CAPITAL ADEQUACY AND

RISK MANAGEMENT REPORT 2020

Pillar 3

June 2021

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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 2020.

The Pillar 3 disclosures are subject to rigorous internal controls to ensure the correctness of the information and compliance with disclosure requirements.

DHB Bank is a Dutch bank that operates internationally. The shareholders are HCBG Holding B.V., which owns 70% and Türkiye Halk Bankası A.Ş., which owns 30%. 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. In conformity with the bank's business model, the primary clients of the bank in the wholesale segment are corporates, and, to a lesser extent, banks, while sovereign exposures account for only a very small portion of the total.

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 report that can be found on its website: www.dhbbank.com.

2. Background

The Basel Committee on Banking Supervision (BCBS) 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.

Developments in disclosure requirements

The BCBS published in December 2018 updated Pillar 3 disclosure requirements. These requirements, together with the updates published in January 2015 and March 2017, complete the Pillar 3 framework.

DHB bank has incorporated the requirements applicable in the Pillar 3 document. In addition to the changes required under CRD IV, DHB Bank closely monitors the ongoing regulatory developments and assess their impact.

For additional information, EBA published its revised final draft comprehensive ITS on institutions' Pillar 3 disclosures and revised final draft ITS on supervisory reporting (Framework 3.0) on 24 June 2020, with reference dates for the first disclosure as 30 June 2021.

Developments in macro-economic environment

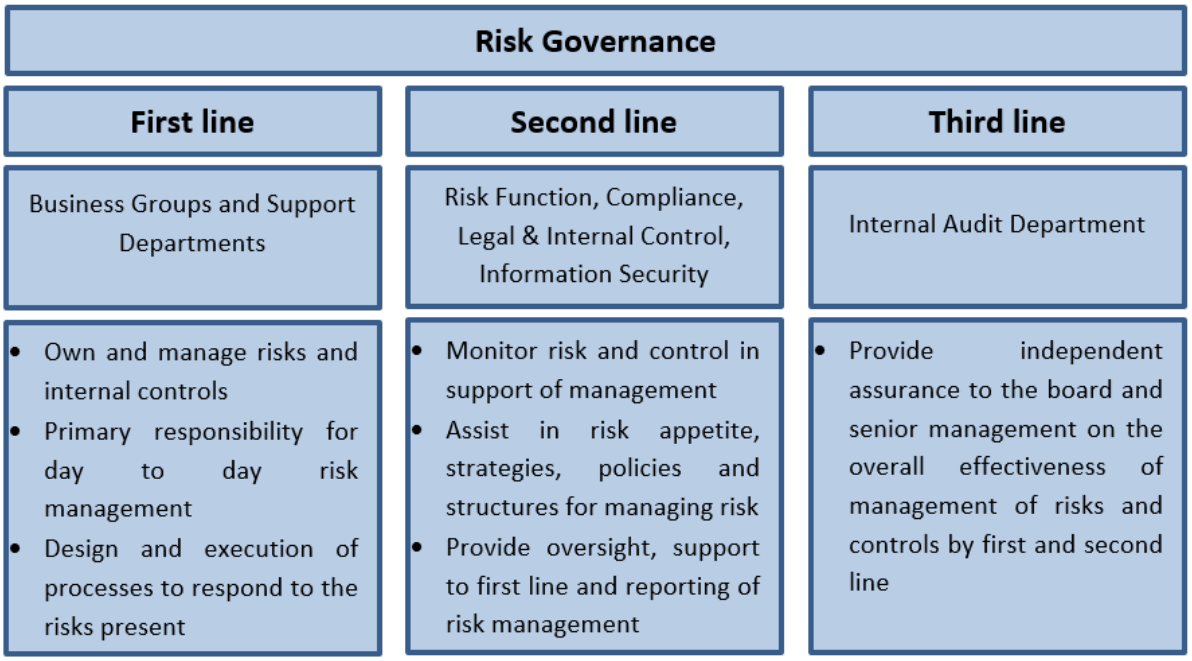
Closely monitoring developments related to the COVID-19 pandemic and its wide-ranging negative impacts has been crucial for the bank's management to steer cautiously in this unprecedented period. The pandemic swiftly severed the production and flow of goods and services worldwide. The support of governments and accommodative policies of central banks designed to contain its negative economic and financial effects provided a cautious comfort. As part of its robust risk management, the bank applied a number of stress scenarios to anticipate the consequences of plausible events like outright defaults and possible delays in the collection of maturing assets in part or in full in order to assess the adequacy of its capital and liquidity. These stress tests revealed that DHB Bank would weather possible adverse scenarios, thanks to its very high liquidity and very strong capital base, and also the long-term relationships with its corporate customers. Even after considering the implications of the pandemic from the perspectives of solvency, liquidity, operational risk, credit risk, market risk, loan loss provisioning, the bank did not face any significant challenges since the start of pandemic in 2020 and does not expect to face any material impact on its operations and financials. The bank will continue to operate in prudent manner, in the currently still uncertain environment, as the prolonged effect of the pandemic is difficult to fully assess at this moment. The bank will closely monitor and proactively manage its capital and liquidity position.

