MTB

Information on risks in activities of AS „ Meridian Trade Bank” in 2014, objectives, methods and policies of risk management, as well as on requirements to equity and internal capital adequacy.

The information has been prepared in compliance with 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, which sets forth the procedure for disclosing the information on the risks pertaining to operations of banks and investment brokerage companies, on purposes, methods, and policies of risk management, on own funds requirements, and internal capital adequacy assessment, as well as the remuneration policy and practices. The information is partially reflected in the AS Meridian Trade Bank (AS SMP Bank until 6 May 2014) Bank separate and Group consolidated financial statements for the year ended 31 December 2014 (hereinafter referred to as the Annual Report for the year 2013. (*http://www.mtbank.eu/static/uploaded_files/documents/latvija/reports/2014/meridian_trade_bank_fin.stat_2014.pdf*)

Information on the Bank's management is reflected in the Annual Report for the year 2014 on page 4, and has not changed since its publication.

Information on organizational structure of the Bank is published in the Annual report for the year 2014 on p.13. and on the Bank home page in the section "About bank" (subsection "Structure" - "*http://www.mtbank.eu/static/uploaded_files/documents/latvija/struktura_eng.pdf*")

Latest information about shareholders of the Bank is published on the Bank's home page in the section "About bank" (subsections "Management" - *http://www.mtbank.eu/en_LV/about/management/*).

Information on the composition of the consolidated group and methods of consolidation is reflected in the Annual Report for Annual Report for the year 2014 on page 13, and has not changed since its publication.

The aim of capital adequacy assessment is to ensure that the capital of the Bank in respect of amount, capital units and their proportion would be sufficient to cover existing and probable risks of current and planned activities of the Bank.

The Bank has worked out the Policy and Process of Capital Adequacy Assessment. For the purposes of the process of capital adequacy assessment the Bank is using and is going to use in the future the definition of capital 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 and amending Regulation (EU) No 648/2012 (hereinafter referred to as Regulation (EU) No 575/2013). The same definition of capital Bank is using for the purposes of the own results assessment, risk management and for other decisions on current and future activity.

For identifying of significant risks an expert method was applied, as well as the results of researches on significant risks in banking sphere worldwide and in separate regions. Significant risks, in the opinion of the Bank's management, were Credit risk, Liquidity risk, Currency risk, Interest rate risk, Operational risk (including legal risk), Risk of non-compliance with Anti Money Laundering regulation, Country risk, Reputation risk and Strategic risk.

During the year 2014, the Bank assessed the capital adequacy by applying „Basel's First Pillar +" approach. The capital amount required to cover the risks (hereinafter referred to as requirements of the Internal Capital) is calculated as the sum of

- minimum capital requirements;

- capital requirements for risks for which no minimum regulatory capital requirements are established. The capital amount required to cover the risks is formed from the capital amount required to cover individual risks and the rest of the existing and potential risks inherent in the Bank's dealing operations;
- Capital reserve - the amount of capital that is needed to ensure that the Bank's capital is sufficient in case of occurrence of possible adverse events, as well as to ensure that banks have sufficient capital over the economic cycle, i.e., during the period of economic upturn the Bank holds capital reserves to cover losses, that may arise during the period of economic downturn.

Methods used for calculation of minimum capital requirements.

The Bank applied standardized approach to calculation of capital requirements for credit risk, according to the Regulation (EU) No 575/2013. The Bank has nominated an external credit rating institution – *Standard & Poor's Ratings Services* – for determining of credit quality level for all categories of risk transactions.

The bank shall assess whether the 35% risk rate, to be applied to the loans secured by residential real estate, is consistent with the projected developments in real estate market. Where there is established customer solvency deterioration, collateral values decrease, the enforcement problems or other negative trends in the real estate market or the economy, when calculating the capital amount required to cover the credit risk concerning this exposure category, the bank will apply a risk weight, which is higher than 35 percent risk weight and which may differ from the risk weights in the standardised approach. In 2014, the Bank did not applied the risk of 35% for risk transactions secured by residential real estate.

The Bank is allowed not to calculate the capital requirements for risk of positions of debt securities and capital securities of trading book. The conditions of application of the above approaches are determined in the Article 94 of the Regulation (EU) No 575/2013 and in the Bank's Trading Book Policy and are strictly controlled.

The capital requirements for settlement risk of trading book were calculated according to the provisions of Part Three Chapter 6 Section 4 of the Regulation (EU) No 575/2013. For determining exposure value the Bank applied the original exposure method according to the provisions of Article 275 of the Regulation (EU) No 575/2013.

