CAPITAL ADEQUACY AND

RISK MANAGEMENT REPORT 2017

Pillar 3

June 2018

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1. Introduction

The purpose of this document is to provide relevant information about the capital position and risk profile of Demir-Halk Bank (Nederland) N.V. (hereafter referred to as DHB Bank) in the interest of a greater transparency towards third parties and to ensure compliance with the disclosure requirements established under the European Union's Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD). This disclosure document has been prepared by DHB Bank in accordance with the requirements of Pillar 3 set out in Articles 431-455 of the CRR. The scope of application of the Pillar 3 requirements is confined to DHB Bank and its branches. Unless otherwise stated, all figures are as of the bank's financial year-end, 31 December 2017.

DHB Bank is a Dutch bank that operates internationally. It funds its operations to a large extent via retail deposits collected in the Netherlands and Germany while its lending is focused on wholesale placements, mainly in the European Economic Area and Turkey. Credit customers comprise corporates and financial institutions, and, on a smaller scale, sovereigns and retail clients.
DHB Bank adopted the Standardised Approach for credit risk, market risk and credit valuation adjustment, and the Basic Indicator Approach for operational risk. The disclosures in this document are based on these approaches.

The Bank also publishes additional information in its annual reports that can be found on its website: www.dhbbank.com.

2. Background

The Basel Committee on Banking Supervision has published its set of rules on 16 December 2010, referred to as Basel III.

Basel III consists of 3 supplementary Pillars:

- Pillar 1 – Minimum Capital Requirements,
- Pillar 2 – Internal Capital Adequacy Assessment Process (ICAAP) and
- Pillar 3 – Public Disclosure, which provides market participants with information on applied rules, own funds, risk analyses and thus the capital adequacy.

The transposition of the Basel III framework into European law was done in two parts: publication of the Capital Requirements Directive IV (CRD IV/Directive 2013/36/EU) and the Capital Requirements Regulation (CRR/Regulation [EU] Nr. 575/2013). It was published in the Official Journal of the European Union on 27 June 2013. Part 8 of CRR includes additional provisions on regulatory disclosure for credit institutions. The CRR/CRD IV is legally enforced by Dutch law by the Financial Supervision Act (Wft, Wet Financieel Toezicht). Both, Directive and Regulation, are applicable since 1 January 2014.

3. Risk and Capital Management

3.1 Risk Governance and Culture

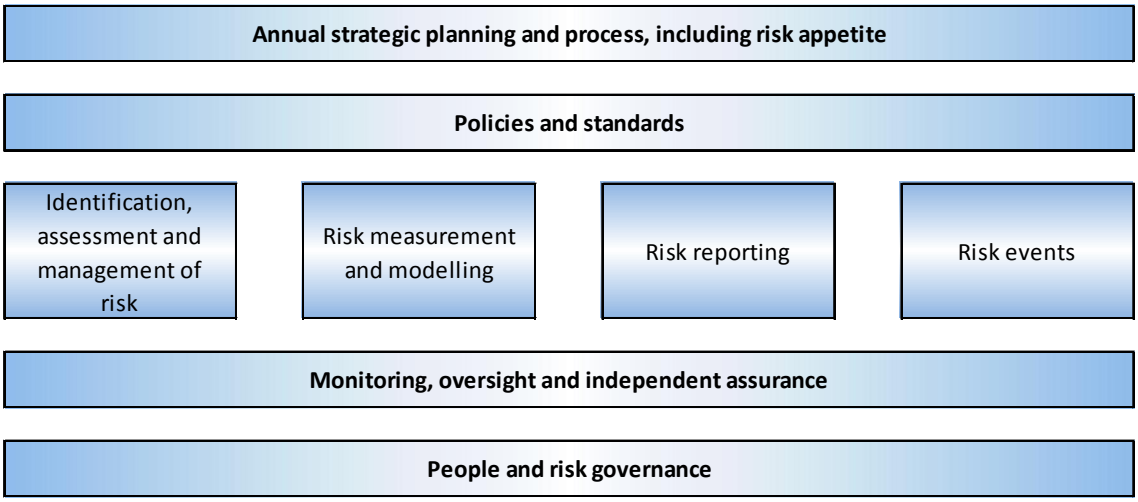
DHB Bank's risk management framework and governance structure are intended to provide comprehensive controls and ongoing management of the major risks taken or faced in its business activities. There is a culture of risk awareness and personal responsibility where collaboration, discussion, escalation and sharing of information are essential. DHB Bank's risk governance structure is based on the "Three Lines of Defence" model for managing the risks inherent in its business, with appropriate risk management oversight. DHB Bank is exposed to mainly credit risk in its business activities. Other relatively important risk areas, like other banks, are liquidity risk, interest rate risk and operational risk.

Three Lines of Defense		
First Line	**Second Line**	**Third Line**
Risk Ownership Business and Operation Units	Risk Control Risk and Control Units	Risk Assurance Internal Audit
- Owns the risks - Owns controls and losses / incidents - Manage day to day risks - Execute processes in the risk framework	- Design the framework - Monitor & Control execution - Report on KRIs - Advise and support 1st Line	Review and assurance on - effective design - execution of Control processes

DHB Bank continually strives to further strengthen the bank-wide risk and capital management framework in terms of organisational structure and processes as well as the methods for identification, assessment, measurement, monitoring and control of risks. Accordingly, the Bank ensures that all risk-related policies are fully communicated and adopted at all levels within the organisation.

The Bank's risk management framework is based on the risk strategy and the risk appetite, which are integrated with the risk organisation, policies and methods. This framework aims to safeguard the Bank's desired risk profile and steer risk management processes in line with the risk appetite of the Bank.

Risk management framework



'Risk Appetite' is defined as the level and types of risk the Bank is willing to undertake within the boundaries of its risk capacity to achieve its strategic objectives. The Supervisory Board formally approves the Bank's Risk Appetite Statement (RAS) proposed by the Managing Board and exercises its oversight of risk management principally through the Board's Risk & Audit Committee (RAC), supported by assessments and reports prepared by the Internal Audit Department (IAD), Risk Management Department (RMD) and Compliance, Internal Control & Legal Department (CL). RAC is responsible for the oversight of policies and processes by which risk assessment and management are carried out within the Bank's governance structure. RAC also reviews internal control and financial reporting systems that are relied upon to ensure integrated risk measurement and disclosure processes.

Formal risk governance processes have been established in the Bank; the management of risk is guided and monitored by a number of committees. Within the governance structure, Credit Committee (CC), Asset & Liability Management Committee (ALCO) and Organization & Control Committee (OCC) oversee particular risks. Risk Management Committee (RMC) oversees the management and control of the Bank's risks on an aggregate level, in addition to the committees and specialized functions that focus on specific risk areas. RMC also discusses and ultimately endorses the methodology and outcomes of the ICAAP and the ILAAP based on the reports by the Risk Management Department (RMD).