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 Defense" model for managing the risks inherent in its business, with

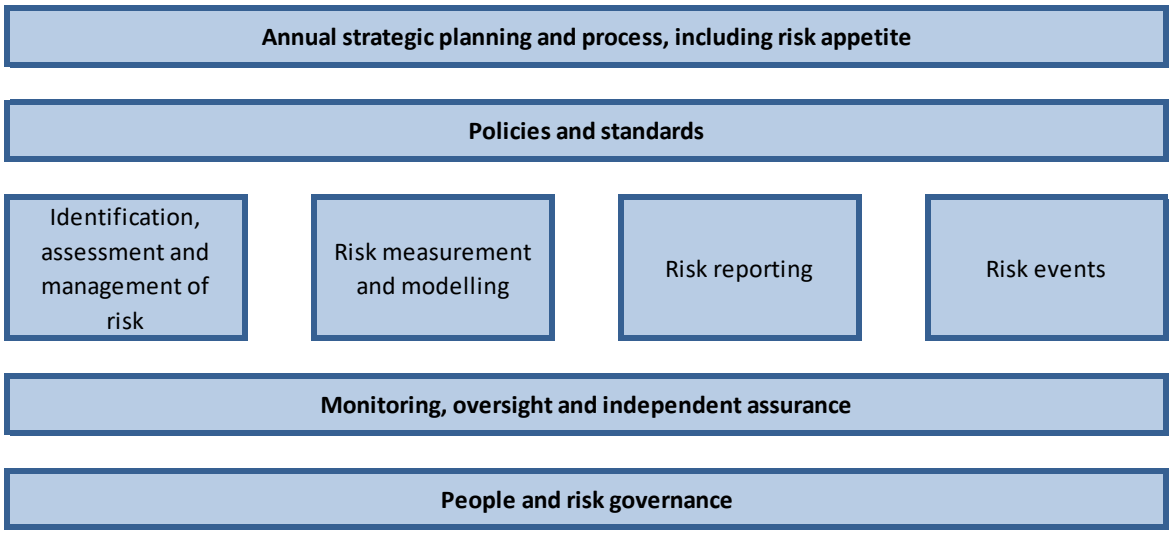
appropriate risk management oversight. DHB Bank is exposed to mainly credit risk in its business activities. Other relatively important risk areas, like in other banks, are liquidity risk, interest rate risk and operational risk.



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 & Legal Department (CLD). 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).

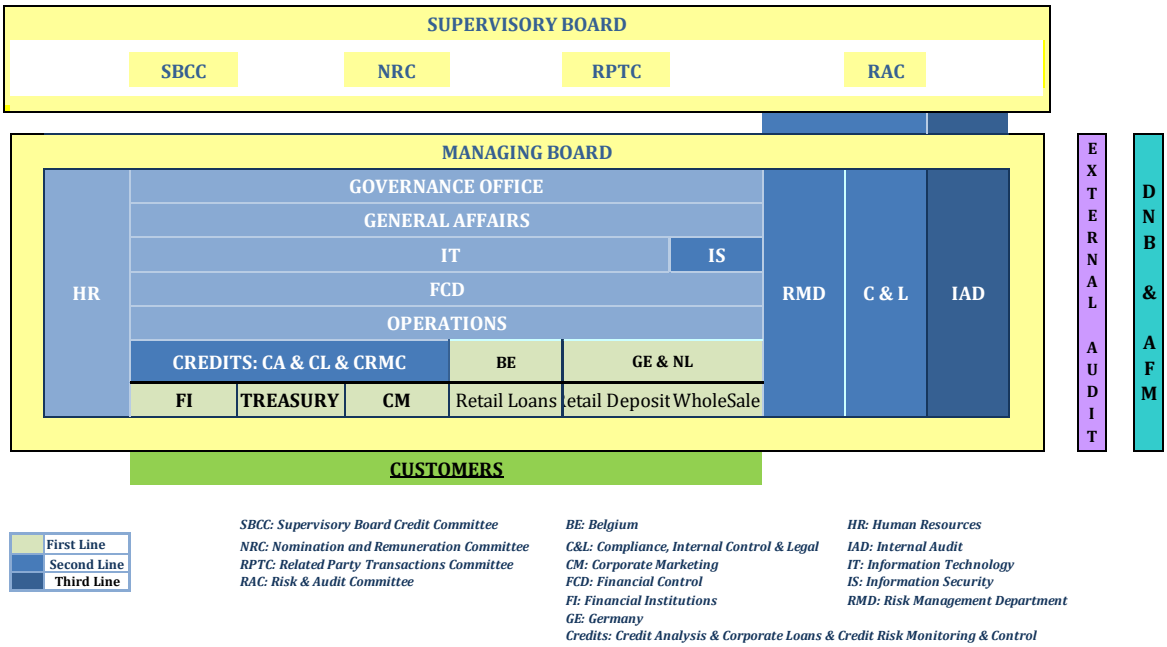
IT related risk factors are controlled and monitored by different departments and committees. The access control to the core banking application resides jointly on System Analysis team and Internal Control Unit, while technical control is exercised by the IT Department. Information security in the broadest sense (including access control, technical control and business continuity policies and activities) is ensured by the Information Security Department (IS). IS 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, Head of Compliance and Legal Affairs Department, besides compliance and legal monitoring, is responsible for the incident as part of the Incident Response Team (IRT) 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 a direct communication line 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. 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 RMD, IAD and CLD, 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. The definition of risks is largely adopted from Basel Committee on Banking Supervision published documents, European Union regulations and requirements, European Banking Authority technical standards, guidelines and recommendations, and DNB's Financial Institutions Risk Manual (FIRM). The Bank thoroughly explains all related risks, mitigation and control measures along with monitoring and management aspects as an integral part of the ICAAP.

