

Translation from the Ukrainian original

**JOINT STOCK COMPANY  
“DEUTSCHE BANK DBU”**

**Management report for 2018**

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## **General Information About the Bank**

Joint Stock Company "Deutsche Bank DBU" (hereinafter referred to as the Bank) is a part of a bank group under foreign control. All shares in the Bank (100%) are owned by Deutsche Bank AG, a corporation established and operating in accordance with the laws of the Federal Republic of Germany. Deutsche Bank AG is a direct parent company of the Bank and its ultimate controlling party. The Bank has not bought or sold any shares during the year.

The Bank has an office in Kyiv, Ukraine. As of 31 December 2018, the Bank employed 35 employees, of which 19 men and 16 women.

According to Deutsche Bank Group's global classification, the Bank is represented in Ukraine by the Global Transaction Banking, which serves corporate clients and provides a wide range of services, in particular:

- Cash flow management
- Trade financing
- Foreign exchange transactions
- Overdrafts and fixed-term financing
- Fixed-term deposits, etc.

In order to support B2B segment, the Bank also carries out transactions in the interbank market, in particular:

- Foreign exchange transactions
- Interbank lending
- Swaps
- Debt securities of the National Bank of Ukraine (NBU), etc.

The business sector is supported by the following core business units:

- Operations
- Finance
- Risk Management
- Compliance and Anti Financial Crime
- HR
- Treasury
- IT security.

All the revenues and expenses retained in the core business units are redistributed among the business units in accordance with the approved global allocation methods.

### **Membership of the Executive Body of the Financial Institution**

The members of the Management Board of the Bank are as follows:

1. Bernd Wurth, Chairman of the Management Board
2. Oleksii Viktorovych Rybenko, Deputy Chairman and Member of the Management Board, Chief Accountant
3. Anastasiia Oleksandrivna Neroshchyna, Operations Director, Member of the Management Board
4. Yevhen Dmytrovych Kharchenko, Member of the Management Board, Acting Risk Management Head
5. Oleksandra Vasylivna Kostiana, Member of the Management Board, Compliance and Anti Financial Crime Head.

The membership of the Management Board has not changed during the year.

## Basic Principles of Corporate Governance

The Bank's corporate governance principles underpin everyday work and are integral part of changes in the corporate culture of Deutsche Bank Group. They regulate cooperation between the Bank's governing bodies and other decision makers in order to achieve the Bank's overall goals. In addition, the corporate governance principles ensure the establishment and allocation of roles, competences, and responsibilities within the regulatory framework governing the Bank's activities, and helps to clearly define responsibilities and duties.

The Bank's corporate governance functions also include compliance with the corporate governance principles of Deutsche Bank Group. Employees regularly review, improve and support compliance with Deutsche Bank Group's corporate governance principles and the Bank's corporate governance principles. Each representative or employee of the Bank takes into account and adheres to the corporate governance principles to the extent that they affect, directly or indirectly, his/her corresponding duties.

The corporate governance principles system is based on the principles of trust and cooperation between the Bank management, the Supervisory Board, shareholders, supervisory authorities regarding compliance with local laws, as well as delegation of powers and responsibilities.

The members of the Management Board and the heads of the structural units are responsible for taking necessary measures to assist the management in complying with these requirements.

The human, technical and financial resources constitute elements of the defined strategy and appropriate risk control means:

- Each representative of the management evaluates whether the unit he/she represents has adequate resources to achieve the unit's strategic goals.
- Human resources should have the appropriate knowledge, skills and experience to perform the relevant tasks, as well as receive effective training; diverse background of team members generate diverse opinions.
- Drawbacks should be analysed to ensure effective use of the resources; the consequences thereof should be evaluated and reported in a transparent way.

Ensuring general awareness of the organization structure:

- The organization structure should be transparent and clear for internal stakeholders and be in line with the business strategy and risk profile.
- The senior management should foster a structure reducing any difficulties, where necessary.

Proper documentation enables fact reconstruction, where necessary:

- Solutions and processes should be properly documented without creating an unnecessary formality burden.
- Decisions taken at committees' meetings should allow for meaningful dialogue and exchange of ideas, be recorded and provided to all interested committee members in a timely manner for review, and then to the persona that have delegated authority. In addition, all internal and external potential stakeholders should be properly informed of the decisions taken.
- Decisions taken outside the committees should be properly communicated to stakeholders, ensuring that the latter clearly understand what needs to be done, taking into account the matrix structure.

Ensuring adequate and effective information flow and reporting, especially on the risk issues:

- It is crucial to address the problem of disaggregated data and provide relevant information to other structural units of the Bank that need such information to respond effectively and comply with the information provision rules on the need-to-know principle.
- The decision-making procedures should be transparent and adequately and effectively recorded in internal reports.
- IT management systems should provide support to the Management Board.
- Risk sensitive information should be immediately communicated to the management and responsible functions



so that they can take the appropriate actions at the initial stages.

- In particular, the risks arising within the same area should be addressed. Information about them should be communicated and transferred to the management for the departments to learn useful practices.

The Management Board and each senior executive should give a lead in compliance with the Code of Business Conduct and Ethics:

- "Giving a lead" means being responsible for accurate formulation of the corporate strategy and risk levels, creation of a culture promoting honesty and accountability in order to protect clients' and shareholders' interests and support responsibility for the proper conduct of activities while being aware of risks and adhering to the corporate values.
- Proper behaviour should be acknowledged and rewarded. Inappropriate behaviour, on the contrary, should be made public and eliminated by countermeasures.

Proper business organization underpins each entity:

- Proper business organization is based on efficient and reliable administration and requires clear written organizational and operational principles, as well as clear definition and monitoring of processes, tasks, competencies, responsibilities, and controls.
- Responsibilities should be clearly defined within the organizational and operational framework. Incompatible tasks leading to conflicts of interest should not be performed by the same employees.
- Any possible drawbacks threatening the proper business organization should be resolved appropriately.

A culture of compliance and control is important for all organization activities:

- Such culture means compliance with the laws, on the one hand, and internal regulations, policies and procedures, on the other hand.
- It is very important that each employee contributes to and supports a culture of compliance.
- The appropriate code of conduct and relevant controls should be provided.

IT systems should match the organizational, operational and supervisory structures:

- Each senior executive should be informed of the IT systems needed to ensure support to organizational, operational and supervisory structures within his/her responsibilities.
- Potential drawbacks should be analysed and evaluated, and the consequences should be transparently communicated.

The corporate governance principles of Deutsche Bank Group are applied to the entire Bank, including the relevant governing bodies (i.e. the Management Board, the Supervisory Board, etc.), while ensuring the structure used to set the Bank's goals and determining the means of their achievement and performance controls. Good corporate governance should create incentives for the Bank management to achieve goals that are in line with the Bank's business strategy, shareholders' interests, and contribute to effective monitoring of work.

The Bank adheres to the global corporate governance principles set by Deutsche Bank Group, namely:

Principle 1: Obligation to Act Lawfully. This obligation, being one of the key obligations of the Management Board, defines the actions of all representatives and employees of the Bank. It comprises three elements:

- Know your regulations, i.e. building and maintaining awareness of the regulations and provisions at the Board level.
- The company should ensure organization transparency by defining, distributing and measuring responsibilities at an employee's or a committee's level, transferring certain definitions of links and interfaces, and eliminating gaps or cases of overlapping responsibilities or duties. In addition, it includes risk prevention and mitigation mechanisms in order to avoid or minimise violations.