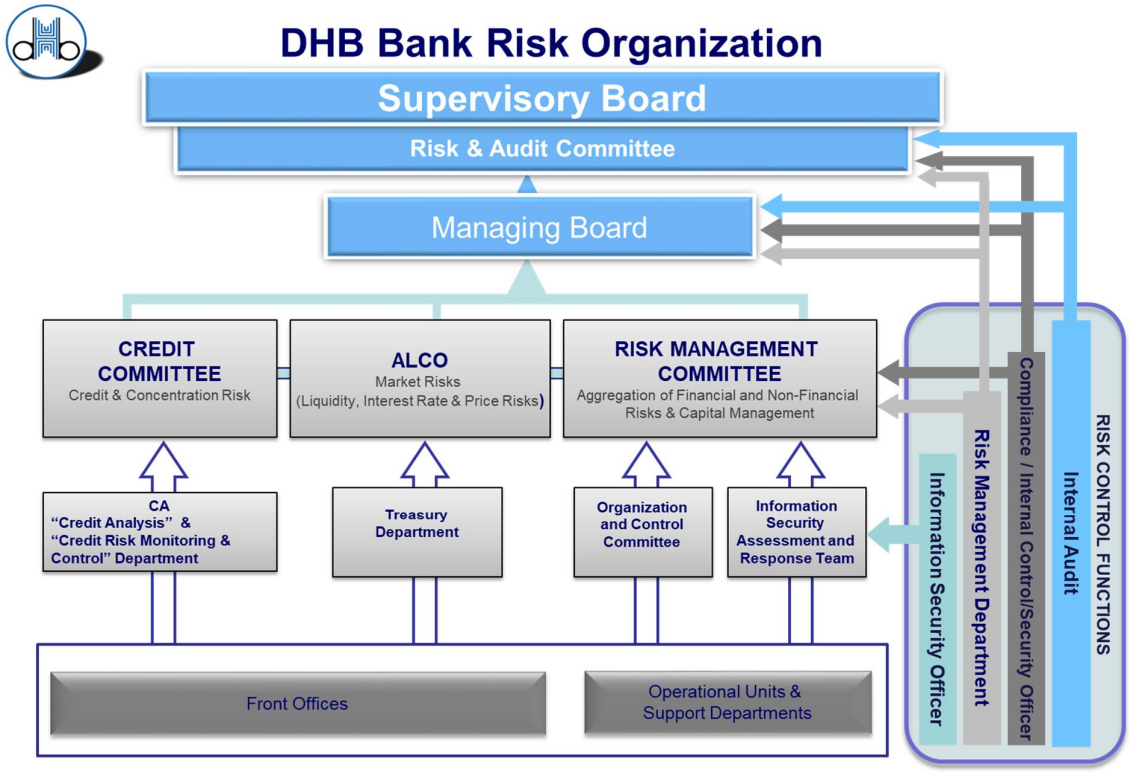
IT related risk factors are controlled and monitored by different departments and committees. The access control to the core banking application resides jointly on System Analysis team and Internal Control Unit, while technical control is exercised by the IT Department. Information security in the broadest sense (including access control, technical control and business continuity policies and activities) is ensured by the Information Security officer (ISO). ISO and IT units are part of the IT & IS Steering Committee, a platform for communication and decision on IT-related procedures and measures.

In the framework of compliance, the Security Officer, beside anti-money laundering measures, is responsible for the incident and the complaint management systems. In addition to the immediate benefits, the ultimate aim for maintaining these systems is gathering sufficient data needed to model operational risks.

Control with respect to the non-financial risks is carried out by the Internal Control Unit (ICU) and the internal and the external auditors. The ICU executes predefined operational controls daily, weekly, monthly or quarterly depending on the risks attributed to the concerned activities. The internal and external auditors also execute their inspections on the risk management systems, policies and practices. Finally the Compliance Officer, who reports directly to the Managing Board, and has direct access to the Chairman of the Risk and Audit Committee and Chairman of the Supervisory Board, is responsible for integrity and compliance in the broadest context.

Assessment in lieu with the adopted risk appetite statement concerning both financial risks and non-financial risks are reported to the RMC at least quarterly. The Managing Board is responsible for reporting to the RAC and the Supervisory Board. With this structure, a consistent segregation of duties is achieved between risk generating, measuring, controlling and reporting units. The independent organisational positions of the IAD and CL, with a direct information line to the RAC, also ensure an effective control in the respective fields.

The risk governance at DHB Bank is depicted in the following figure;



3.2 Risk Appetite

The risk appetite framework describes the types of risk and their magnitude that the Bank is prepared to take in executing its strategy. Risk appetite is central to an integrated approach to risk controls and capital management. It also supports the bank in achieving its strategic objectives for all stakeholders, including but not limited to shareholders, depositors, customers and employees as

well as being a key element of meeting the Bank's obligations under the supervisory review and evaluation process.

The risk appetite is articulated by the Managing Board through a comprehensive set of metrics. Thresholds are established to measure the performance of the business against its risk appetite. The articulation of risk appetite is also linked to the results of a comprehensive risk assessment, which is periodically performed during ICAAP and ILAAP. In addition, the Bank also uses stress testing and scenario analysis to formulate risk appetite, especially in liquidity and capital adequacy management.

The Risk Appetite Statement (RAS) is discussed and re-evaluated annually by the Supervisory Board's Risk & Audit Committee to enable the alignment of the Bank's strategy with the chosen risk appetite. RAS can also be revised during the year whenever there are material changes in the Bank's strategy or business environment.

Periodic risk assessment and reporting of inherent risks in the Bank's activities is part of the risk management framework to allow for an aggregated view of risks. Both qualitative and quantitative targets are actively monitored, managed and mitigated by the Managing Board, Risk Management Committee and Risk & Audit Committee, to ensure that the performance of business activities remains within pre-determined risk tolerance levels. Risk appetite adopted by the Bank is communicated to the assistant general managers, head of departments and country managers. By communicating within the organisation and embedding it in the internal processes, the Bank encourages a more conscious risk taking behaviour and reinforces risk culture within the organisation. A strong and widespread risk culture is in its turn an essential catalyst that elevates a risk appetite statement from a set of words into a statement of action.

3.3 Capital Management Framework

The Bank's risk environment requires continual monitoring and assessment in order to identify and manage complex interactions. The risk governance and ownership, the risk appetite as well as the scope and nature of monitoring and reporting processes that DHB Bank has put in place are aimed at meeting these challenges.