The capital requirements for foreign currency risk of non-trading book and trading book were calculated according to the provisions of Part Three Title IV Chapter 3 of the Regulation (EU) No 575/2013.

The capital requirements for commodity risk of non-trading book and trading book were calculated according to the provisions of Part Three Title IV Chapter 4 of the Regulation (EU) No 575/2013.

For calculation of capital requirements for operational risk the Bank applied the basic index approach, according to the Part Three Title III Chapter 2 of the Regulation (EU) No 575/2013.

For calculation of capital requirements for Settlement/delivery risk the Bank applied the basic index approach, according to the Part Three Title V of the Regulation (EU) No 575/2013.

For currency and transaction risk the Bank assessed whether the level of risk, calculated according to minimum capital requirements, is sufficient to cover damages related to such risk. An open foreign exchange position in recent years did not exceed 5% of its own capital. Exchange rate risk, as calculated in compliance with regulatory minimum capital requirements, in 2014 was sufficient to cover exchange rate risk related losses. In 2014 the operational risk internal capital requirement was added to the operational risk capital requirement.

The Bank calculates the individual internal capital requirements for the following risks for which no minimum capital requirements have been determined:

- interest rate risk in the nontrading book;
- the effect of concentration risk on the credit risk;
- money laundering and terrorism financing risks;

The Bank uses a simplified method for calculating the capital amount required to cover the interest rate risk.

The Bank uses a simplified method for calculating the capital amount required to cover the concentration risk. In addition, the Bank limits the potential exposure levels – requirements for one client, requirements for a group of mutually connected clients, the requirements for customers whose activities are related to one sphere and economic sector. In 2014 the Bank strictly observed the concentration risk limits. Risk limit reviews are regularly examined by the Board.

The Bank uses a simplified method for calculating the capital amount required to cover the money laundering and terrorist financing risks.

Other included risks are the following: liquidity risk, country risk, reputation risk, strategic risk, as well as non-essential risks.

The Bank uses a simplified method for calculating the capital amount required to cover other risks. The capital amount required to cover the risks is 5% of the total sum of regulatory minimum capital requirements.

The Bank counts a capital reserve in order to assure that the capital of Bank was sufficient for a covering of losses in case of possible adverse scenario, and the size of the capital of Bank was sufficient during all business cycle. During economic growth the Bank creates a capital reserve for a covering of losses which can appear during decline of economy. In case of adverse events the Bank can use a capital reserve for a covering of losses and support a smaller capital reserve, covering losses from earlier created capital reserve. At the same time, the Bank foresees necessary actions for restoration of the capital reserve in an acceptable time period to cover losses in case of adverse events, and assure that the size of the capital of Bank was sufficient during all business cycle. The most essential to Bank is the credit risk, therefore for calculation of a capital reserve results of credit risk stress testing are used.

Depending on results of credit risk stress testing and current state of economy the capital reserve is as follows:

	The economy developments is steady and successful	The economy declines	The economy is restored after crisis
Results a stress - testings show that at realization of any of scenarios the indicator of the minimum sufficiency of the capital is carried out (minimum amount of the capital reserve)	3% from minimum capital requirements	1% from minimum capital requirements	2% from minimum capital requirements
Results a stress - testings show that implementation of any scenario follows with non-performance of an indicator of the minimum capital adequacy	100% of a lack of the capital in the worst scenario, but not less than a size of the Minimum capital requirements	30% of a lack of the capital in the worst scenario, but not less than a size of the Minimum capital requirements a	60% of a lack of the capital in the worst scenario, but not less than a size of the Minimum capital requirements

The assessment of current state of economy for an assessment of capital adequacy is given in Strategy of the Bank.

The Bank calculates the total capital amount required as the sum of the required amount of capital and capital reserve to cover all the risks for which the Bank provides capital in the process of capital adequacy assessment.

The legislation of the Republic of Latvia provides for the banks minimum capital adequacy index of 8%. In accordance with the requirements of the Finance and Capital Market Commission, since 01.10.2013. till 30.10.2014., the Bank's regulative capital adequacy ratio should be equal to 10.8% or higher. Since 01.11.2014., the Bank's regulative capital adequacy ratio should be equal to 11.6% or higher. The internal capital adequacy ratio (minimum capital requirements plus special internal capital requirements and capital reserve) should be 8% or higher. The above limits are adequate to the scope and complexity of the Bank's activities and are sufficient to cover the risks inherent to the Bank's activities. In 2014 the Bank observed these requirements.