The table below illustrates a summary of the risk appetite and methodologies under the ICAAP framework:

Summary of risk appetite and Pillar 2 capital assignment per risk type for FYE 2020

Risk area	Risk type	Risk appetite*	Regulatory reference, benchmark and method for risk evaluation	Capital requirement calculation approach	
				Pillar 1	Pillar 2
Credit Risk (CR)	Default and rating migration	Medium	Standardized Approach (SA), periodical credit portfolio risk assessment, 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			✓
	Climate	Medium	Qualitative review		No add-on
Country risk		Medium	Policy Rule on country concentration		✓
Market Risk (MR)	Trading risk	Low	Standardized Approach, Value-at-risk model (VaR) and Limits	✓	
	FX risk	Low	Standardized 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 to Medium	Basic Indicator Approach	✓	
	Outsourcing	Low			
	Non-IT related risks	Low			
	Underestimation of OR under SA	Low	Qualitative review		No add-on
Other Risks	Legal	Low	Qualitative review		No add-on
	Integrity, compliance and reputational risk				
	Business (incl. strategy)	Low	Policy rule on business model		
	Pension	Low	Qualitative review		
	Model	Low			

** Risk appetite is scaled up here according to: Low, Medium and High. Based on periodical risk assessments, any temporary deviation from the prescribed appetite level is reported, acknowledged and treated by the management under the supervision of the Risk & Audit Committee of the SB.*

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 Tier 1 common capital - which includes paid-in capital and reserves.

The total capital base of DHB Bank is Euro 239.9 million at the end of 2020. The components of the capital base are presented in the table below.

Capital items (EUR '000)	2020	2019
Tier 1 capital		
Paid up capital (A)	**113,750**	**113,750**
Reserves (incl. retained earnings)	126,737	110,313
Eligible reserve (B)	**126,737**	**110,313**
Tier 1 capital (A + B, before deductions)	240,487	224,063
Adjustments to CET1 due to prudential filters	(606)	(523)
Total Tier 1 capital	**239,881**	**223,540**
Tier 2 capital	-	-
Capital base (Tier 1 + Tier 2)	**239,881**	**223,540**

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 2020.

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 external ratings from eligible external credit assessment institutions (ECAI). 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 Bank;

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.

MDBs; this exposure class includes exposure to multilateral development banks (MDBs). Exposures to multilateral development banks that are not referred to in Articles 119(2) of CRR are treated in the same manner as exposures to institutions i.e. the risk weights are based on the ratings assigned to them by eligible rating agencies. The preferential treatment for short-term exposures as specified in Articles 119(2), 120(2) and 121(3) shall not be applied.

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%.

Items associated with particularly high risk; this exposure class includes investments in venture capital firms, investments in AIFs, investments in private equity and speculative immovable property financing. Exposures in this class are assigned a risk weight of 150%.

Exposure secured on real estate property; this exposure class refers to the exposures or any part of an exposure secured by mortgages on immovable property. Exposures in this class are assigned a risk weight of 35%, if secured by mortgages on residential property, and 50%, if secured on commercial immovable property.

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 in default; 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 2020 and 2019 divided into different risk types is presented in the table below.

		2020		2019	
Pillar 1 Risks and Capital Requirement (EUR '000)		**RWA**	**Capital Requirement 8%**	**RWA**	**Capital Requirement 8%**
Credit risk		998,918	79,913	1,051,610	84,129
of which:	*Sovereign*	4,492	359	5,489	439
	MDBs	3,683	295	-	-
	Banks	170,086	13,607	135,779	10,862
	Corporates	661,591	52,927	732,573	58,606
	Retail	233	19	557	45
	Exposure secured on real estate property	16,209	1,297	23,904	1,912
	Exposures in Default	31,080	2,486	30,142	2,411
	Covered bonds	326	26	-	-
	Items associated with particularly high risk	101,374	8,110	111,689	8,935
	Others	9,846	788	11,477	918
Market risk		-	-	-	-
Operational risk		73,758	5,901	77,560	6,205
Credit valuation adjustment (CVA)		617	49	349	28
TOTAL		**1,073,293**	**85,863**	**1,129,518**	**90,361**

3.6 Credit Risk

Credit risk is the largest risk making up more than 93% of the total RWA at 31 December 2020. 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, geographies and industries.

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 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 and Credit Risk Monitoring Control Departments which 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 2020 and 2019.

