework and principles, and for review of the policy framework on a regular basis to ensure compliance thereof with the Bank’s current priorities as well as with changes in external factors.

The Supervisory Council sets the Remuneration for members of the Board, Internal Audit, Risk Director and positions where the fixed part of the salary is equal to or larger than the minimum base salary set for any Member of the Board.

No remuneration committee established at the Bank taking into account the volumes of Bank’s activity, level of their complexity, specific of operations and its organizational structure.

The remuneration at the Bank is determined with objectives:

- Attract to the Bank well-motivated high-level professionals who will ensure critical competences for the development of Bank’s business.
- Contribute to the achievement of Bank’s objectives, to recognize high performance culture and professional development by providing appropriate assessment and remuneration for quality of work and the results achieved.
- Strengthen the loyalty of those employees who contribute to the Bank’s operational efficiency, achievement of strategic objectives, and minimization of risks through compliance with the Bank’s standards of ethics and professional conduct and by ensuring the consistency with the interests of the Bank’s management and its shareholders.

The principles of setting remuneration at the Bank are that:

- Do not promote risk taking over the Bank’s risk level predefined in the Bank’s normative document *“The strategy of risk management and capital adequacy”*.
- Do not limit the Bank’s ability to ensure capital adequacy.
- Corresponds to the Bank’s values, ethical standards, long-term interests, goals of development strategy, as well as ensures efficient practice of risk management.
- Are not contradictory to the principles of interest defense of clients and other related parties.

There was no variable part of remuneration determined in Bank for year 2013, incl. no variable part of remuneration was set for positions influencing the Bank’s risk profile.

Information about the remuneration of the positions influencing the bank’s risk profile in 2013 divided according the categories and types of activity are shown in table 4.1.:

Table 4.1

**Remuneration’2013 (EUR)\* of positions influencing the Bank’s risk profile divided according categories and types of activity**

| Category                                 | Employees | Type of Activity    |                  |   |        |
|--|-----------|---------------------|------------------|---|--------|
|  |           | Investment services | Asset management | Physical persons and small and medium size enterprises services | Others |
| <b>Base salary (EUR)</b>                 |           |                     |                  |   |        |
| The Board                                | 6         | 332604              |                  |   |        |
| Internal Controll functions and Others** | 7         | 133241              |                  |   |        |

During year 2013 Bank terminated employment relationship with 4 (four) employees of positions influencing the Bank's risk profile, and paid out the compensations for employment relationship termination in total amount of 18358 EUR\*\*\*.

The total remuneration paid for all Bank employees including members of Bank's Supervisory Council and the Board (incl. employees who did not worked full year 2013) was 1 469 306 EUR.

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\* Remuneration indicated without employer's social tax.

\*\* In accordance with the principles of person's data protection information about positions of Internal control functions, investment services and asset management cannot be published.

\*\*\* In accordance with the principles of person's data protection information about the largest compensation for one person cannot be published.