Furthermore, DHB Bank ensures that it has adequate own resources to cover unexpected losses arising from discretionary risks such as credit risk and market risk, or non-discretionary risks, which are risks arising by virtue of its operations, such as operational risk and reputation risk etc. DHB Bank essentially has two approaches for the calculation of its capital need; a regulatory and an internal approach. The regulatory approach is largely based on fixed, uniform rules for covering the Bank's risks in accordance with the Basel II/III standards. The internal approach sets capital adequacy targets and uses the Bank's risk appetite along with its risk profile and business plans as a basis. Other determining factors are expectations and/or requirements of the stakeholders as well as the position of the bank in its operating markets. As a consequence, the internal approach encompasses the regulatory approach in order to be comprehensive, effective and consistent.

The requirements/expectations of regulators concerning capital adequacy are not only driven by the Basel guidelines for standard Pillar 1 and Pillar 2 risks, but also by a capital add-on requirement introduced in the Netherlands in July 2010 to achieve a certain prudential objective, namely to reduce the banks' credit risk concentration in emerging countries. The Bank manages capital in accordance with prudential rules set out under CRD IV, and relevant rules issued by DNB.

The internal capital management approach is embedded in a formal ICAAP whose regulatory framework is rooted in the CRD IV. It consists of a number of interlinked components that form part of management and decision-making processes such as the Bank's risk appetite, capital and risk management frameworks, and stress testing. Risk management department performs the ICAAP by which the Managing Board examines the bank's risk profile from both regulatory and economic capital viewpoints and ensures that the level of available capital;

i. Exceeds the bank's minimum regulatory capital requirements by a predetermined margin,
ii. Remains sufficient to support the bank's risk profile,
iii. Remains consistent with the bank's strategic goal,
iv. Is sufficient to absorb potential losses under severe stress scenarios.

Although the regulatory approach and constraints have become more dominant as indicated above, the ICAAP retains its relevance as an integral part of risk management since it ensures a coherent link between the bank's risk profile, its risk management and capital adequacy. ICAAP also promotes a continuous monitoring of the risk environment and an integrated evaluation of various risks and their interactions. It represents a bank-wide approach to deal with all material risks and all business activities of DHB Bank.

The process itself starts with risk identification, assessment and measurement, which involves all relevant departments. DNB's Financial Institutions Risk Analysis Method (FIRM) has been chosen by the Bank as an integral part of the ICAAP for its comprehensiveness in identifying and assessing risks and control qualities. Identified risk types are classified into low, medium and high risk levels based on the assessment of their potential impacts.

The table below shows a summary of the risk assessment results and methodologies under the ICAAP framework:

Risk area	Risk type	Risk assessment	Regulatory reference, benchmark and method for risk evaluation	Capital requirement calculation approach	
				Pillar 1	Pillar 2
Credit Risk (CR)	Default and rating migration	Medium	Standardised Approach (SA), periodical credit portfolio risk assessment, collective provisioning and stress testing	✓	
	Underestimation of CR in the SA	Low	Qualitative assessment and adjustment		✓
	Concentration:				
	-Borrower	Medium	Adapted from Bank of Spain Approach		✓
	-Sector	Medium			✓
Country risk		Medium to High	Policy Rule on the treatment concentration risk in emerging countries (2010)		✓
Market Risk (MR)	Trading risk	Low	Standardised Approach, Value-at-risk model (VaR) and Limits	✓	
	FX risk	Low	Standardised Approach, Value-at-risk model (VaR) and Limits	✓	
	Underestimation of MR in the SA	Low			No add-on
Interest Rate Risk in the Banking Book		Low	(Duration) Gap analysis, Earnings-at-Risk and Capital-at-Risk models		✓
Liquidity Risk		Low	Addressed in Internal Liquidity Adequacy Assessment Process (ILAAP)		No add-on
Operational Risk (OR)	IT related risks	Low	Basic Indicator Approach	✓	
	Non-IT related risks	Low			
	Underestimation of OR under SA	Low			No add-on
Other Risks	Legal	Low	Qualitative review		No add-on
	Reputation	Low			
	Business (incl. strategy)	Low	Policy Rule on business model		
	Pension	Low	Qualitative review		
	Model	Low			

The projected capital position is subjected to stress testing to determine the impact on the Bank's position should a severe economic downturn materialise. These stress testing scenarios consider not only changes in the macroeconomic environment but also the key risks and vulnerabilities within the Bank's business model. Stress testing scenarios are developed based on DNB's recommendations and workshops with representation from various business units including the Managing Board. By incorporating appropriate stress testing and capital planning, ICAAP reflects internal measures to ensure that the Bank is adequately capitalised now and in the future. Outcomes of the stress tests are also used as early warning indicators to evaluate the adequacy of the Bank's Recovery Plan. Recovery Plan sets out the possible key measures to be taken by a bank in case of a near-default situation – without assuming the availability of publicly funded (emergency) support – in order to emerge from a severe crisis independently and with its core business intact.

The Bank continually develops its capital management framework by benchmarking its ICAAP and stress testing methodology against recommended good practices. As the regulation and supervision of financial institutions are currently undergoing a period of significant change in response to the global financial crisis and the ensuing financial, market and economic environment, the Bank has dedicated considerable time to monitor policy actions that may influence its capital position and capital management framework. Refinement of the internal methodology has been performed regularly since its first implementation in 2007/2008.

The primary purposes of the Bank's capital management framework, policies and practices are to support its business strategy and to ensure that it is sufficiently capitalised to withstand even severe macroeconomic downturns.

3.4 Capital Base

DHB Bank's capital structure consists entirely of common tier 1 capital - which includes paid-in capital and reserves.

The total capital base of DHB Bank is Euro 224.3 million at the end of 2017. It was Euro 225.2 million a year earlier. The components of the capital base are presented in the table below.

Capital items Euro (1,000)	2017	2016
Tier 1 capital		
Paid up capital (A)	**113,750**	**113,750**
Reserves (incl. retained earnings)	111,065	111,937
Net income from current year*	-	-
Eligible reserve (B)	**111,065**	**111,937**
Tier 1 capital (A + B, before deductions)	224,815	225,687
Adjustments to CET1 due to prudential filters	- 545	- 507
Total Tier 1 capital	**224,270**	**225,180**
Tier 2 capital	-	-
Capital base (Tier 1 + Tier 2)	**224,270**	**225,180**

*100% of the net profit for the year 2017 and 100% for the year 2016 are distributed as dividend.

3.5 Pillar 1 Risks and Capital Requirements

This section describes DHB Bank's regulatory capital requirements that arise from Pillar 1 risks in the CRD IV, namely credit risk including counter party credit risk, credit valuation adjustment, market and operational risks as of 31 December 2017.

The regulatory minimum capital requirement is expressed as eight percent of risk weighted assets (RWA). To calculate RWA according to the Basel II/III framework, DHB Bank adopted the Standardised Approach (SA) for credit and market risk, and the Basic Indicator Approach for operational risk. The adopted approaches are consistent with the size, complexity and nature of the Bank's activities.