	2020		2019	
Credit exposures by risk weights (EUR '000)	**Exposures***	**RWA**	**Exposures***	**RWA**
0%	313,953	-	354,117	-
10%	3,257	326	-	-
20%	122,142	24,428	93,425	18,685
35%	2,217	776	4,773	1,670
50%	315,097	157,549	244,808	122,404
75%	2,626	1,967	4,666	3,499
100%	686,390	686,389	742,964	742,960
150%	84,989	127,483	108,260	162,391
Other risk weights	-	-	-	-
TOTAL	**1,530,671**	**998,918**	**1,553,013**	**1,051,610**

** 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 2020 and 2019 respectively.

Credit Exposures by maturity at 31 December 2020, (EUR '000)	< 3 months	3 - 6 months	6 - 12 months	1-3 years	> 3 years	TOTAL
Sovereign	233,974	10,536	6,998	8,471	18,519	**278,500**
MDBs	-	7,366	-	-	-	**7,366**
Banks	92,496	70,640	29,883	73,525	36,807	**303,351**
Corporates	72,369	73,967	72,004	247,463	299,799	**765,603**
Retail	231	3	1	67	8	**311**
Exposure secured on real estate property	827	3,227	1,158	19,366	7,352	**31,930**
Past due items	1,172	401	70	4,490	16,243	**22,376**
Covered bonds	-	-	-	-	3,257	**3,257**
Items associated with particularly high risk	-	16,501	4,618	23,395	23,067	**67,582**
Other items	10	6,600	18,824	11,968	12,994	**50,395**
Total Credit Exposures	**401,081**	**189,242**	**133,556**	**388,746**	**418,046**	**1,530,671**

Credit Exposures by maturity at 31 December 2019, (EUR '000)	< 3 months	3 - 6 months	6 - 12 months	1-3 years	> 3 years	TOTAL
Sovereign	254,082	5,238	7,047	46,130	22,010	**334,507**
MDBs	-	-	-	-	-	-
Banks	19,324	102,127	13,715	70,509	9,516	**215,191**
Corporates	112,726	82,543	56,367	218,000	353,873	**823,510**
Retail	615	-	4	25	99	**743**
Exposure secured on real estate property	159	3,948	1,837	20,133	21,201	**47,278**
Exposures in Default	5,496	728	1,740	12,770	15	**20,750**
Covered bonds	-	-	-	-	-	**-**
Items associated with particularly high risk	-	18,025	11,616	21,864	22,954	**74,459**
Other items	8	2,145	12,363	17,536	4,524	**36,576**
Total Credit Exposures	**392,411**	**214,755**	**104,688**	**407,038**	**434,121**	**1,553,013**

The following table breaks down the main exposure categories according to the sectors of DHB Bank's counterparties at end of 2020 and 2019.

Credit Exposures by exposure class and industry, (EUR '000)		2020	2019
Sovereign		278,500	334,507
MDBs		7,366	-
Banks		303,351	215,191
Corporates		765,603	823,514
of which:	*A - Agriculture, forestry and fishing*	-	-
	B - Mining and quarrying	-	-
	C - Manufacturing	211,993	179,879
	D - Electricity, gas, steam and air conditioning supply	56,040	68,555
	E - Water supply	-	-
	F - Construction	65,130	66,026
	G - Wholesale and retail trade	18,151	47,509
	H - Transport and storage	32,037	55,858
	I - Accommodation and food service activities	29,461	38,424
	J - Information and communication	11,440	13,003
	K - Financial and insurance activities	232,242	269,138
	L - Real estate activities	40,619	32,365
	M - Professional, scientific and technical activities	15,294	19,783
	N - Administrative and support service activities	26,153	13,683
	O - Public administration and defence, compulsory social security	-	-
	P - Education	-	-
	Q - Human health services and social work activities	18,169	17,704
	R - Arts, entertainment and recreation	8,875	1,585
	S - Other services	-	
	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		311	743
Exposure secured on real estate property		31,930	47,274
Exposures in Default		22,376	20,750
Covered bonds		3,257	-
Items associated with particularly high risk		67,582	74,459
Other items		50,395	36,576
Total Credit Exposures		**1,530,671**	**1,553,013**

The tables below show the credit exposures divided into main geographical areas according to the location of the ultimate shareholder at the end of 2020 and 2019 respectively.

Credit exposures by exposure class and geography at 31 December 2020, (EUR '000)	Netherlands	Other Europe	Turkey	Others	TOTAL
Sovereign	186,751	91,748	-	-	278,500
MDBs	-	3,233	-	4,132	7,366
Banks	75,272	128,208	99,871	-	303,351
Corporates	131,432	512,091	43,009	79,071	765,603
Retail	288	23	-	-	311
Exposure secured on real estate property	5,726	5,354	3,763	17,086	31,930
Exposures in Default	1,596	20,378	401	-	22,376
Covered bonds	-	3,257	-	-	3,257
Other Items	5,657	26,576	15,383	2,779	50,395
Items associated with particularly high risk	18,159	49,424	-	-	67,582
Total Credit Exposures	**424,882**	**840,293**	**162,428**	**103,068**	**1,530,671**

Credit exposures by exposure class and geography at 31 December 2019, (EUR '000)	Netherlands	Other Europe	Turkey	Others	TOTAL
Sovereign	221,539	112,967	-	-	334,507
MDBs	-	-	-	-	-
Banks	42,961	66,743	105,486	-	215,191
Corporates	136,289	540,202	65,778	81,240	823,510
Retail	483	-	259	-	743
Exposure secured on real estate property	6,468	9,541	10,884	20,385	47,278
Exposures in Default	18,613	397	1,740	-	20,750
Covered bonds	-	-	-	-	-
Other Items	3,982	13,200	16,359	3,035	36,576
Items associated with particularly high risk	17,721	56,739	-	-	74,459
Total Credit Exposures	**448,057**	**799,790**	**200,506**	**104,661**	**1,553,013**

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 end of 2020 and 2019, the main sources of counterparty risk were currency swaps and interest rate swaps.