The Policy of Capital Adequacy Assessment stipulates that the Bank's capital must be sufficient for current activities and future development of the Bank. The Bank plans capital adequacy for at least a three-year period.

For planning of capital adequacy the Bank takes into account:

- forecast for the Bank's activities (risk level forecast, profit forecast, forecast of amount and structure of assets and liabilities, customer needs and maximally allowable amounts of risk transactions of the Bank, results of stress tests);
- intentions of the Bank's shareholders (dividends policy, possibility of new issues);
- economic conditions and forecast for market trends.

Increase of the Bank's equity can be achieved by:

- increase of the Bank's net profit;
- additional contributions to capital (additional stock issue);
- attraction of subordinated capital.

In a crisis situation, when the regulatory or internal limits of capital adequacy are not observed or most likely will be exceeded, the Bank, first of all, provides for attraction of subordinated capital with the help of its shareholders. During the year 2014 capital was increased to EUR'000000 4, through the sale of all shares owned by the Bank .

The Bank uses stress tests for assessment of future risks. Stress tests help identify such probable events or probable market changes, which may have negative affect on the amount of the Bank's capital. Stress tests simulate situations corresponding to strategic approaches to the Bank's economic activities and possible changes of market situation. Stress testing methodology is adequate to the scope and complexity of the Bank's activities. The Bank carried out stress tests in credit risk (5 scenarios). When performing the credit risk stress testing, Bank analyzes how the macroeconomic indicators effects on credit risk, analyzes for changes in the balance sheet, profit and equity in accordance with the Bank's current economic development strategy, within one year and two years as well the Bank conducts reverse stress testing. The Bank carried out stress tests in liquidity risk (7 scenario) as well the Bank conducts reverse stress testing. The Bank carried out stress tests in interest rate risk (1 scenario). The Bank carried out stress tests in operations risk , using internal database of losses, internal database of key risk indicator performance and public information based on external database of losses.
Test results as at 31.12.2014 confirm that the Bank's capability to absorb negative consequences of realization of different scenarios is acceptable.

Additional information about significant risks management methods used by the Bank is reflected in the Annual Report for the year 2014 on pages 23-70, and has not changed since its publication.

Remuneration policies and practices of the Bank.

Employees' salaries are determined based on the list of salary rates, defining salary interval boundaries applied for each post, which is approved by the Board of the Bank.

For making decisions on the employee's salary increase within the definite salary interval boundaries the Bank can use:

- the results of regular certification of employees,
- recommendation by Head of Department,
- other objective information about the employee's results compiled by the Bank staff inspector.

By developing and applying models of remuneration, the Bank ensures that the remuneration model, either directly or indirectly, does not motivate the employee to treat carelessly concerning his or her official duties, or to use his or her power contrary to the Bank's interests, including complying with the risk limits, as well as other quasi-boundary conditions, defined by the Bank's policies, procedures, or the legislation, regulations and laws of the Republic of Latvia.

In the Year 2014 both fixed and variable salary model was applied to separate categories of staff of Bank. The variable part was paid in the form of cash, simultaneously with the fixed part.

The Shareholders meeting didn't make the decision on applying of a salary to members of council of the Bank.

Figure 1. Information on staff remuneration; Year 2014 (EUR'000)

Name of the heading	Council	Board	Investment services	Servicing of private persons and small and medium commercial entities	Asset management	Corporate support function	Internal control function	Other types of activity
Number of employees at the end of the year		6	4	15	1	60	27	143
Profit / (loss) after taxes	-299							
Total remuneration, EUR		250	79	163	25	774	342	1540
Including: variable part of remuneration		5	8		1	47	10	123

Figure 2. Information on employees that have an impact on the staff remuneration risk profile; Year 2014 (EUR'000)

		Council	Board	Investment services	Servicing of private persons and small and medium commercial entities	Asset management	Corporate support function	Internal control function	Other types of activity
	Number of employees at the end of the year that have an impact on the institution's risk profile:		6	1	1		6	4	3
	including number of employees in the highest management positions that have an impact on the risk profile		6						
Fixed part of remuneration	Total fixed part of remuneration:		250	13	27		191	95	74
	including cash and other payment means		250	13	27		191	95	74
	including shares and related instruments								
	including other instruments								
Variable part of remuneration	Total variable part of remuneration:		5	4			7	6	
	including cash and other payment means		5	4			7	6	
	including shares and related instruments								
	including other instruments								
Variable part of deferred remuneration	Total variable part of unpaid deferred remuneration allocated in the reporting year:								
	including deferred part of cash and other payment means								
	including deferred part of shares and related instruments								
	including deferred part of other instruments								
	Total variable part of unpaid deferred remuneration allocated before the reporting year:								
	including the part to which irrevocable parts have been obtained								
	including the part to which irrevocable parts have not been obtained								
	Total variable part of deferred remuneration paid out in the reporting year								