In order to calculate the regulatory capital requirements under the SA, the Bank uses eligible external ratings from Standard & Poor's, Moody's and Fitch Ratings. These are applied to all relevant exposure classes in the SA. If more than one rating is available for a specific borrower, the selection criteria as set out in the CRR are applied in order to determine the relevant risk weight for the capital calculation.

The following standardised exposure classes apply to DHB;

Sovereigns; Exposures to governments consist of sovereign governments, central monetary institutions and agencies guaranteed by a sovereign government. Sovereign exposures are risk weighted based on their credit ratings. Exposures to central governments within the European Union are assigned a risk weight of 0%, where such claims are denominated and funded in the relevant domestic currency of that sovereign.

Banks; Exposures to banks relate to all claims on financial institutions authorised and supervised by the competent authorities and subject to prudential requirements comparable to those in the European Union. Exposures to a bank are risk weighted based on the ratings assigned to them by eligible rating agencies. Exposures to a bank of up to three months residual maturity for which a credit assessment by eligible rating agencies is available are assigned risk weights that are generally one category more favourable than the standard risk weights applied to banks exposures (see CRR Article 120).

Corporates; Exposures to corporates include exposures to large non-bank corporations as well as to small and medium-sized companies that do not meet the conditions of retail exposure. Exposures to corporates with external credit ratings by eligible rating agencies are assigned a risk weight from 20% to 150%. Exposures without external rating are assigned a risk weight of 100%.

Retail; Exposures are classified as retail exposures upon meeting the conditions stipulated insolvency requirements for credit risk. Retail exposures are assigned a risk weight of 75%.

Exposure secured on real estate property; this exposure class refers to the exposures or any part of an exposure secured by mortgages on residential property. Exposures in this class are assigned a risk weight of 35%.

Past due items; this exposure class includes claims which are past due more than 90 days. Shorter past due items are included in the corresponding exposure classes mentioned above. The unsecured part of any past due item is assigned a risk weight of 150% if value adjustment allowances are less than 20%, and 100% if value adjustments allowances are no less than 20% of the unsecured part.

Others; Other items consist of fixed assets, prepayments and other assets for which no counterparty can be determined. Other items are assigned a risk weight of 100%.

An overview of the capital requirements and the RWA at the year-ends of 2017 and 2016 divided into different risk types is presented in the table below.

		2017		2016	
Pillar 1 Risks and Capital Requirement Euro (1,000)		**RWA (Basel III)**	**Capital Requirement 8%**	**RWA (Basel III)**	**Capital Requirement 8%**
Credit risk		1,252,322	100,186	1,261,913	100,953
of which:	*Sovereign*	-	-	2,856	228
	Banks	205,873	16,470	306,708	24,537
	Corporates	1,030,896	82,472	932,945	74,636
	Retail	2,906	232	3,058	245
	Exposure secured on real estate property	1,776	142	2,208	177
	Past due items	1,858	149	6,794	543
	Covered bonds	-	-	250	20
	Others	9,014	721	7,095	568
Market risk		-	-	1,408	113
Operational risk		71,883	5,751	69,686	5,575
Credit valuation adjustment (CVA)		1,876	150	1,154	92
TOTAL		**1,326,082**	**106,087**	**1,334,161**	**106,733**

3.6 Credit Risk

Credit risk is the largest risk making up more than 94% of the total RWA at 31 December 2017. The information in this section is analysed in several dimensions to give an in-depth view of the distribution of the credit portfolio in different exposure classes, risk weights, geography and industry.

3.6.1 Overview of credit risk management

DHB Bank manages credit risk in a coordinated manner at all relevant levels within the organisation.

A primary element of the credit approval process is a thorough risk assessment of the credit exposure associated with each obligor. An obligor is defined as a group of individual borrowers that are linked to one another by various numbers of criteria, including capital ownership, demonstrable control over business or other indication of group affiliation. The Bank measures and consolidates all claims on the same obligor ("one obligor principle"), requiring the aggregation of all facilities (direct or contingent) to the borrower itself, its subsidiaries, parent and related affiliates.

The creditworthiness of an obligor is represented by an internal rating. While DHB Bank uses the standardised approach for credit risk, internal rating system has been further refined in order to strengthen the Bank's credit risk management system. In addition to the internal rating on obligor,

the Bank's risk assessment procedures also take into consideration the risks specific to the type of credit facilities and the applicable risk mitigation factors.

DHB Bank dedicates considerable resources for controlling credit risk effectively. Credit monitoring is carried out through credit reviews on obligor level as well as on portfolio level by the Credit Analysis Department that reports to the Credit Committee on a regular basis.

3.6.2 Credit risk profile

This section presents an overview of DHB Bank's credit risks. All exposures mentioned refer to on- and off balance sheet items after the application of credit conversion factors and the specific provisions.

In the following table, the credit exposures are broken down into risk weights at the end of 2017 and 2016.

	2017		2016	
Credit exposures by risk weights Euro (1,000)	***Exposures**	**RWA (Basel III)**	***Exposures**	**RWA (Basel III)**
0%	308,606	-	200,249	-
10%	-	-	2,501	250
20%	202,409	40,482	212,090	42,418
35%	5,075	1,776	6,308	2,208
50%	210,771	105,385	262,183	131,092
75%	3,874	2,906	3,986	2,989
100%	1,102,418	1,101,773	1,080,129	1,080,129
150%	-	-	1,885	2,827
Other risk weights	-	-	-	-
TOTAL	**1,833,152**	**1,252,322**	**1,769,332**	**1,261,913**

* Credit Exposures in this document refer to on-and off balance sheet items after application of credit conversion factors

The next tables provide the distribution of DHB Bank's total exposure by remaining maturity at the end of 2017 and 2016 respectively.

Credit Exposures by maturity at 31 December 2017, Euro (1,000)	**< 3 months**	**3 < 6 months**	**6 < 12 months**	**1-3 years**	**> 3 years**	**TOTAL**
Sovereign	219,452	-	20,219	31,315	15,567	**286,553**
Banks	61,522	67,956	128,609	87,096	43,263	**388,446**
Corporates	268,432	71,019	164,226	350,649	261,954	**1,116,280**
Retail	2,017	113	710	149	885	**3,874**
Exposure secured on real estate property	-	12	13	49	5,001	**5,075**
Past due items	172	-	-	-	1,685	**1,858**
Covered bonds	-	-	-	-	-	**-**
Other items	13	-	10,336	-	20,718	**31,067**
Total Credit Exposures	**551,608**	**139,100**	**324,113**	**469,258**	**349,073**	**1,833,152**

Credit Exposures by maturity at 31 December 2016, Euro (1,000)	< 3 months	3 < 6 months	6 < 12 months	1-3 years	> 3 years	TOTAL
Sovereign	121,662	759	2,000	63,741	-	**188,161**
Banks	75,943	92,484	40,162	288,677	39,100	**536,366**
Corporates	249,560	37,837	132,745	338,690	253,430	**1,012,263**
Retail	2,800	5,628	352	876	-	**9,656**
Exposure secured on real estate property	-	-	4	71	6,233	**6,308**
Past due items	488	-	2,067	-	4,238	**6,794**
Covered bonds	2,501	-	-	-	-	**2,501**
Other items	19	-	7,264	-	-	**7,283**
Total Credit Exposures	**452,974**	**136,707**	**184,593**	**692,056**	**303,001**	**1,769,332**

The following table breaks down the main exposure categories according to the sectors of DHB Bank's counterparties at the year-ends of 2017 and 2016.