Principle 2: Business Decision Rule:

- Business decisions (which may be subject to freedom of action as opposed to Principle 1) are taken in the Bank's interests based on the relevant information and should not be affected by conflicts of interest or personal interests.

#### Principle 3: Values and Principles Adherence:

- The Bank adheres to the corporate culture, acquires and develops talents, promotes teamwork and partnership, supports independent thinking, respect for other people's ideas, and courage to express opinions.

According to the Deutsche Bank Group's global approach, the Bank's compliance with these standards is reflected in six core values:

#### Integrity

- We live up to the highest integrity standards in everything we say or do.
- We do what is right, not just what is allowed.
- We speak openly; we congratulate, express and respect opposite views.

#### Continuous Effectiveness

- We provide value to shareholders, because we prefer long-term success to short-term benefits.
- We support the entrepreneurial spirit balancing risks and profits.
- We achieve long-term performance by developing, cultivating and investing in the best talents and by guiding them based on the merits of each.

#### Focus on Clients' Needs

- We deserve to be trusted by our clients who are in the heart of our organization.
- We provide true value by understanding and satisfying the needs of our clients in the best possible way.
- We strive to develop mutually beneficial relations with our clients and share their value.

#### Innovation

- We support innovation and appreciate intellectual curiosity of our staff.
- We enable our clients to succeed by constantly searching for solutions suitable to their tasks.
- We are constantly improving our processes and platforms by introducing new and more effective ways of doing business.

#### Discipline

- We protect corporate resources, always thinking and acting as owners.
- We observe rules and are responsible for our promises –no excuses.
- We achieve high expertise, striving to "do everything right from the very beginning".

#### Partnership

- We build different teams to create the best ideas and make more informed decisions.
- We put corporate goals over "individual" loyalty by trusting, respecting and working with each other.
- We act as responsible partners with all our stakeholders and regulatory authorities, as well as meet the wider public interests.

#### Monitoring Obligation:

- Monitoring of the effectiveness of power delegation chains and escalation of relevant issues to the management, as well as vesting with powers and ensuring regular and timely exchange of information in order to timely identify critical issues and make necessary adjustments.

When adhering to Principle 1, the management should ensure that it has the necessary skills and experience to perform the function assigned, can devote enough time and efforts to perform its work, and make decisions being sufficiently informed and weighing possible consequences.

The Management Board and the Supervisory Board (hereinafter referred to as the Corporate Bodies) interact on the basis of trust and cooperation in order to meet the best interests of the Bank, employees and other stakeholders, taking into account their tasks and responsibilities. The tasks and responsibilities of the Management Board and the Supervisory Board complement each other and form a solid corporate governance system:

- Performance of own tasks and responsibilities – each corporate body consistently performs its tasks and responsibilities.
- Prohibition of excess of powers – each corporate body should not exceed its powers and interfere with internal affairs and responsibilities of other corporate bodies.
- Mutual trust – cooperation of corporate bodies with each other, as well as among its members, is based on



mutual trust. Members of the Management Board should act in good faith for the benefit of the Bank.

- Good faith – members of the Management Board are obliged to act reasonably in respect of the Bank.
  - Open debate and maintenance of confidentiality – both corporate bodies openly debate with each other, but always maintain confidentiality.
  - Sufficient information – the Management Board is responsible to ensure adequate, accurate and timely information. The Management Board regularly informs the Supervisory Board of all material issues related to strategies, planning, business development, risk levels, risk management, compliance with the established requirements, structural mechanisms and culture in a timely manner. The Management Board indicates deviations from the previously formulated plans and goals, and provides the relevant reasons. The Supervisory Board should ensure that it is properly informed.
  - Effective interaction – all members of corporate bodies should have enough time to fully perform their duties.
- Relations with supervisory authorities. The Bank ensures cooperation with relevant supervisory authorities based on the following principles:

- Trust-based relations – the Management Board is committed to building and maintaining relations with supervisory authorities on the basis of trust and communicating with them openly.
- Available experience – the Management Board has members with experience and expertise in the relevant field to ensure interaction with supervisory authorities of the appropriate level.
- Supervision of the relations between the management and supervisory authorities – the Management Board monitors the Bank's relations with supervisory authorities and supports the exchange of knowledge among all executives.
- Commitment to implementation – the Management Board ensures that all relevant regulations are properly performed.
- Active interaction with supervisory authorities – the Management Board ensures active interaction with supervisory authorities, and communicates with them not only in response to their inquiries.

Know your structure / Know your business

- The Bank internal management system is represented by the organizational structure. The full transparency principle of the Bank structure is applied in all areas of its activity and corresponds to the changes in the laws, prevents conflicts of interest (including the division of functions), and ensures the effective operation of the Bank.
- The Bank recognises that the maximum transparency and understanding of the organizational and operational structure, business activity and related risks, ensuring the correspondence of the Bank's structure and activity with the approved business strategy, is crucial for the management.

Delegation of powers. The Management Board also adheres to a set of corporate governance principles in the context of delegation of powers and duties of the Bank under the relevant corporate governance principles, in particular:

- Prohibition to delegate duties not subject to delegation. Some duties are assigned to certain persons/units in accordance with the applicable laws and are not subject to delegation.
- One duty is one delegation. One duty may be delegated to "one person" only – either an individual or a committee.
- Delegation of powers to committees in case of reasonable diversification. If a duty may be fulfilled by an individual, this duty should be delegated to such individual, rather than to a committee. However, an individual may consult with others.
- Delegation within one vertical only. A delegating person may delegate a duty only to his/her direct subordinate.
- Prohibition of delegation of powers to other legal entities. Delegation of duties to legal entities is possible only within specific contractual obligations (for example, outsourcing), which allows the principal responsible party to control its service provider.
- Delegation of basic organizational duties. Heads of business units and infrastructure support functions shall assist the Management Board and its members in fulfilling their basic (core) duties within their own duties.

## Bank Performance Indicators

### *Main performance indicators of the Bank at the end of 2018.*

Net income – UAH 159.6 million (2017 – UAH 135.5 million)  
 Profit before tax – UAH 54.2 million (2017th - 47.6 million UAH)  
 Return on equity – 14.8% (2017 – 13.2%)  
 Risk weighted assets – UAH 414.6 million (2017 – UAH 406.6 million)  
 Total capital ratio – 85.1% (2017 – 132.8%)  
 LCR (all currencies) – 197% (in 2017, LCR was not calculated)