Adjustment of the variable part of remuneration	Adjustment of the variable part of remuneration during the reporting year that concerns the variable part of remuneration allocated in the previous years								
Guaranteed Variable part of remuneration	Number of persons receiving the guaranteed variable part of remuneration (sign-on payments)								
	Amount of guaranteed variable part of remuneration (sign-on)								
Compensation for termination of legal employment relationships	Number of employees that received a compensation for termination of legal employment relationships						1		5
	Amount of compensation for termination of legal employment relationships paid in the reporting year								5
	Amount of the largest compensation for a single person for termination of legal employment relationships								2
Benefits related to retirement	Number of employees that receive benefits related to retirement								
	Amount of benefits related to retirement								

Minimum Capital Adequacy Assessment results.

Figure 3. Minimum Capital Adequacy Assessment as per 31.12.2014. EUR'000

Item	Bank	Group
Minimum capital adequacy requirements; total	13891	13977
Credit risk capital adequacy requirements; total	12448	12481
incl. claims or contingent claims against central governments or central banks	128	128
incl. claims or contingent claims against regional or local governments	33	33
incl. claims or contingent claims against institutions	1902	1902
incl. claims or contingent claims against entities	7881	6912
incl. claims or contingent claims with real estate collateral	0	0
incl. Exposures in default	2264	2346
incl. claims or contingent claims on Equity exposures	2	2
incl. other claims	238	1158

Item	Bank	Group
Market risk capital adequacy requirements; total	0	0
incl. capital requirements for foreign currency risk of non-trading book and trading book	42	54
Settlement/delivery risk capital adequacy requirements	0	0
Operational risk capital adequacy requirements	1401	1442

The Bank use cash deposits as collateral for purposes of Credit Risk Mitigation.

Figure 4. Bank's exposure before and after Credit Risk Mitigation (CRM) as at 31.12.2014. EUR'000

Conversion factor	Exposure Classes	central governments or central banks	regional or local governments	Institutions	Entities	with real estate collateral	Exposures in default	Equity exposures	other claims
0%	before CRM	29992			5977				4849
	after CRM	29992			8389				4749
20%	before CRM	7978	2062	62882					3539
	after CRM		2062	62882					3539
35%	before CRM			12769	400				
	after CRM			12769	400				
	before CRM								
	after CRM								
100%	before CRM			4820	102178		7802	2	2267
	after CRM			4820	99766		7802	2	2267
150%	before CRM				28		13664		
	after CRM				28		13664		

Information about Normative Regulations for Disclosure of Encumbered and Unencumbered Assets ar per 31.12.2014.

(according to Annexes to Financial and Capital Market Commission 25.02.2015 regulations No. 24)

Figure 5. Form A Assets; EUR'000

		Carrying value of encumbered assets	Fair value of encumbered assets	Carrying value of unencumbered assets	Fair value of unencumbered assets
		010	040	060	090
010	Total institution assets	5168	X	245317	X
030	including equity instruments			3	3
040	including bonds and notes	714	955	33004	32480
120	including other assets	4454	X	212310	X

Figure 6. Form B Collateral received; EUR'000

		Fair value of received collateral or issued bonds and notes that are encumbered	Fair value of received collateral or issued bonds and notes that are available for encumbering
		010	040
130	Total collateral received by institution		560
150	including equity instruments		
160	including bonds and notes		
230	including other collateral received		560
240	Issued bonds and notes, except issued bonds and notes with coverage,		

Figure 7. Form C Encumbered assets and received collateral serving as security for the institution's financial liabilities; EUR'000

		Relevant liabilities, potential liabilities, loaned securities	Encumbered assets, received collateral issued bonds and notes (except issued bonds and notes with coverage,
		010	030
010	Carrying value of financial liabilities		5168

Leverage

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 exposure).
The leverage ratio is calculated on the basis of data as at the end of reporting period. The capital measure is the Tier 1 capital.
The total exposure measure is the total amount of the exposure values of all assets and off-balance sheet items.

Figure 8. Leverage as per 31.12.2014

	Bank	Group
Tier 1 capital; EUR'000	24562	24555
Total amount of the exposure values of all assets and off-balance sheet items; EUR'000	263898	263718
Leverage %	9.31	9.31