Credit Exposures by exposure class and industry, Euro (1,000)		2017	2016
Sovereign		286,553	188,161
Banks		388,446	536,366
Corporates		1,116,280	1,012,263
of which:	*A - Agriculture, forestry and fishing*	7,010	-
	B - Mining and quarrying	25,236	*30,946*
	C - Manufacturing	160,917	*117,369*
	D - Electricity, gas, steam and air conditioning supply	84,351	*23,248*
	E - Water supply	2,627	-
	F - Construction	116,695	*34,340*
	G - Wholesale and retail trade	58,163	*93,515*
	H - Transport and storage	73,243	*81,023*
	I - Accommodation and food service activities	31,173	*23,175*
	J - Information and communication	-	*836*
	K - Financial and insurance activities	359,068	*369,003*
	L - Real estate activities	75,401	*49,943*
	M - Professional, scientific and technical activities	57,493	*134,877*
	N - Administrative and support service activities	19,519	*6,151*
	O - Public administration and defence, compulsory social security	-	-
	P - Education	-	-
	Q - Human health services and social work activities	15,981	*14,901*
	R - Arts, entertainment and recreation	27,928	*30,495*
	S - Other services	1,476	*2,441*
	T - Activities of households as employers; undifferentiated goods and services-producing activities of households for own use	-	-
	U - Activities of extraterritorial organisations and bodies	-	-
Retail		3,874	9,656
Exposure secured on real estate property		5,075	6,308
Past due items		1,858	6,794
Covered bonds		-	2,501
Other items		31,067	7,283
Total Credit Exposures		**1,833,152**	**1,769,332**

The tables below shows the credit exposures divided into main geographical areas according to the location of the ultimate shareholder at the end of 2017 and 2016 respectively.

Credit exposures by exposure class and geography at 31 December 2017, Euro (1,000)	Netherlands	Other Europe	Turkey	CIS	Others	TOTAL
Sovereign	207,574	78,978	-	-	-	286,553
Banks	51,196	185,051	136,599	-	15,600	388,446
Corporates	176,483	555,598	286,850	14,781	82,568	1,116,280
Retail	2,990	796	89	-	-	3,874
Exposure secured on real estate property	916	4,159	-	-	-	5,075
Past due items	540	677	508	-	132	1,858
Covered bonds	-	-	-	-	-	-
Other items	2,185	28,882	-	-	-	31,067
Total Credit Exposures	**441,885**	**854,140**	**424,045**	**14,781**	**98,300**	**1,833,152**

Credit exposures by exposure class and geography at 31 December 2016, Euro (1,000)	Netherlands	Other Europe	Turkey	CIS	Others	TOTAL
Sovereign	123,637	63,765	-	759	-	188,161
Banks	88,967	279,592	143,073	-	24,733	536,366
Corporates	169,180	401,545	310,735	8,526	122,277	1,012,263
Retail	2,864	6,539	253	-	-	9,656
Exposure secured on real estate property	1,107	5,037	148	-	16	6,308
Past due items	830	1,299	4,665	-	-	6,794
Covered bonds	-	2,501	-	-	-	2,501
Other items	1,174	6,110	-	-	-	7,283
Total Credit Exposures	**387,759**	**766,389**	**458,874**	**9,284**	**147,026**	**1,769,332**

3.6.3 Counterparty Risk and Derivatives

Derivatives are not only affected by the market risk but also by the counterparty risk measured within the calculation of RWA related to the credit risk. DHB Bank uses derivatives to manage interest rate and currency risks on an ongoing basis.

Counterparty risk is the risk that DHB Bank's counterparts in a derivative contract defaults prior to maturity of the contract and that DHB Bank has a claim on the counterpart at that time.

As per year-ends of 2017 and 2016, the main sources of counterparty risk were currency swap and interest rate swap.

Derivative Contracts Euro (1,000)	2017			2016		
	Exposures*	RWA (Basel III)	Capital requirement	Exposures*	RWA (Basel III)	Capital requirement
Interest rate contracts	3,593	1,852	148	2,313	1,261	101
Foreign exchange contracts	4,648	968	77	2,753	601	48
Other contract	-	-	-	-	-	-
TOTAL	**8,241**	**2,820**	**226**	**5,065**	**1,862**	**149**

*The exposures represent the credit exposure to derivative transaction after taking account of legally enforceable netting agreements and collateral arrangements

DHB Bank uses the mark-to-market method to calculate the exposure value according to the credit risk framework in CRR. Counterparty credit exposure comprises the sum of current exposure (replacement cost) and potential future exposure. The potential future exposure is an estimate that reflects possible changes in the market value of the individual contract during the remaining life of the contract, and is measured as the notional principal amount multiplied by a risk weight. The size of the risk weight depends on the contract's remaining lifetime and the underlying asset.

The Bank applies limits to mitigate counterparty risk similar to any other credit risk. In addition, the Bank enters into collateral agreements with all major counterparties.

3.6.4 Credit risk mitigation

DHB Bank uses a variety of instruments to mitigate and reduce credit risk on its lending. The most essential of these is to assess, at the outset, the ability of an obligor to service the proposed level of borrowing without distress. As a result, depending on the customer's standing and the type of product, credit facilities may be granted on an unsecured basis. However, DHB Bank usually obtains collaterals for the loans granted. Collateral is considered as credit risk mitigation even if it does not affect the regulatory capital adequacy calculations for the respective exposure. The internal facility rating assignment process also includes the assessment and valuation of collaterals among other factors.

Besides cash collaterals, to a small extent the Bank also accepts credit protection mainly in the form of mortgages, third party (customer) cheques, promissory notes, assignment of receivables, insurance or bank guarantees. In the cases of insurance and bank guarantee, risk mitigation is effected in the form of substituting the risk of the counterparty by the risk of the provider of credit protection. However, this shift only takes place when the risk weighting of the guarantor is better than that of the obligor and other prudential conditions are met. The following table gives information on the credit risk mitigation for regulatory capital calculation as per year-ends of 2017 and 2016.