### *Financial performance*

(in UAH Thousand)	2018	2017	Deviation, UAH Thousand	Deviation, %
Interest income	278,161	164,737	113,424	40.8%
Interest expenses	(141,760)	(60,111)	(81,649)	57.6%
<b>Net interest income</b>	<b>136,401</b>	<b>104,626</b>	<b>31,775</b>	<b>23.3%</b>
Expected credit losses	(2,389)	1,160	(3,549)	148.6%
<b>Net interest income with allowance for impairment</b>	<b>134,012</b>	<b>105,786</b>	<b>28,226</b>	<b>21.1%</b>
Net commission income	18,165	20,810	(2,645)	-14.6%
Net trade returns	7,454	7,988	(533)	-7.2%
Other operating income	0	893	(893)	n/a*
<b>Total non-interest income</b>	<b>25,619</b>	<b>29,691</b>	<b>(4,071)</b>	<b>-15.9%</b>
Personnel costs	(47,421)	(43,719)	(3,702)	7.8%
Other administrative and operational expenses	(58,056)	(44,194)	(13,862)	23.9%
<b>Total non-interest expenses</b>	<b>(105,477)</b>	<b>(87,913)</b>	<b>(17,564)</b>	<b>16.7%</b>
<b>Profit before tax</b>	<b>54,154</b>	<b>47,564</b>	<b>6,591</b>	<b>12.2%</b>
Income tax	(11,867)	(9,493)	(2,374)	20.0%
<b>Profit for the year</b>	<b>42,287</b>	<b>38,071</b>	<b>4,217</b>	<b>10.0%</b>

\*n/a – not applicable

Increase in the number of clients and, accordingly, extension of resources available for investment enabled the Bank to increase interest income by UAH 113.4 million or 40.8% in 2018.

At the same time, more competitive environment led to higher proportion of fixed-term deposits in clients' funds, and in combination with an increase in the refinancing rate of the National Bank of Ukraine and, consequently, an increase in the cost of resources raised, interest expenses increased by 57.6% or UAH 81.6 million.

At the same time, net interest income also showed a trend to increase by UAH 31.8 million or 23.3%.

Impairment loss increased by UAH 3.5 million or 148.6%, which is, first of all, due to a significant increase in active transactions by the end of 2018 as compared to the end of 2017. Loans directly to borrowers grew by UAH 1,334.0 million or 259.1%.

As a result of the revision of approaches to the client base formation in terms of reducing the share of local clients, and due to a decrease in the foreign exchange transactions and trade financing, the Bank reduced its net commission income by UAH 2.6 million or 14.6%.

Net trade returns decreased only slightly by UAH 0.5 million or 7.2% primarily due to the narrowing of currency spreads in Foreign exchange transactions because of more competitive environment.

In 2018, personnel costs increased by UAH 3.7 million or 7.8%. The key factors were salary growth due to high



inflation and intense competition in the labour market.

Administrative and other operating expenses increased by UAH 13.9 million or 23.9%. The largest increase by UAH 6.4 million occurred in administrative expenses due to the review of group approaches to administrative expense allocation. The expenses for the Supervisory Board also increased significantly by UAH 2.2 million or 133.1% due to changes in the regulatory environment and the need to engage independent members in the Supervisory Board.

Thus, a big increase of net income in 2018 was significantly reduced by an increase in non-interest expenses, while profit before tax increased by UAH 6.6 million or 12.2%.

Income tax increased by UAH 2.4 million or 20% due to an increase in the tax base and the effective income tax rate from 20.0% in 2017 to 21.9% in 2018.

As a result, in 2018 net profit of the Bank increased by UAH 4.2 million or 10.0% as compared to 2017.

### Balance Sheet

At the end of 2018, the Bank's balance increased by UAH 1,432.3 million or 68.6% as compared to the end of 2017. Such increase was primarily due to an increase of the number of clients and balances on current and deposit accounts.

The growth of the resources caused an increase in active banking transactions. In particular, due from other banks, represented by balances on nostro accounts and cash cover on trade financing, increased by UAH 511.0 million or 122.4%.

Cash balances and due from NBU were reduced by UAH 411.6 million or 36.2% due to the redistribution of assets in favour of loans to clients against the backdrop of high demand for loans by the Bank's clients. Thus, loans and debts of clients increased by UAH 1,334.0 million or 259.1%.

Other asset items have not changed significantly.

The Bank's liabilities grew by UAH 1,426.2 million or 82.5%. At the end of 2018, fixed-term deposits amounted to UAH 1,737.5 million, which is UAH 1,050.4 million or 152.9% more than at the end of 2017. On demand deposit balances also increased by UAH 376.1 million or 36.9%.

The Bank's equity slightly grew by UAH 6.1 million or 1.7%. Payment of dividends for 2017 in the amount of UAH 36.2 million was compensated by the profit of 2018.

(in UAH Thousand)	31 December 2018	31 December 2017	Deviation, UAH Thousand	Deviation, %
<b>Assets:</b>				
Cash and due from NBU	726,361	1,137,952	(411,591)	-36.2%
Due from other banks	928,521	417,561	510,960	122.4%
Loans and debts of customers	1,848,792	514,802	1,333,990	259.1%
Accounts receivable on current income tax	10	0	10	n/a*
Deferred tax assets	1,278	932	347	37.2%
Fixed assets	11,514	12,944	(1,430)	-11.0%
Intangible assets	554	578	(24)	-4.2%
Other assets	2,909	2,895	14	0.5%
<b>Total assets</b>	<b>3,519,939</b>	<b>2,087,664</b>	<b>1,432,275</b>	<b>68.6%</b>



<b>Liabilities and Equity:</b>				
Funds held for customers	3,132,954	1,706,565	1,426,389	83.6%
Current income tax liabilities	3,937	2,381	1,556	65.3%
Provision for off-balance-sheet liabilities	54	88	(34)	-38.9%
Dividends payable	0	0	0	n/a*
Other liabilities	17,471	19,227	(1,756)	-9.1%
<b>Total liabilities</b>	<b>3,154,416</b>	<b>1,728,261</b>	<b>1,426,155</b>	<b>82.5%</b>
Share capital	301,839	301,839	0	0.0%
Retained profit and other provisions	63,684	57,564	6,120	10.6%
<b>Total equity</b>	<b>365,523</b>	<b>359,403</b>	<b>6,120</b>	<b>1.7%</b>
<b>Total liabilities and equity</b>	<b>3,519,939</b>	<b>2,087,664</b>	<b>1,432,275</b>	<b>68.6%</b>

## Economic Environment

### *Foreign Economic Environment*

According to the Inflation Report of the National Bank of Ukraine (January 2019), the external environment of the Ukrainian economy continue to deteriorate. Both developed and developing markets are evolving increasingly unevenly. Extension of protectionist measures and geopolitical instability caused slowdown in global trade dynamics and lower prices in most commodity markets.

The international financial markets have become even tighter. The rapid rise in oil prices in previous periods and depreciation of national currencies to the US dollar accelerated global inflation and strengthened the monetary policy of central banks in a number of countries. Investors have become much less interested in risk assets, while world stock indices have decreased – worst in the US market. As a result of capital flight into safe assets, interest rates on long-term US securities have fallen to their lowest level in the last eight months, while the risk premium in emerging markets has increased.

The growth of the Euro zone economy has slowed down to its lowest pace in the past four years, primarily due to the deterioration of foreign demand. First of all, German and Italian economic activities have significantly weakened. In addition to the significant role of external factors (especially for Germany), such dynamics was primarily due to the narrowing of consumer demand despite the favourable situation in the labour market, and also by investment activity as a result of political uncertainty in the previous periods in Italy. In late 2018 – early 2019, the business growth rate in the Euro zone continued to slow down to its minimum in the past four years, according to PMI index. Creation of new enterprise has almost stopped and creation of new jobs has fallen to its lowest level in the past two years. Such dynamics was caused by the escalation of protests in France, the crisis in Germany's automotive industry, trade conflicts, and Brexit uncertainty.