Derivative Contracts (EUR '000)	2020			2019		
	Exposures*	RWA	Capital requirement	Exposures*	RWA	Capital requirement
Interest rate contracts	1,857	661	53	1,368	630	50
Foreign exchange contracts	6,686	1,716	137	1,831	370	30
Other contract	-	-	-	-	-	-
TOTAL	**8,543**	**2,377**	**190**	**3,198**	**1,000**	**80**

**The exposures represent the credit exposure to derivative transactions 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, 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 with 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 end of 2020 and 2019.

Credit exposures and credit risk mitigation (EUR '000)	2020			2019		
	Credit Exposures	Collateralised	Guaranteed	Credit Exposures	Collateralised	Guaranteed
Sovereign	278,500	-	-	334,507	-	-
MDBs	7,366	-	-	-	-	-
Banks	303,351	-	18,380	215,191	-	18,380
Corporates	765,603	37,435	21,744	823,477	24,449	22,190
Retail	311	378	138,118	743	511	136,912
Exposure secured on real estate property	31,930	-	-	47,278	-	-
Exposures in Default	22,376	-	-	20,782	33	-
Covered bonds	3,257	-	-	-	-	-
Items associated with particularly high risk	67,582			74,459		
Other items	50,395	-	-	36,576	-	-
TOTAL	**1,530,671**	**37,813**	**178,242**	**1,553,013**	**24,993**	**177,482**

3.6.5 Asset quality

The information presented in this section uses financial statement values and is largely sourced from the 2020 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 end of 2020 and 2019.

Asset Quality (EUR '000)	2020	2019
Neither past due nor impaired	1,449,980	1,476,062
Past due but not impaired	27,909	43,982
Impaired (*)	47,702	25,824
Impairment Allowances	(8,867)	(5,722)
Total	**1,516,724**	**1,540,146**

(*) Impaired amount does not include the fully insured impaired retail loans in Belgium.

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.

The bank is calculating the general provisions under IFRS 9 based on forward looking expected credit loss (ECL) methodology for the entire portfolio. Specific 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.

In scope of provision calculation, the bank's exposures are classified as Stage 1, Stage 2 or Stage 3 depending on the change in credit quality of exposures, presented below as of the end of 2020 and 2019 respectively.

	Gross carrying amount as at	Gross carrying amount as at	Allowance as at	Allowance as at	Net Values	Net Values
	2020	2019	2020	2019	2020	2019
Financial assets at FVOCI (*)	**292,732**	**240,018**	**160**	**29**	**292,572**	**239,989**
Stage 1	282,907	240,018	156	29	282,751	239,989
Stage 2	9,825	-	4	-	9,821	-
Stage 3	-	-	-	-	-	-
Financial assets at amortized cost-Total	**1,005,242**	**1,048,784**	**8,867**	**5,723**	**996,375**	**1,043,061**
- Securities at amortized cost	**30,925**	**40,478**	**1**	**2**	**30,924**	**40,476**
Stage 1	30,925	40,478	1	2	30,924	40,476
Stage 2	-	-	-	-	-	-
Stage 3	-	-	-	-	-	-
-Loans and advances - Banks	**90,861**	**40,648**	**24**	**6**	**90,837**	**40,642**
Stage 1	90,861	40,648	24	6	90,837	40,642
Stage 2	-		-	-	-	-
Stage 3	-	-	-	-	-	-
-Loans and advances - Customers	**883,456**	**967,658**	**8,844**	**5,715**	**874,612**	**961,943**
Stage 1	759,063	808,652	1,806	1,266	757,257	807,386
Stage 2	76,691	133,182	1,041	1,308	75,650	131,874
Stage 3	47,702	25,824	5,996	3,141	41,706	22,683
Financial guarantee contracts	**1,544**	**1,512**	**3**	**1**	**1,541**	**1,511**
Stage 1	1,544	15,212	3	1	1,541	15,211
Stage 2	-	-	-	-	-	-
Stage 3	-	-	-	-	-	-
Total	**1,299,518**	**1,290,314**	**9,031**	**5,753**	**1,290,487**	**1,284,561**

The following table details the change of provisions balance at the end of 2020 and 2019 respectively.

Change of total credit risk provisions Euro (1,000)	2020	2019
Opening balance, 1 january	5,722	11,684
Addition	4,654	3,340
Release	(1,505)	(1,576)
Write-off	-	(7,922)
Exchange rate movement	(4)	196
Closing balance, 31 December	**8,867**	**5,722**

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.

During 2020, DHB Bank implemented payment moratoria to the obligors operating in certain sectors to alleviate their financial stress that arose as a result of their temporary liquidity constraints due to the negative impact of COVID-19. DHB Bank's moratorium was applied in connection with the EBA guidelines on legislative and non-legislative moratoria on loan repayments which clarify that payment moratoria do not trigger classification as forbearance or distressed restructuring if the measures taken are based on the applicable national law or on an industry or sector-wide private initiative agreed and applied broadly by the relevant credit institutions. The bank continues to closely monitor the developments from both systemic and individual borrower perspectives with regard to the prolonged effect of the COVID-19 pandemic.