Credit exposures and credit risk mitigation Euro (1,000)	2017			2016		
	Credit Exposures	Collateralised	Guaranteed	Credit Exposures	Collateralised	Guaranteed
Sovereign	286,553	-	-	188,161	-	-
Banks	388,446	-	19,509	536,366	-	12,009
Corporates	1,116,280	20,964	5,302	1,012,263	59,151	-
Retail	3,874	11	94,857	9,656	14	67,861
Exposure secured on real estate property	5,075	-	-	6,308	-	-
Past due items	1,858	0	-	6,794	0	-
Covered bonds	-	0	-	2,501	0	-
Other items	31,067	-	-	7,283	-	-
TOTAL	**1,833,152**	**20,975**	**119,668**	**1,769,332**	**59,165**	**79,870**

3.6.5 Asset quality

The information presented in this section uses financial statement values and is largely sourced from the 2017 Annual Report of DHB Bank.

An assessment is made at each balance sheet date to test whether there is objective evidence that a specific financial asset or group of financial assets may be impaired ('loss event'). Developments that lead to loss events may include:

- A breach of contract, such as default in the payment of interest or principal;
- Significant financial difficulty of the issuer or obligor;
- Restructuring of the loan where a concession is granted due to the borrower's financial difficulty.

If such evidence exists, an impairment loss is recognised in the statement of income.

An indication of the overall credit quality of DHB Bank's financial assets can be derived from the table below as per year-ends of 2017 and 2016.

Asset Quality Euro (1,000)	**2017**	**2016**
Neither past due nor impaired	1,816,854	1,755,588
Past due but not impaired and/or impaired	16,857	18,658
of which impaired	*15,022*	*18,138*
Provisions (including IBNR)	(9,035)	(10,402)
Total	**1,824,676**	**1,763,844**

The creditworthiness of the customers that are not rated by external rating agencies is assessed with reference to the Bank's internal credit rating system. The internal rating is based on many factors derived from both financial and non-financial assessments of the borrower. The internal rating system is an essential tool for managing and monitoring the credit risk of the Bank.

The assessment and administration of past due and impaired loans, write-offs and provisions fall under the responsibilities of the credit risk management units and the Credit Committee.

Provisions are set aside for estimated losses in outstanding loans for which there is doubt about the borrower's capacity to repay the principal and/or interest. Provision amounts are determined through a combination of specific reviews, historical data and estimates. Provisions for loan losses are determined separately for each exposure for wholesale loans, and according to a predefined model for retail loans. Provisions against a particular impaired loan may be released when there is improvement in the quality of the loan. The Bank's write-off policies are determined on a case-to-case basis. For restructured loans, the policy enables reclassification of a restructured loan into a performing loan when a certain number of repayments are executed.

The following table details the change of provisions balance at the end of 2017 and 2016 respectively.

Change of total credit risk provisions Euro (1,000)	**2017**	**2016**
Opening balance, 1 january	10,402	8,828
Addition	1,706	3,987
Release	(801)	(212)
Write-off	(1,707)	(2,117)
Exchange rate movement	(566)	(84)
Closing balance, 31 December	**9,034**	**10,402**

Though provisions for loan losses are considered adequate, the use of different methods and assumptions could produce different provision amounts for loan losses, and amendments may be

required in the future, as a consequence of changes in the estimated loss, the value of collateral and other economic events.

Furthermore, the Bank also sets aside provisions to cover potential losses of loans for which a triggering event has occurred, while the related individual loan is not yet identified as such at the balance sheet date. This process to determine incurred but not reported losses includes an estimate, based on a model, by the management to reflect current market conditions.

3.6.6 Transition to IFRS 9

The IFRS 9 Financial Instruments standard was approved by the EU in November 2016 and it replaces IAS 39 Financial Instruments: Recognition and measurement. IFRS 9 introduces new rules for hedge accounting and a new impairment model for financial assets. DHB Bank implemented IFRS 9 when the standard became mandatory on 1 January 2018.

With the introduction of IFRS 9, allowance levels are generally expected to increase due to the addition of stage 1 and stage 2 categories which apply to financial instruments that did not previously meet the criteria for having an allowance under IAS 39. This will lead to a decrease in equity. On the other hand, the increase in allowance levels due to the addition of stages 1 and 2 is partially offset by the release of the current IAS 39 allowance for incurred but not reported (IBNR) losses. Overall, the bank does not expect that the decrease in equity due to the application of IFRS 9 requirements will lead to any material impact on its equity or on other key regulatory ratios. Additionally, transitional arrangements published by EU for mitigating the impact of IFRS 9 Impairment requirements on banks' own funds (CET1 capital) are not applied by DHB Bank.

3.7 Market Risk

DHB Bank uses the Standardised Approach to capture the market risk capital requirement. As of 31 December 2017, the capital requirement for market risk is solely due to foreign currency positions. Foreign currency risk is managed generally by using derivatives to reduce currency exposures to acceptable levels. After taking into account foreign currency derivatives, the Bank has no material net exposure to foreign exchange rate fluctuations.

The Bank uses a combination of value-at-risk (VaR) model and stress tests to monitor the risk arising from open foreign currency positions representing the net value of assets, liabilities and derivatives in foreign currency. The internal VaR model and risk limits are used only for risk management purposes and not regulatory capital measurement purposes.

The following table shows the breakdown of capital requirement for market risk at the end of 2017 and 2016 respectively.

Market Risk and Capital Requirement Euro (1,000)	2017		2016	
	Basel III RWA	Capital Requirement 8%	Basel III RWA	Capital Requirement 8%
Market risk	-	-	1,408	113
of which:				
Foreign Exchange	-	-	*1,408*	*113*
Trading Book	-	-	-	-

3.8 Operational Risk

The Bank defines operational risk as the potential for incurring losses in relation to employees, technology, system failure (including non-availability) and frauds. It excludes legal, compliance, business and reputation risk.

The capital requirement for operational risk is calculated at DHB Bank according to the Basic Indicator Approach. Under this approach, the capital requirement for operational risk is equal to 15% of the three- year average gross income, which results in a capital requirement for operational risk of Euro 5.8 million at 31 December 2017.

Operational risk is inherent in all business activities and can never be eliminated entirely. However, shareholder value can be preserved and enhanced by managing, mitigating and, in some cases, insuring against operational risk. For the purpose of mitigating operational risk, since 2007 DHB Bank has implemented a risk self-assessment program called ORCA, which stands for Operational Risk and Control Assessment.

The main aim of this program is to enhance risk awareness of every staff member in the Bank and minimise operational risk at every stage of daily activities. The ORCA program covers all units of the Bank and involves all staff in developing a strong control environment. This program focuses on different areas of operational risks (IT related risks, process related risk, staff related risks and external risks) according to the specific business activities, business lines, departments and countries.

With the guidance of Risk Management Department, all units proceed through a predefined route to identify risks by using tools such as questionnaires, interviews and workshops; estimate their potential impact, and devise an action plan suitable to the size and nature of those risks. As a permanent self-improvement initiative, the program cycle foresees continuous monitoring and periodical independent review of the involved risks and respective measures in response to changing activities and operating environments.