Economic growth in Central and Eastern Europe remained robust. These economies were mainly supported by domestic demand due to both expanded consumption (household incomes increased as a result of higher employment and improved expectations) and investments (in particular, state investments through co-financing from EU foundations).

### *Balance of Payments*

Total current account deficit was USD 4.7 billion in 2018 (as compared to USD 2.4 billion in 2017). Deficit has increased primarily due to an increase in the negative balance of commodity trade (up to USD 13 billion as compared to USD 9.7 billion in 2017). Favourable foreign economic conditions and further EU market development by exporters were the main factors of growth of exports of goods. However, the significant

complication of freight traffic in the Sea of Azov at the end of the year against the backdrop of overhauls on a number of iron and steel plants has reduced the positive effect of high yields of maize and oil crops. As a result, exports of goods grew moderately (by 9.2% per year). Imports grew faster than exports, supported by stable domestic demand and high energy prices for most of the year. In addition, dividend payments significantly increased in 2018. At the same time, remittances grew by 18.7%, thereby restraining an increase in the current account deficit.

Capital inflow on the financial account for the year amounted to USD 7.5 billion and was provided by both private and public sectors. At the same time, the latter's role in forming capital flows increased at the end of the year, primarily due to the placing sovereign Eurobonds and obtaining official financing. Capital inflow to the private sector was due to net FDI and debt capital inflow to the real economy. The surplus of the consolidated balance of payments and obtaining official financing caused the international reserves to grow to USD 20.8 billion at the end of the year or 3.4 months of the future period, despite significant payments on IMF loans.

### **Banking Sector**

According to the banking sector survey (February 2019) prepared by the National Bank of Ukraine, the banking sector received a record net profit of UAH 21.7 billion (Return on equity – 14.3%) in 2018. Net profit of profitable banks amounted to UAH 34.4 billion, losses of loss-making ones amounted to UAH 12.7 billion. Operating income increased by 27.5% as compared to the previous year primarily due to the growth of net interest and commission income, while expenses increased by 27.6% as compared to the previous year. Operating profit before creation of provisions increased by 25.4% year over year. Operational efficiency was stable: CIR was 58.9%.

There are still large amounts of bad loans on banks' balance sheets, but banks have recognised almost all losses of the loan portfolio impairment. Bad loans are 95.5% covered with provisions, which is an acceptable level in accordance with international standards. In 2018, allowances for provisions in the banking sector were twice lower than the year before and amounted to UAH 23.7 billion.

77 banks operated in Ukraine at the end of 2018. Two banks completed their merger, one was transformed into a financial company, and another was declared insolvent. The market share of state financial institutions has hardly changed by net assets and private deposits – 54.7% and 63.4%, respectively. The sector concentration has not changed during the past two years: 20 banks accounted for 91% of net assets at the end of 2018.

Net loans in UAH to corporations grew by 8.1% year over the reporting year, and to borrowers without defaults by + 25.8% year over the reporting year. The lending rates of private and foreign banks were respectively 17.6% and 7.6% year over the reporting year. At the same time, state-owned banks stopped increasing corporate lending in UAH: while in 2017 net loans in UAH grew by 12.7%, in 2018 they decreased by 1.5%. Foreign exchange net business loans grew by 2.6% year over the reporting year.

During 2018, UAH funds of individuals and business entities grew: by 14.8% and 6.8%, respectively. During the year, the bank liability structure by instrument has hardly changed. In 2018, funds of business entities grew to 35.7%.

Forecast for 2019. Profits in the banking sector will continue to grow as due to low allowances for provisions. However, significant risk remains – low operating efficiency of state-owned banks. In 2019, the growth of the fund base is expected at the previous year's level. Banks will keep interest in retail lending. The corporate portfolio growth, which began in 2018, will accelerate. This will be stimulated by the expected decrease in commercial interest rates, since the NBU may turn to easing monetary policy in 2019.

The NBU continues to introduce new CRD/CRR 4 based regulations. The framework of the new Net Stable Funding Ratio (NSFR), as well as a new framework of the regulatory capital structure will be presented for consideration in 2019.



## Bank Development Strategy

The Bank's activity in the Ukrainian market plays an important part for Deutsche Bank Group, creating a point of presence in Eastern Europe. The Bank has its competitive advantages, which allow it to forecast sustainable development and achievement of positive financial performance.

According to the Bank's strategy, its main goal is to use the existing opportunities in order to grow in the domestic market, develop deep long-term relationships with clients, and assist them in using the full range of services and benefits offered by Deutsche Bank Group.

The Bank's strategy is based on five main trends, which largely shape the economic environment and banking market.

### 1. Domestic Market Recovery

The Ukrainian market is recovering through:

- Changing the inherited business culture
- Creating new markets
- Offering an updated range of products
- Evolving from the tied-up one to a reliable target market of FDI
- Occupying advantageous ground in the close proximity of the Western European markets
- Having the developed infrastructure
- Having the dynamic labour market
- Having the cleared financial market
- Having the prospect of sustainable economic growth under the EU Association Agreement.

**Strategic goal:** to increase the market share of international corporations and engagement of the Bank into work with leading domestic companies.

### 2. Digital Revolution

By the pace of IT technology, the Ukrainian market is often ahead of other more developed Western markets. The introduction of IT technology enables the Bank to provide clients with more convenient and efficient solutions and, as a result, increase the number of clients at the lowest cost.

**Strategic goal:** to accelerate the IT product introduction.

### 3. Regional Communication Enhancement

Despite the growth of anti-globalization sentiments in some countries, the mid-term perspective shows the emergence of complex logistical chains combined with new forms of cooperation, such as the EU Association Agreement, the Silk Road initiative, and new bilateral trade agreements with various countries. As part of Deutsche Bank Group, we have unique opportunities to capitalise on the momentum using our extensive experience in international markets.

**Strategic goal:** to use the benefits of Deutsche Bank Group.

### 4. Financial Market Strengthening and Regulatory Framework Development

Bank customers are searching for innovative solutions for international financing, cash flow management and investment, as well as local hedging tools for more effective risk management. Along with the increasing complexity of the financial services sector, the regulations on risk management and ongoing reforms by the Government and the National Bank of Ukraine lead to a steady development of local financial markets.

**Strategic goal:** to strengthen market opportunities through the introduction of new products and their proper market positioning.

## 5. Inherent Risks

The Bank applies the natural growth strategy, given the risks inherent in banking activities, such as credit risk, market risk, foreign exchange risk, interest rate risk, liquidity risk, reputation risk, etc. The Bank has a transparent and clear risk management system and adheres to the established risk limits. Strong financial position allows it to use the local market capabilities with continuous monitoring of potential threats. The Bank takes into account external risk factors and ensures maximum readiness to them. These include macro- and geopolitical changes in Ukraine and the world, lower business profitability, and incidents related to the use of new technology.