3.7 Market Risk

DHB Bank uses the Standardised Approach to capture the market risk capital requirement. As of end of 2019 and 2020, there is no capital requirement for market risk. Foreign currency risk in the bank 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.

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 5.9 million at 31 December 2020.

Operational risk is inherent in each of the bank's business and support activities, resulting from inadequate or failed internal processes, human resources and systems or external events, 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 the risk awareness 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 EBA guidelines (EBA/GL/2018/02) effective from 30 June 2019. The IRRBB is monitored and controlled both from a value perspective (such as using the economic value of equity and PV01 measure) and from an income perspective (sensitivity in net interest income, NII).

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. Regarding the value perspective, EVE measures the loss in economic value of equity due shocks to yield curve. The IRRBB as measured by changes in EVE is minimised, since the bank's rate sensitive assets and liabilities are mostly floating rate, where the (duration) risk 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 interest rate risk in the asset book.

The bank applies certain assumptions mainly for the instruments without maturity. Non-maturity interest rate sensitive assets and liabilities are bucketed in the short term. Non-maturing retail deposits (NMDs) are considered as core if they are stable and are unlikely to reprice even under significant changes in interest rate environment. Non-core deposits are considered as overnight deposits. Based on historical behavioural analysis, a maturity profile of core deposits is modelled with a maturity cap of 4.5 years. Based on the modelled maturity profile, the average behavioural maturity of total NMDs (core as well as non-core) is estimated to be around 9 months. The bank's equity is considered a non-interest sensitive component and is excluded from the interest rate risk computations.

The following tables indicate the bank's interest rate sensitivities in the banking book from the income perspective at the end of 2020 and 2019 respectively.

NII sensitivities by major currencies at December 2020, Euro (000)	Interest rate shock of +/- 200 bp	
	200 bp decrease	200 bp increase
EURO	558	886
US Dollar	24	(24)
Other	224	(224)
Total	**806**	**638**

NII sensitivities by major currencies at December 2019, Euro (000)	Interest rate shock of +/- 200 bp	
	200 bp decrease	200 bp increase
EURO	3,060	3,122
US Dollar	58	(58)
Other	16	(17)
Total	**3,134**	**3,048**

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 shocks in rates, by currency. Furthermore, the bank reports PV01 to 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 threshold of 5%. The following tables show a range of severe interest rate shocks with positions at the end of 2020 and 2019 respectively. At 31 December 2020, the standard instantaneous parallel shock of 200 bps leads to a potential decrease of Euro 6.98 million, or 2.82% of the capital base. In terms of the outlier criterion, the bank's interest rate risk position 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 December 2020, Euro (000)	-200	+200	PV01
EURO	2,646	(6,921)	(35)
US Dollar	8	(37)	-
Other	5	(23)	-
Total	**2,659**	**(6,980)**	**(35)**
Equity value (IFRS)		**247,683**	
Standard 200 bps shock as % of the equity		**(2.82%)**	

Fair value sensitivity to interest rate shocks at December 2019, Euro (000)	-200	+200	PV01
EURO	2,267	(5,476)	(27)
US Dollar	(1)	-	-
Other	6	(13)	-
Total	**2,272**	**(5,489)**	**(27)**
Equity value (IFRS)		**239,735**	
Standard 200 bps shock as % of the equity		**(2.29%)**	

4.2 Liquidity risk

Liquidity risk is defined as the risk of being unable to meet the bank's current or future payment obligations without incurring unacceptable costs or losses. The ability to maintain a sufficient level of liquidity is crucial to financial institutions, particularly in maintaining appropriate levels of liquidity during periods of adverse conditions. The bank's funding strategy is to ensure adequate liquidity and various funding sources to meet actual and contingent liabilities during both stable and adverse conditions. Liquidity risks can be categorized in broader terms as funding liquidity risk and market liquidity risk.

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 countries 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 2020 comfortably met the requirements. As on 31 December 2020, the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) were at 868% and 165%, respectively, well above the minimum 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[1]. 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 2020 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.

According to European Banking Authority (EBA) Report on asset encumbrance, an asset is treated as encumbered if it has been pledged or if it is subject to any form of arrangement to secure, collateralise or credit enhance any transaction from which it cannot be freely withdrawn.

In certain cases, assets on DHB Bank's balance sheet are encumbered. The table below provides an overview of the bank's asset encumbrance position based on the CRR (Part Eight) and the related guidance from the EBA. All totals are reported using the median-of-the-sums method.

Encumbered and unencumbered assets: ***Based on median value of the 4 quarters in the financial year 2020, (EUR '000)***	**Carrying amount of encumbered assets**	**Fair value of encumbered assets**	**Carrying amount of unencumbered assets**	**Fair value of unencumbered assets**
Assets of DHB Bank	**137,938**	**-**	**1,395,315**	**-**
Loans on demand	-	-	246,808	-
Equity instruments	-	-	-	-
Debt securities	129,693	129,693	119,234	119,303
- of which: covered bonds	-	-	3,218	3,218
- of which: asset-backed securities	-	-	-	-
- of which: issued by general governments	-	-	32,286	32,356
- of which: issued by financial corporations	111,769	111,769	74,417	74,422
- of which: issued by non-financial corporations	17,378	17,378	17,623	17,623
Loans and advances other than loans on demand	8,368	-	1,019,188	-
- of which: mortgage loans	-	-	233,299	-
Other assets	-	-	17,735	-

The following activities at DHB Bank give rise to encumbered assets:

- Collateral agreements (ISDA/CSA contracts) encumbered assets to secure derivative positions.
- Encumbered Syndication for TRS Funding
- Participation in Targeted longer-term refinancing operations (TLTRO) for which eligible assets are pledged as collateral

[1] The stress scenario used to measure compliance with the risk appetite framework includes among others an assumption of retail 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.