4 Pillar 2 Risks

4.1 Interest rate risk in the banking book (IRRBB)

Interest rate risk in the banking book consists of exposures deriving from the balance sheet and is measured in several ways in accordance with the financial supervisory authority's guidelines. The IRRBB is monitored and controlled both from a value perspective (such as using the duration of equity and PV01 measure) and from an income perspective (sensitivity in net interest income, NII)[1].

Through its management of interest rate risk, DHB Bank aims to hedge the effect of prospective interest rate movements that could reduce its future net interest income, while balancing the cost of such hedging activities on the current net revenue stream.

Regarding the income perspective, NII is exposed to external factors such as yield curve movements and competitive pressure. The NII risk depends on the overall business profile, especially mismatches between interest-bearing assets and liabilities in terms of volumes and repricing periods. The IRRBB is minimised as the Bank's rate sensitive assets and liabilities are mostly floating rate, where duration is lower. In general, DHB Bank aims to use matched currency funding and usually converts fixed rate instruments to floating rate to better manage the duration in the asset book.

The following tables indicate the Bank's interest rate sensitivities in the banking book from the income perspective at the end of 2017 and 2016 respectively.

NII sensitivities by major currencies at 31 Dec 2017, Euro (000)	**Interest rate shock of +/- 200 bp**	
	200 bp decrease	**200 bp increase**
EURO	-2,679	3,023
US Dollar	-48	48
Other	-31	31
TOTAL	**-2,759**	**3,103**

NII sensitivities by major currencies at 31 Dec 2016, Euro (000)	**Interest rate shock of +/- 200 bp**	
	200 bp decrease	**200 bp increase**
EURO	-1,826	2,003
US Dollar	-262	262
Other	-6	6
TOTAL	**-2,094**	**2,272**

In addition to the regular monitoring of the interest rate risk using the above mentioned metrics, on a monthly basis DHB Bank performs stress testing to calculate the immediate net effect on the fair value (FV) of a range of parallel shocks in rates, by currency. Furthermore, the Bank reports PV01 to

[1] Non-maturity interest rate sensitive assets and liabilities are bucketed in the short term. The bank's equity is considered a non-interest sensitive component and is excluded from the interest rate risk computations.

measure changes in economic value resulting from a one basis point (0.01%) parallel rise in interest rates. The PV01 measure incorporates the entire rate sensitive segment of the balance sheet for the Bank and is classified into appropriate buckets.

As per the regulatory requirements, interest rate risk reporting also include the measurement of the 'outlier criterion', which refers to the maximum loss of market value expressed as a percentage of capital base in the event of a parallel rate hike or drop of 200 basis points. The 'outlier criterion' is subject to an internal limit of 5%. The following tables show a range of severe interest rate shocks with positions at the end of 2017 and 2016 respectively. At 31 December 2017, the standard instantaneous parallel shock (decline) of 200 bps leads to a potential decrease of Euro 0.9 million, or 0.35% of the capital base. In term of the outlier criterion, the Bank's interest rate risk position decreased somewhat in 2017, and is at a risk level that is considered low in view of the above-mentioned 5% threshold.

Fair value sensitivity to interest rate shocks at 31 Dec 2017, Euro (000)	**-300**	**-200**	**-100**	**+100**	**+200**	**+300**	**PV01**
Euro	3,198	2,068	1,003	-939	-1,815	-2,628	10
USD	-1,486	-989	-494	492	982	1,471	-5
Other	20	14	8	-9	-18	-29	0
TOTAL	**1,731**	**1,093**	**516**	**-456**	**-851**	**-1,186**	**5**
Capital base					**241,818**		
Standard 200 bps shock as % of capital					**-0.35%**		

Fair value sensitivity to interest rate shocks at 31 Dec 2016, Euro (000)	**-300**	**-200**	**-100**	**+100**	**+200**	**+300**	**PV01**
Euro	3,436	2,308	1,163	-1,180	-2,377	-3,592	-12
USD	-1,459	-991	-504	522	1,062	1,620	5
Other	71	48	24	-25	-51	-79	0
TOTAL	**2,047**	**1,365**	**683**	**-683**	**-1,367**	**-2,050**	**-7**
Capital base					**239,779**		
Standard 200 bps shock as % of capital					**-0.57%**		

4.2 Liquidity risk

Liquidity risk is the risk of being able to meet liquidity commitments only at increased cost or, ultimately, being unable to meet obligations as they fall due. Liquidity risk is categorised into two risk types - funding liquidity and market liquidity:

a. Funding liquidity risk occurs when the Bank cannot fulfil its obligations as they come due without incurring excessive losses. Payments have to be executed on the day when they are due, or the Bank is declared illiquid if it fails to perform.
b. Market liquidity risk occurs when the Bank is unable to sell specific assets without losses.

In the aftermath of the latest global financial crisis, regulators have introduced stricter supervisory guidelines in many areas with regard to liquidity standards. The Netherlands is also among the first country in the EU that has started to monitor and observe the local (Dutch) banks' compliance plan with Basel III.

Liquidity Coverage Ratio (LCR) became binding for all EU credit institutions in October 2015. Liquidity ratios (LCR and NSFR), the measure originated from the 2010 Basel Accord (Basel III), are both monitored within DHB Bank's risk framework.

The LCR regulation stipulates that banks must have a liquidity reserve that ensures a survival horizon of at least 30 calendar days in case of a severely stressed liquidity situation.

The Net Stable Funding Ratio (NSFR) is intended to ensure a sound funding structure by promoting an increase in long-dated funding. The NSFR regulation stipulates that at all times banks must have stable funding equal to the amount of their illiquid assets for one year ahead.

The liquidity and funding position of DHB Bank in 2017 comfortably met the requirements. The Liquidity Coverage Ratio (LCR) is 664% and Net Stable Funding Ratio (NSFR) is 153.3%, well above the regulatory requirements of 100%.

Furthermore, DHB Bank also performs an internal liquidity adequacy assessment process (ILAAP) based on DNB's ILAAP Policy Rule and submits the required documentation to DNB for supervisory review and evaluation process (SREP). The internal process, governance and consultative dialogue with the supervisory body to meet the ILAAP rules are similar to the ICAAP mentioned above.

Policy statements that are part of the ILAAP package stipulate that DHB Bank's liquidity management reflects a conservative attitude towards liquidity risk. The Bank defines the liquidity risk appetite by setting limits for applied liquidity risk measures. The most central measure is the Survival Horizon, which defines the risk appetite by setting a minimum survival of 6 months under a combination of bank-specific and market-wide stress scenarios with limited mitigation actions[2]. Furthermore, to ensure funding in situations where DHB Bank is in urgent need of cash and the normal funding sources do not suffice, the Bank holds a liquidity buffer that consists of ECB eligible debt securities and highly liquid assets.