**Strategic goal:** to reduce credit losses to zero, control risk level, and to comply with all the regulations.

The Bank constantly monitors the goals and objectives, analyses the status of their implementation, works on error correction and improvement of services. The Bank's clients include large corporations headquartered in Europe, America and the Middle East or operating/investing in these regions. Significant local presence in these markets allows the Bank to meet international clients' needs in trading activity financing, cash management, and provision of working capital, taking into account the special features of domestic markets.

The Bank's priorities are as follows:

- To ensure sustainable growth through understanding of customer development plans, providing reliable advice, and building leadership in current solutions.
- To administer the balance sheet to increase profitability of operating activities while constantly monitoring potential risks.
- To increase efficiency, introduce innovation to expand consumer experience.

# Compensation Report

## *Report on Compensation to Members of the Management Board*

The Supervisory Board is responsible for structuring the compensation system for members of the Management Board, as well as for defining their individual compensation.

The compensation package for the Management Board consists of the fixed and variable parts; the latter consists of the group and individual components.

Fixed compensation is a component not related to performance. When determining the appropriate level of basic salary, various factors are taken into account. Firstly, the salary is paid for appointment of a member of the



Management Board and his/her corresponding general duties. In addition, the basic salary size is adjusted for the current level of remuneration in the competitive market.

Fixed compensation not related to the achievement of goals also includes additional benefits. Additional benefits are the monetary value of non-cash benefits, such as company cars and driver's services, insurance premiums, costs of social functions associated with a company, and security measures, including taxes on these benefits, if any, and taxable reimbursement costs.

Variable compensation is a component related to performance. This part primarily depends on the performance of the short- and mid-term plans and corporate goals of the Bank. Yet not only financial success is assessed. Attitude toward employees or clients who underpin the cultural and business environment in the Bank has a significant impact on the variable part.

The goals used to determine the variable compensation part are divided into group or individual ones for each member of the Management Board. Accordingly, the variable part of the compensation package was divided into two components: group and individual components.

Compensation for the Management Board for 2018 fiscal year is as follows:

- Fixed part – UAH 8.3 million
- Variable part – UAH 0.6 million.

### ***Bank Employee Compensation Report***

Regulatory environment. Compliance is a comprehensive point in the compensation strategy. The Bank seeks to be at the forefront of regulatory changes regarding compensation and will continue to work closely with regulatory authorities to meet all existing and new requirements.

Compensation strategy. The Bank recognises that the compensation system plays an important part in supporting its strategic goals. This allows the Bank to attract and retain the individuals needed to achieve the goals. The compensation strategy is in line with the strategic goals of Deutsche Bank Group and its corporate values and principles. The Group Compensation Policy informs employees about the compensation strategy, compensation management processes, as well as reimbursement practices and structures.

General compensation system. The compensation system coordinates incentives for sustainable development at all levels of the Bank, while enhancing the transparency of compensation decisions and their effect on shareholders or employees. The compensation structure ensures a balance between its fixed and variable parts, which together constitute the "total compensation".

In 2016, Deutsche Bank Group introduced a new conceptual idea of the "total compensation". Each employee has the right to an approximate total compensation in accordance with his/her role in the Bank. This reference information provides the Bank employees with a benchmark for fixed and variable compensation parts.

The actual total compensation may be larger or smaller than a reference amount. It is set by the Bank at its own discretion subject to regulatory constraints, depending on the achievement of goals at the individual and units' and Deutsche Bank Group's levels.

Fixed payment is used to compensate employees for their skills, experience, and competencies. It should be competitive and match the labour market level, as well as consistent with other roles at the Bank and comply with regulations. It plays a key role in achieving the Bank's strategic goals by acquiring and retaining the most talented staff. Most of our employees receive this fixed part in the form of salary, the proportion of which far exceeds 50% of total compensation.



The variable compensation allows the Bank to differentiate individual indicators and employees' conduct through the appropriate incentive system, which also has a positive impact on business culture. The variable part also provides the flexibility of the cost base and increases the Bank's resistance to market crises.

The group component of the variable compensation is based on one of the main goals of the compensation system, namely: strengthening the link between the variable compensation and the results of Deutsche Bank Group. The group component is directly aligned with achievement of the strategic goals of Deutsche Bank Group, including the following four key goals: Total Tier 1 Capital, Total Capital Ratio, Leverage Ratio, and Return on Capital. These four indicators measure the capital, risk, cost and yield of the group, and determine its stability in the long run.

The individual component of the variable compensation takes into account a number of financial and non-financial factors, including an employee's individual performance and conduct, comparison with a group of employees at the similar positions. Payments for high achievements acknowledge and reward outstanding achievements of the support staff. They are paid twice a year based on the review of nominations at the Deutsche Bank Group units' level.

### ***Supervisory Board Compensation Report***

In 2018, the Supervisory Board consisted of 5 members. Two members of the Supervisory Board, including the Chairman of the Supervisory Board, represented Deutsche Bank Group and performed their functions within the framework of duties of Deutsche Bank Group and did not receive a separate compensation from the Bank. Three members of the Supervisory Board were independent and received fixed compensation in 2018.

The total payments to the members of the Supervisory Board in 2018 amounted to UAH 3.9 million. They were paid on a quarterly basis. The total cost of the Supervisory Board amounted to UAH 4.1 million.

## **Risk Management System**

The Bank has developed a comprehensive, adequate and effective risk management system that meets the following principles:

- "Efficiency", i.e. provision of an objective assessment of the degree of the Bank's risks and completeness of risk management measures while using financial resources, personnel, and risk management information systems of the Bank in an optimal way;
- "Timeliness", i.e. provision of a timely (at an early stage) detection, measurement, monitoring, control, reporting, and mitigation of all types of risks at all organizational levels;
- "Structuring", i.e. a clear allocation of functions, duties, and powers in risk management among all structural units and employees of the Bank, and their responsibilities in accordance with such allocation;
- "Delimitation of duties" (separation of the control function from the operations of the Bank), i.e. avoiding a situation in which the same person carries out operations of the Bank and discharges control functions;
- "Integrity and Comprehensiveness", i.e. coverage of all types of banking activities at all organizational levels and in all its structural units and assessment of the mutual influence of risks;
- "Proportionality", i.e. compliance of the risk management system with the Bank's business model, its systemic importance, as well as the complexity of transactions carried out by the Bank;
- "Independence", i.e. freedom from circumstances that threaten an impartial performance of the relevant functions by the Risk Management and the Compliance and Anti Financial Crime;
- "Confidentiality", i.e. restriction of access to information that is subject to protection against unauthorised access;
- "Transparency", i.e. disclosure of the information about the system by the Bank;
- Risk management and risk profile.

The Bank shall perform a comprehensive assessment of the following types of risks:

- Credit risk
- Liquidity risk
- Interest rate risk
- Foreign exchange risk
- Operational risk
- Compliance risk
- Reputation risk.

The Bank's risk management system ensures a continuous risk analysis in order to ensure timely and adequate managerial decisions to mitigate risks and to reduce related losses.

The risk management system is based on the allocation of duties between the Bank's structural units by means of the model of three protection lines:

- Line 1 – at the level of business units and support units of the Bank. These units take risks and bear responsibility for them;
- Line 2 – at the level of the Risk Management and the Compliance;
- Line 3 – at the level of the Internal Audit for verifying and assessing the effectiveness of the risk management system operation.

The organizational structure of the risk management system in the Bank ensures a clear allocation of functions, duties and powers in the field of risk management among all actors of the risk management system.