DHB Bank has a low level of asset encumbrance, as a result of prudent balance sheet management, whereby a variety of funding sources is readily available. The total asset encumbrance as per end of year 2020 was Euro 138 million. The median asset encumbrance ratio for DHB Bank in 2020 was 9%.

The following table shows the encumbered assets along with their associated liabilities.

Sources of encumbrance *Based on median value of the 4 quarters in the financial year 2020, (EUR '000)*	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
Carrying amount of selected financial liabilities	**120,011**	**137,938**
Derivatives	475	8,368
- of which: Over-The-Counter	475	8,368
Deposits	119,758	129,693
Repurchase agreements	119,758	129,693
- of which: central banks	119,758	129,693
Total Sources Of Encumbrance	**120,011**	**137,938**

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 14.3% at the end of 2020, which is well 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

4.4.1 Legal, Compliance, Integrity 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. The three lines of defense of DHB Bank's governance framework are used to manage these risks effectively. These three lines of defense principles provide a clear division of activities and define roles and responsibilities for risk management at different levels within the bank.

4.4.2 Climate Risks

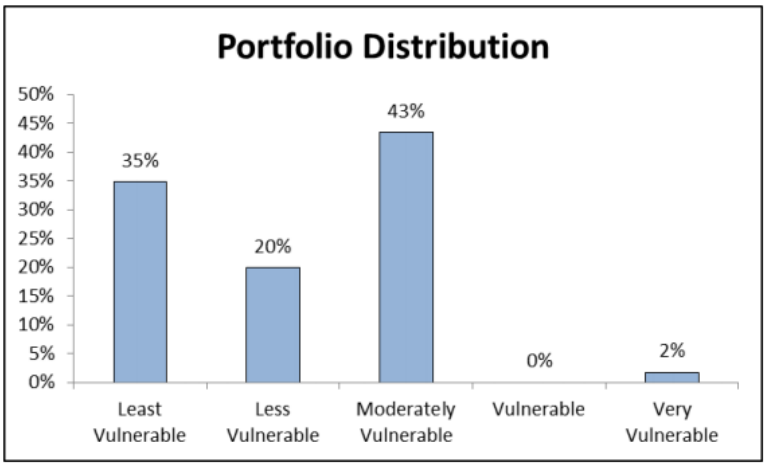
DHB Bank, in line with the regulatory guidelines (DNB's 'Waterproof') and the recent consultative Good Practice document by DNB (Integration of climate-related risk considerations into banks' risk management), use the supporting assessment frameworks (Equator Principles, S&P climate risk vulnerability index etc.) to assess the riskiness of its portfolio with respect to the climate related risks.

At DHB Bank, the responsibility for managing the climate-related risks and opportunities lies with the Managing Board. The MB acknowledged the importance of incorporating environmental related risks particularly in its lending strategy within the governance structure of managing credit risk. The bank introduced the climate risk impact in the Internal Rating Model as well as part of the credit proposals. In this respect, the bank also incorporated the climate related risks, among other concentration metrics, in the Risk Appetite Statement 2021. The bank presents the portfolio level climate risk measurements (using externally available metrics like S&P Vulnerability Index) in MIS reports and risk assessments, and the bottom up analysis on annual basis in the credit portfolio risk report. The bank monitors the concentration in vulnerable sectors and geographies with high climate related risks, as well as mitigation measures, if applicable.

The bank assesses the physical consequences of climate change (physical risks) as well as the consequences of a transition to a climate neutral economy (transition risks). The bank includes the

physical risk impact in its stress testing framework by incorporating defaults and credit downgrades of clients in vulnerable sectors and geographies. For transition risk, the bank has gauged the impact on its portfolio over longer term horizon, and conducted a separate generalized analysis.

The bank has applied certain standardized measures to assess climate risks at portfolio level. It has adopted to use the vulnerability index developed by S&P. This index makes use of different variables that take into account both the effects of climate change, as well as the related countries' economic resilience. Based on the year-end 2020 portfolio, the bank's exposure to countries by 'vulnerability' classification is summarized below:



According to the above distribution, the portfolio level vulnerability score as of year-end 2020 has been determined as 2.14 (Less Vulnerable), based on the weighted average calculation. DHB Bank intends to maintain this score below 3 (Moderately vulnerable) and has incorporated this Climate Risk dimension in its Risk Appetite Statement 2021.