Please refer to the DHB Bank's Annual Report as of 31 December 2017 for a maturity distribution table.

Under the ICAAP framework, no capital was allocated to cover liquidity risk considering the strength of the Bank's liquid assets as mentioned above and the appropriateness of the Bank's current policies and measures.

[2] The stress scenario used to measure compliance with the risk appetite framework includes among others an assumption of saving deposit outflows under a combination of bank-specific and market-wide stress amounting to respectively 25%, 35% and 40% in one-month , three-month and six-month periods along with significant haircuts on the bank's liquidity buffer.

4.3 Concentration risk

DHB Bank deals with concentration risk by taking into account separately single name concentration, country concentration and sector concentration.

A main assumption used in the determination of the Pillar 1 risk weights is that the credit portfolio is well diversified. In practice, however, a portfolio is not necessarily fully diversified, causing the so-called concentration risk that is to be addressed under Pillar 2.

DHB Bank has a framework to measure concentration risk quantitatively and established an approach that links concentration risk levels to capital allocation within the ICAAP process in a conservative manner.

The Policy Rule on Maximising the Deposits and Exposures Ratio was introduced under the Act on Financial Supervision (hereafter referred to as New Business Model Policy Rule) in February 2014.
The Policy Rule requires Dutch banks to comply with a certain ratio between the banks' exposure outside the European Economic Area (EEA) and their deposits under the coverage of the Dutch deposit guarantee scheme, with the required ratio determined in relation to the respective banks' balance sheet size. DHB Bank is fully compliant with the Policy Rule and has deposits to exposures ratio of 19.8% at the end of 2017, which is within the required limit of 25%. DHB Bank plans to maintain its share of lending activities towards the EEA, thus progressing in a direction that the bank had already started to pursue following the 2008 crisis in the context of its strategic alignment. This strategic path further strengthens the bank's standing by maintaining the diversification in its assets. It is notable that country risk diversification not only strengthens the Bank's risk position but also allows it to reduce Pillar 2 capital add-on requirements under the current capital regime.

The Bank also has to comply with the Large Exposure Rule as embedded in CRD IV, and with the above mentioned (referred to section 3.3 Capital Management Framework) policy rule on the treatment of concentration risk in emerging countries, introduced by DNB in July 2010, to reduce the credit concentration in emerging markets.

4.4 Other risks: Legal, Compliance and Reputation risk

Legal risk is the possibility that lawsuits, adverse judgments or contracts that turn out to be unenforceable can disrupt or adversely affect the operations of the Bank. The Compliance and Legal Department supports to manage legal risk. External legal advisors are also consulted wherever necessary. In addition, the Compliance Officer has a proactive role in this respect, aiming at reducing pro-actively the risk of compliance, as well as legal and eventual reputation risk.

Reputation risk is highly correlated with integrity and compliance risk management, which are embedded in the policies and corporate governance of the Bank. The Managing Board takes the necessary actions to establish a proper ethical culture within the Bank. The Bank's line management is responsible for applying, monitoring and controlling the integrity policy and rules in their units, and reports to the Managing Board and the Compliance Officer. As a third line of defense, the

Internal Audit Department also evaluates integrity issues in particular and compliance issues in general during its regular and specific audits.

5 Capital Adequacy Conclusion

DHB Bank is committed to exceed its capital adequacy targets on a continuous basis. Overall risk position and capital level are constantly monitored and adjusted, if necessary, to meet the capital requirement from regulatory and economic perspectives. DHB Bank's capital base and capital ratios exceed the regulatory minimum requirements outlined in CRR/CRD. Considering the results of capital adequacy stress testing, and business expectations, the Bank's assessment is that the buffers held for regulatory and economic capital purposes are sufficient. Capital ratio in 2017 was about 2 times the regulatory capital ratio of 8%.

The following table provides an overview of DHB Bank's capital adequacy ratios as per year-ends of 2017 and 2016.

Capital Adequacy Ratios **Euro (1,000)**	**2017**	**2016**
RWA (Pillar 1)	1,326,082	1,334,161
Regulatory capital requirements	106,087	106,733
CET1 capital	224,270	225,180
Capital base	224,270	225,180
Tier 1 ratio (in %)	16.9%	16.9%
Capital ratio (in %)	16.9%	16.9%
Capital ratio/Regulatory capital requirement (in %)	211.4%	211.0%

6 Leverage Ratio

Since January 2014, the CRR/CRD IV rules have required credit institutions to calculate, report and monitor their leverage ratios, defined as tier 1 capital as a percentage of total exposure.

In January 2015, the requirements for calculating the leverage ratio were redefined and issued by the European Commission in Delegated Act EU 2015/62.

The leverage ratio is based on the relationship between Tier 1 capital and the unweighted total of all on-balance-sheet and off-balance-sheet asset items (including derivatives).

DHB Bank takes the leverage ratio requirements into account for optimisation of its portfolio. The risk of excessive leverage is addressed by including the leverage ratio in the internal planning and control process. Based on the business and risk strategy, an internal target ratio is specified as an additional key risk indicator, supplementing the capital ratios. Changes in the leverage ratio are subject to regular monitoring.

The following table shows the Bank's leverage ratios based on CRR/CRD IV regulation as per year-ends of 2017 and 2016.

Leverage Ratio **Euro (1,000)**	**2017**	**2016**
Total Tier 1 capital for the leverage ratio	224,270	225,180
Total Common Equity Tier 1 (CET1) capital	224,270	225,180
Additional Tier 1 (AT1) capital	-	-
Total Tier 1 capital for the leverage ratio	**224,270**	**225,180**
	-	**-**
Total statutory assets per the statement of financial position	1,821,955	1,760,843
Off balance sheet items	3,468	3,842
Derivative exposures adjustment	8,241	5,065
SFT exposure adjustment	-	-
Other regulatory adjustment	-	-
Exposures for the leverage ratio	**1,833,664**	**1,769,750**
Leverage ratio	**12.2%**	**12.7%**

7 Remuneration

DHB Banks's current Remuneration Policy, was approved in the General Meeting of Shareholders (GMS) in April 2011, further developed in 2012 and lastly revised in 2017 with respect to the new regulations in this area.

It is composed of four sub-policies that have separate stipulations for the members of the Management Board (MB), for the members of senior staff in general, for senior staff engaged in risk management and control functions, and for other staff members. The body overseeing the remuneration of the MB members is the General Meeting of Shareholders (GMS) with the recommendation of the Supervisory Board (SB). With the prior approval of the SB, the MB decides on the remuneration for the senior staff in general and senior staff engaged in risk management and control functions.

The MB is authorised to independently arrange the remuneration of the other staff members. The remuneration policy stipulates criteria according to many financial and non-financial objectives, all reflecting the bank's long-term strategies and risk policy. From these objectives, performance targets are derived for staff members throughout the organisation. The remuneration of the SB and MB members is reported in the annual reports of the bank.