The actors of the Bank's risk management system shall include:

- Supervisory Board
- Management Board
- Credit Committee of the Board
- Asset and Liability Management Committee
- Information Security Committee
- Risk Management Unit
- Compliance Unit
- Internal Audit Unit
- Business units and support units (first line of defence).

The risk management strategy is developed in close connection with the Bank's business development strategy. Development and adoption of the Strategy is within the exclusive competence of the Supervisory Board, which defines the goals, principles, and tools of risk management and risk appetite for various risk areas.

The Management Board, committees appointed by the Management Board, the Risk Management, as well as the heads of the structural units are responsible for the Strategy implementation.

Development of internal risk management procedures and allocation of responsibilities between functions should be carried out in full compliance with the Bank's internal policies. Compliance with the Risk Management Strategy and Policies is mandatory for all governing bodies, structural units, and employees of the Bank.

The risk management system is integral part of the decision-making process in the Bank, which allows it to focus on the main banking risks in accordance with the policies and procedures for their identification, assessment, and further application of risk mitigation techniques, risk communication and results monitoring.



The strategy purpose is to reduce the Bank's losses from various types of banking risks and provide relevant solutions, in particular:

- Implement the Bank Business Development Strategy
- Maintain the optimal risk to income ratio
- Control the correspondence of risks with the Bank's transactions scope
- Fulfil all the Bank's obligations to all counterparties, creditors, and depositors.

The Strategy defines the following:

- Bank's risk appetite for each type of risks below;
- Appropriate thresholds/limits of the level of risks that the Bank should adhere in its operations, so that the operational risk of the Bank does not exceed the overall risk appetite.

The system of limits in the Bank is revised from time to time or in the event of significant changes in the external or internal environment of the Bank.

The Bank risk management is based on the following principles:

- 3-level Risk Management System
- Collective decision-making
- Sufficient information for decision making regarding risks
- Risk management relevancy, which includes the review of policies, methods, approaches, and procedures in accordance with changes in the requirements of the regulator and the economic environment.

The Bank carries out risk management using the following means:

- Recording the procedures for provision of banking services (products) and conduct of transaction in accordance with the Bank's internal policies;
- Conducting quantitative and qualitative evaluation of all significant banking risks and determining acceptable risk levels;
- Using the system of limits restricting the size of portfolios and positions, as well as decision-making powers;
- Using credit ratings for clients and counterparties;
- Monitoring the level of risks accepted by the Bank on a regular basis.

Risk Management Structure and Allocation of Responsibilities.

The exclusive competence of the Supervisory Board includes the following:

- Approve the Bank's development strategy in accordance with the core activities;
- Determine and approve the risk management strategy, policies, and procedures, as well as a list of risks and their limits;
- Ensure the functioning of the Bank's internal control system and effectiveness monitoring thereof;
- Control over the effectiveness of the risk management system;
- Determine the Bank's risk policies;
- Approve reports on risks and outcomes of stress tests.

The competence of the Management Board includes the following:

- Develop the strategy and its implementation through a clear business development plan of the Bank;
- Implement the risk management strategy and policies approved by the Supervisory Board, ensure implementation of procedures for the risk identification, assessment, supervision, and monitoring;
- Inform the Supervisory Board of the Bank's performance indicators, detected violations of the laws and Bank's internal regulations, and any deterioration in the Bank's financial position or threat thereof, as well as the level of risks arising in the course of the Bank's operation;
- Create special-purpose committees involved in the risk management system, such as the Credit Committee, the Assets and Liabilities Management Committee, etc.

The competence of the special-purpose committees created in the Bank includes the following:

- Assess the risks inherent in the Bank's activities;
- Take decisions on lending transactions (and/or any substantial changes thereto) with borrowers of the Bank, (i) except when decisions on individual lending transactions are taken by another body of the Bank in accordance with the Bank's internal regulations and/or applicable laws of Ukraine, or (ii) provided that the relevant decision of the Committee is agreed with another body of the Bank;
- Take decisions on the establishment or revision of limits;
- Coordinate risk models.

The competence of the Risk Management includes the following:

- Participate in determination of the strategy and business plan of the Bank for further development of the Bank;
- Participate in the development and implementation of the strategy, policies, and other internal documents on risk management establishing the risk management organization and functioning procedure in the Bank, and keep them up to date;
- Calculate risk appetites;
- Ensure the functioning of the risk management system by timely identifying, evaluating, monitoring, controlling, reporting, and mitigating all types of risks inherent in the Bank's activities, and assessing the adequacy of the Bank's capital and liquidity level, taking into account the Bank's risk profile, market and macroeconomic environment;
- Analyse all types of risks of the Bank in the course of its activities on an ongoing basis in order to take managerial decisions to mitigate certain types of risks and/or losses for the types of Bank's activities that are sensitive to such risks;
- Conduct quantitative and qualitative assessment of risks inherent in the Bank's activities;
- Conduct stress analysis;
- Report on the functioning of the risk management system through regular preparation and submission of quarterly reports on risk management to the Supervisory Board and monthly reports to the Management Board.

The competence of the Compliance includes the following:

- Organization of control over compliance with the norms of legislation, internal banking documents and the relevant standards of professional associations applied to the bank;
- Monitoring of changes in the legislation and relevant standards of professional associations applied to the bank, and evaluation of the effect of such changes on processes and procedures introduced in the bank, as well as provision for control over the implementation of the relevant changes in internal banking documents;
- Control over the relations of the bank with its clients and counterparties in order to prevent participation and/or use of the bank in illegal transactions;
- Manage the risks associated with conflicts of interests; control over the personal data protection in accordance with the applicable laws of Ukraine;
- Training and awareness of the bank's employees on compliance with the legislation, relevant standards of professional associations applied to the bank, and the Risk Management Culture, taking into account the Code of Conduct (Ethics);
- Submission of reports on risk compliance to the Council at least once a quarter and to the Management Board at least once a month.

The competence of the heads of structural units of the Bank includes the following:

- Conduct of current monitoring of the Bank's transactions and risks;
- Adherence to the established procedures, rules, and limits;
- Escalation of violations of limits, operational cases, and any evidence of a significant increase in risk.

The Bank's risk management strategy establishes the qualitative provisions on acceptable risk parameters that are consistent with the acceptable risk parameters of Deutsche Bank Group, as well as limits of the Bank's business



functions and infrastructure, and ensures that each risk taken by the Bank will be duly compensated, evaluated and controlled.

The qualitative provisions on acceptable risk parameters are determined for each significant type of risk associated with the Bank's activities.

### **Credit risk**

Credit risk covers all transactions that give ground to actual, unforeseen or potential claims against any other party, undertaking person, or borrower, including those that the Bank plans to distribute when the Bank will bear the risk of loss in case of debtor's default on obligations. This includes the counterparty risk, country-related risk, product-related risk, and industry-specific risk.

Credit risk management involves the steady application of a number of qualitative principles and quantitative metric parameters using the services of experienced risk management experts and the established system of constraints. The focus areas include the quality of counterparties, scheme of operations and aspects related to securing liabilities and portfolios, taking into account the scale of the country, product, and industry.