DHB Bank also attempts to link the climate risk in the portfolio with the carbon emissions on sector basis. Since the emissions data for clients is not readily available so as a preliminary analysis the bank relies on sectoral carbon-emissions data from Eurostat[2] on NACE code level. The bank performed the analysis based on carbon-emissions exposure index. The index captures the emissions intensity of the portfolio according to the bank's sectoral exposures and the industry-average emissions for those sectors. The relative exposures to each NACE sector multiplied with the sectoral carbon emissions (% share) are aggregated across all sectors, and then multiplied by 100, to arrive at the carbon-emissions exposure index. Based on the year-end 2020 portfolio, carbon-emissions exposure index for DHB Bank is around 7.71. This means if the NACE sectors are classified based on carbon emissions as Low (<1), Medium (1-10) and High (>10), then the carbon-emissions exposure index indicates that the bank is financing a portfolio which is in the "Medium" emissions category. The bank will continue to monitor and improve the carbon emissions based approach based on developing industry practices, and in time will strive to have a more mature approach.

[2] https://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=env_ac_ainah_r2&lang=en

5. Capital Buffers

DHB Bank is subject to the capital buffer requirements that are applicable since 2016.

The capital conservation buffer (CCB) is a capital buffer of a bank's total exposures that needs to be met with an additional amount of required capital. The effect of CCB is particularly significant. It is currently at 2.5% since beginning of 2019.

The institution specific countercyclical capital buffer (CCyB) is part of a set of macro prudential instruments, designed to help counter pro-cyclicality in the financial system. Capital should be accumulated when cyclical systemic risk is judged to be increasing, creating buffers that increase the resilience of the banking sector during periods of stress when losses materialise.

DHB Bank's exposures in countries which have set a countercyclical buffer rate greater than zero is relatively small, resulting in countercyclical buffer requirement of 0.04% as of year-end 2020. The table below gives an overview of the exposure distribution for the countries along with the countercyclical buffer requirement.

List of Countries (EUR '000)	General Credit Exposures	Own funds requirements		Own funds requirements weights	Countercyclical buffer rate
	Exposure Value for SA	of which: General credit exposures	Total		
Netherlands	162,907,129	151,924,587	12,153,967	18.51%	
Belgium	145,979,444	76,832,908	6,146,633	9.36%	
Germany	142,502,072	114,732,761	9,178,621	13.98%	
Turkey	62,558,109	45,362,897	3,629,032	5.53%	
Bulgaria	56,969,846	63,670,059	5,093,605	7.76%	0.50%
United States Of America	41,674,498	36,499,635	2,919,971	4.45%	
Hungary	39,961,005	48,211,673	3,856,934	5.87%	
Italy	33,714,601	30,783,292	2,462,663	3.75%	
Macedonia	33,077,472	44,611,126	3,568,890	5.44%	
Romania	27,315,154	27,133,081	2,170,646	3.31%	
United Arab Emirates	22,642,869	19,589,056	1,567,125	2.39%	
Egypt	20,083,368	20,083,368	1,606,669	2.45%	
Slovenia	20,050,271	20,050,271	1,604,022	2.44%	
France	16,886,595	11,613,431	929,074	1.42%	
Croatia	15,885,310	13,347,746	1,067,820	1.63%	
Malta	13,215,636	12,084,608	966,769	1.47%	
Greece	12,521,545	12,521,545	1,001,724	1.53%	
Ukraine	10,046,905	10,046,905	803,752	1.22%	
Poland	9,405,789	11,473,666	917,893	1.40%	
Switzerland	8,956,883	8,706,916	696,553	1.06%	
United Kingdom	8,940,999	10,656,374	852,510	1.30%	
Others	36,159,404	30,725,028	2,458,002	3.74%	
Total	**941,454,904**	**820,660,934**	**65,652,875**	**100.00%**	

Amount of institution specific CCyB (EUR '000)	
Total risk exposure amount	1,073,293
Institution specific countercyclical buffer rate	0.04%
Institution specific countercyclical buffer requirement	416

6. 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 2020 was more than twice the minimum regulatory capital ratio requirement of 8%. Owing to its straightforward business model and strategies as well as to its robust equity base, the bank does not make use of hybrid capital instruments.

The following table provides an overview of DHB Bank's capital adequacy ratios as per end of 2020 and 2019.

Capital Adequacy Ratios (EUR '000)	2020	2019
RWA (Pillar 1)	1,073,293	1,129,518
Regulatory capital requirements	85,863	90,361
CET1 capital	239,881	223,540
Capital base	239,881	223,540
Tier 1 ratio (in %)	22.4%	19.8%
Capital ratio (in %)	22.4%	19.8%
Capital ratio/Regulatory capital requirement (in %)	279.4%	247.4%

7. 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. DHB Bank calculates its leverage ratio on a quarterly basis and the 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 end of 2020 and 2019.

Leverage Ratio (EUR '000)	2020	2019
Total Tier 1 capital for the leverage ratio	239,881	223,540
Total Common Equity Tier 1 (CET1) capital	239,881	223,540
Additional Tier 1 (AT1) capital	-	-
Total Tier 1 capital for the leverage ratio	**239,881**	**223,540**
Total statutory assets per the statement of financial position	1,521,357	1,549,060
Off balance sheet items	1,427	1,484
Derivative exposures adjustment	8,543	3,198
SFT exposure adjustment	-	-
Other regulatory adjustment	-	-
Exposures for the leverage ratio	**1,531,327**	**1,553,742**
Leverage ratio	**15.7%**	**14.4%**

8. Remuneration

DHB Bank's current Remuneration Policy, which is subject to annual review, was approved in the General Meeting of Shareholders (GMS) in April 2011, further developed over the years, and lastly revised in 2021 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.