Risks covered:

- Counterparty risk
- Country-related risk
- Product-related risk
- Industry-specific risk

Qualitative provisions on acceptable risk parameters:

- Assume the credit risk only with creditworthy clients based on the proper comprehensive check;
- Manage the concentration risk at the level of the counterparty, product, country, and industry; actively reduce the concentration risk by enforcing loan obligations, loss insurance and/or distribution;
- Determine the parameters of acceptable risk, taking into account the stability of risk/profit;
- When calculating the amount of credit risk, apply IFRS 9 and NBU Resolution No. 351;
- Control the effect of non-liquid assets and/or assets for which it is difficult to set a price;
- Act cautiously in relation to unsecured cash risks and exposure to long-term bills of exchange.

Practical aspects of credit risk management

In accordance with IFRS 9, the Bank has the right to consider that in the event when the credit risk of a financial asset at its recognition is assessed as low, the expected credit losses will be calculated within the 12-month period.

The general approach to the calculation of expected loss is used to recognise the provision for credit losses in the profit and loss statement for financial assets recognised in the Bank's financial statements. The asset impairment provision to cover expected loss is determined as a reduction in the amount by which a financial asset is recognised in the Bank's balance sheet.

The general approach to expected losses governs the assets under both proper and improper fulfilment of contractual terms. This approach does not govern created or purchased financial instruments that are impaired at the time of their recognition by the Bank.

According to the expected loss approach, the impairment provision is measured as follows:

- 12 month expected credit losses; or
- Expected credit losses for the entire asset period.



A period should be chosen based on a significant increase in the credit risk since the initial recognition of a financial asset. If such a significant increase arises after the initial recognition of a financial asset, the impairment should be measured as expected credit losses for the entire asset period. Therefore, the general principle of IFRS 9 is the recognition of expected credit losses in accordance with changes in the credit quality of a financial asset for the entire life of the asset.

The Bank applies the following methods for determining the current provision for credit losses:

1. Financial assets that have not had a negative change in credit risk since the initial recognition (creation or acquisition) – 12-month expected credit loss approach (Stage 1);
2. All financial assets that have had a significant increase in credit risk since the initial recognition (creation or acquisition) – the approach of expected credit losses for the entire life of the asset (Stage 2);
3. Assets defined by the Bank's risk managers as defaulting/non-performing assets – the approach of expected credit losses for the entire life of the asset (Stage 3).

As of 31 December 2018, the Bank created the following provisions in accordance with IFRS 9:

<b>Asset type</b>	<b>Expected credit losses, k UAH</b>
Nostro	235,30
Credit facilities	-
Loans and Off BS exposure	1 535,25
Financial debtors	50,74
Other debtors	906,28
<b>Total</b>	<b>2 727,57</b>

The amount of credit risk is insignificant due to the following factors:

- High credit rating of clients
- Guarantee of client's obligations by parent companies
- Revocability of the Bank's obligations

According to NBU Resolution No. 351 dated 31 December 2018, the Bank has created the following provisions:

<b>Asset type</b>	<b>Credit risk, k UAH</b>
Nostro	60 578,34
Credit facilities	-
Loans	17 381,41
Off BS exposure	14 258,06
Financial debtors	50,75
Other debtors	906,28
<b>Total</b>	<b>93 174,84</b>

The credit risk calculation is substantially affected by large balances on nostro accounts within Deutsche Bank Group and a decrease in its credit rating to BBB+.

### **Interest Rate and Foreign Exchange Risks**

Both risks arise as a result of uncertainty concerning changes in market prices and rates (for example: interest rates, share prices, exchange rates, commodity prices), their interconnections, and levels of instability.

The parameters of acceptable market risk for the Bank are determined taking into account the Bank's risk targets and distribution, starting with the level of the Group's acceptable risk parameters. When establishing the acceptable risk parameters, the following is taken into account:

- Avoidance of concentration risk and liquidity risk of markets, issuers and emissions; these risks are identified, monitored and managed, taking into account absolute and relative amounts, as well as liquidity in normal and complex market conditions;
- Ensuring a stable potential for reducing market risk, which may occur due to a specific phenomena or major risks; the Bank conducts the stress analysis, which assesses the course of events under the macroeconomic scenarios or scenarios typical for business activity;
- Control of interest gaps and the maximum amount of foreign exchange positions;
- Ensuring the consistency of the Bank's market activity with its strategy;
- Ensuring restraints of product complexity with the possibilities of monitoring and determining the risks the Bank is exposed to.

The Bank has approved the limit calculation procedure, which provides a set of interrelated measures aimed at the calculation, evaluation, monitoring and control of the effects of changes in interest rates and exchange rates in order to prevent and mitigate losses that may be incurred in case of adverse changes.

As of 31 December 2018, the Bank had the following limits:

<b>Risk Indicator</b>	<b>Limit, EUR Thousand</b>	<b>Actual risk, EUR Thousand</b>	<b>Use %</b>
<i><u>Interest rate risk</u></i>			
Net sensitivity	10	3.3	33%
Stress	5,000	962	19%
<i><u>Foreign exchange risk</u></i>			
VaR	3	0.25	8%
Stress VaR	15	0.86	6%
IR Delta	3	0	0%
Foreign exchange Delta	50	23.96	48%
Total foreign exchange position	35	24.77	74%
Stress	17	14.73	88%

### **Liquidity risk**

The liquidity risk is a risk that arises from our potential failure to fulfil all payment obligations at maturity or fulfilment thereof with suffering heavy costs.

Qualitative provisions on acceptable risk parameters:

- the Bank pays special attention to the operational liquidity risk management based on the development of a cash flow schedule, taking into account highly liquid assets, as well as to the compliance with the applicable standards on liquidity coverage ratio (LCR);
- With regard to all currencies, the Bank should be able to survive in a hard combined market environment and overcome a specific stressful phenomenon related to liquidity during a minimum initial period of up to 8 weeks, while maintaining an appropriate net liquidity buffer;
- The Bank should monitor excess concentrations and have the right to restrict them in view of the liquidity and financing prospects;
- The internal transfer pricing limit is used as a mechanism to ensure that prices for economic activities are formed taking into account the basic liquidity risks of the Bank in the course of such business activities.

For daily liquidity risk management, the Bank uses the following tools:

1. Calculation of cash flows for a month. The calculation includes liquid assets and current liabilities (current accounts of customers are divided into stable and unstable), 100% cash flows on fixed-term loans and deposits, overdrafts (until repayment on the 30th day).

As of 31 December 2018, there the following operational liquidity limits were established:

Term	Limit, UAH Thousand	Actual position, UAH Thousand
Overnight	-50,000	541,306
1 week	-50,000	600,366
1 month	-50,000	535,566

2. Short-term liquidity coverage ratio (LCR).

Actual arithmetic mean ratio as of 31 December 2018:

- by all currencies – 197%
- by foreign currencies – 431%

### Operational risk

The operational risk means a risk of loss resulting from inadequate or false internal processes, staff incompetence and improper operation of systems or external events. This risk also includes the legal risk. The operational risk excludes the business risk and reputation risk.

Occurrence of the operational risk is caused by a number of basic risks defined in the Risk Classification. The below types of risk are considered material in the context of identifying a risk and assessing its significance:

- Internal fraud
- External fraud
- HR management and OHS
- Customers, products, and business practices
- Damage or destruction of assets
- Prevention of the operation and functioning of systems
- Transfer of funds, issue of payment orders to transfer funds and administer processes.

Qualitative provisions on acceptable risk parameters:

#### Single Scheme

- The Bank uses a single operational risk management scheme for the entire organization. All structural units should comply with the risk tolerance and control standards for each type of risk in the risk classification.
- Control Environment
- To achieve the desired strictness of internal control, the Bank has established controls with the following purposes:
  - To ensure continuous operation in any event that affects business processes and related systems;
  - To maintain the information security comprehensively;
  - To ensure that appropriate measures are taken to restore the IT and other infrastructure to enable the Bank to continue its operation and fulfil its obligations to clients, market and regulatory obligations in case of unforeseen events destabilising the Bank;
  - To ensure that the Legal is solely responsible for interpreting the laws, regulations, and the Bank's procedures, legal content of all documentation; supervise resolution of all disputes;
  - To maintain the control and management system in order to detect and prevent significant misstatements in the financial statements and presentation of financial information, as well as control internal risk, liquidity, and capital;



- To maintain the comprehensive control system to ensure that the Bank complies with the applicable laws and regulations, including prevention and detection of potential money laundering, fraud, bribery and corruption, or non-compliance with sanctions and embargoes;
- To detect or prevent untimely, inaccurate or incomplete processing of transactions and reduce the frequency of occurrence and general severity of events;
- To determine the outsourcing cooperation procedure;
- To detect and monitor key risk indicators;
- To archive documents in appropriate repositories in order to provide timely, complete and accurate response to authorised information requests, and to preserve all documents and dispose of them in accordance with the laws, regulations, and requirements for business activity.

The operational risk management system is defined as a set and sequence of stages of identification, assessment, mitigation, follow-up monitoring, reporting, and calculation of operational risk economic indicators. It is implemented through the following tasks:

1. Organization and methodological support of the Bank's operational risk mapping system;
2. Determination of the operational risk appetite;
3. Organization of the internal control system, including updating of the Bank's control plan and methodological support;
4. Organization and methodological support to the operational data collection system;
5. Organization and methodological support to the action plan base;
6. Initiation and methodological support to trainings aimed at promoting an operational risk management culture, including risk of fraud, among the Bank employees.

#### Determination of the Operational Risk Appetite of the Bank for 2018

The Bank applies the group top down approach to the global operational risk tolerance at the level of a particular country. The Bank's risk appetite for the current year is revised and agreed by the Supervisory Board at the beginning of the year or at the end of the previous year.

Current losses and other events associated with operational risks should be monitored on a daily basis, within a defined level of risk appetite. Any actual or potential risk appetite violation should be duly escalated.

Potential losses are calculated as the average absolute value of actual losses (excluding pending litigation) over the past five years. The global tolerance for operational risk should be distributed to the Bank, taking into account its amount.

Allocation of global tolerance (EUR 200 million) to the Bank's level, taking into account its amount, is EUR 48,000. The Bank's risk appetite in 2018 amounted to EUR 24,000 – the average of global tolerance and historical losses.

Actual risk appetite by the end of the year:

Operational risk appetite for 2018, EUR		Q1	Q2	Q3	Q4
Annually	24,000	320	655	965	965
Quarterly	6,000	320	335	310	0

#### Reputation risk

It is a risk of potential damage to the Bank's trademark or reputation, as well as related risk for profits, capital or liquidity resulting from any association, action or omission that might be perceived by stakeholders as inappropriate, unethical, or incompatible with the Bank's values or principles.

The Bank seeks to ensure the situation in which reputation risk would be "as low as reasonably possible". Since it is impossible to fully avoid the reputation risk, and, moreover, its occurrence is caused by any unpredictable changes in the practices of our various stakeholders (for example: the public/clients; shareholders; regulatory authorities), the Group tries to promote the establishment of permanent standards to increase profitability and mitigate the risk that any association, action or inaction is perceived by stakeholders as inappropriate, unethical, or incompatible with the Bank's values or principles.

#### Internal Control Systems

The Bank uses the effective internal control system in order to achieve the following goals:

- Efficiency of the Bank's operations, protection against potential errors, violations, losses in the Bank's activities;
- Risk management efficiency;
- Adequacy, comprehensiveness, completeness, reliability, availability, timeliness of providing information to users for them to make relevant decisions, including financial, statistical, administrative, tax and other reporting;
- Completeness, timeliness and accuracy of the Bank's transaction recognition in the balance sheet;
- Compliance;
- Personnel management efficiency;
- Prevention of the use of bank services for illegal purposes, detection and prevention of financial transactions related to money laundering or terrorist financing.

In order to achieve these goals and ensure the functioning of the internal control system, the Bank performs the following tasks:

- Control of the Bank management over compliance with the applicable laws of Ukraine and the Bank's internal procedures;
- Allocation of duties to carry out the Bank's activities;
- Control over the functioning of the risk management system;
- Control over information security and information exchange;
- Introduction of the internal control procedures;
- Monitoring of the internal control system;
- Introduction of internal audit procedures.

The Bank's internal control system includes the following areas:

- Control by the governing bodies over the Bank's activities (in accordance with Section 3 of this Regulation);
- Control over the operation of the banking risk assessment and management system;
- Control over the allocation of powers in the conduct of transactions;
- Control over the information flow management (receiving and transmitting information) and information security;
- Regular monitoring of the internal control system in order to assess its correspondence to the Bank's objectives and activities, identification of deficiencies, development of proposals and control over the implementation of decisions to improve the Bank's internal control system.

Control over the operation of the banking risk assessment and management system

The Bank controls the operation of the risk management system on a regular basis in accordance with the procedure established by the internal documents.



The banking risk assessment involves identification and analysis of internal (complexity of the organizational structure, qualification of employees, organizational changes, personnel turnover, etc.) and external (changes in the economic context of the Bank, etc.) factors that affect the Bank's activities.

The Bank has established the following procedure for informing the Bank's management about the identified factors increasing banking risks:

- The Bank's employees who become aware of the facts of violation of the laws and transaction rules of the Bank, as well as the facts of damage to the Bank, depositors, or clients are obliged to immediately bring this information to the notice of their line managers, the Risk Management and the Corporate and Legal Standards (Compliance). The heads of the Bank's structural units are liable for concealing the facts of violation.
- In case of detecting violations of the laws or transaction rules, excess of powers, violations of the decision-making and risk assessment procedures, as well as other actions (omission) in the activities of the Bank's structural units and/or employees that may result in both direct damage to and imposition of sanctions on the Bank by the regulatory authorities, the Risk Management, the Compliance, and the Internal Audit shall inform the Bank's management in due course in order to take decisions on measures needed to eliminate the violations identified.
- If a violation has been detected in activities of a head of structural unit, he/she shall take measures to eliminate them in a timely manner.

The management and employees of various structural units, including those that conduct banking and other transactions, their recognition in accounting and reporting, as well as the Internal Audit, shall monitor the internal control system on a continuous basis.

The Bank shall take the necessary measures to improve internal control and ensure its effectiveness, taking into account changing internal and external factors affecting the Bank's activities.

16 April 2019



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Bernd Wurth  
Chairman of the Management Board