Interim Pillar 3 Disclosures

30 June 2024

izola Bank

1. Introduction

The Basel III capital adequacy framework consists of three complementary pillars. Pillar 1 provides a framework for measuring minimum capital requirements for credit, market, and operational risks. Pillar 2 establishes a system of supervisory review aimed at improving banks' internal risk management and capital adequacy assessment in line with their risk profile. Pillar 3 is intended to enhance market discipline and requires banks to publish a range of disclosures aimed at providing further insight on the capital and liquidity structures including their adequacy and risk management practices. The Pillar 3 Disclosures bearing reference date 30 June 2024 comprise both quantitative and qualitative information required under Pillar 3. These disclosures are made in accordance with Part Eight of the Capital Requirements Regulation (CRR 2) and the European Banking Authority's (EBA) Pillar 3 Disclosure Guidelines. Furthermore, the Pillar 3 Disclosures are compliant with the 'Reporting Framework' issued by the European Banking Authority. This interim report provides an updated overview of the Bank's key metrics, in accordance with EBA Pillar 3 Disclosure Guidelines and EBA Pillar 3 Implementing Technical Standard.

2. Statement of the Management Body

In line with Article 431 (3) CRR and CRR 2, the Bank has disclosed all information within the Pillar 3 Disclosures in accordance with the disclosure requirements, formal policies and internal processes, systems, and controls. Furthermore, these disclosures are not subject to an external audit. The Bank's management is responsible for the verification of these Pillar 3 disclosures. The Bank, through its internal verification process, is satisfied that these disclosures are presented fairly.

3. Risk Measurement and Key Risk Metrics

Table EU KM 1 Key Metrics gives an overview to the Bank's key metrics including the risk-weighted exposure amounts over the past relevant periods. As of June 30, 2024, the Bank exceeded the P2G threshold of 1.5% set in the SREP letter issued by the MFSA in 2023. Following a review of its own funds requirements under Regulation (EU) No 575/2013 (the "CRR"), the Bank reclassified certain items included under its Tier 1 capital. Such reclassification resulted in adjustments being made to both December 2023 and June 2024 ratios. In response to this regulatory breach, the Bank's Directors implemented a capital management plan aimed at improving the Tier 1 ratio in both the short and medium term. As part of this initiative, the Board authorized the issuance of €3 million in perpetual notes, to be subscribed to by a related company, IBL I Limited. These notes qualify as Additional Tier 1 instruments under Articles 51 to 56 of the EU Capital Requirements Regulation (No 575/2013) and, upon MFSA approval, will be classified as equity in the Bank's Statement of Financial Position under EU-adopted IFRS standards.

Table 1: EU KM1- Key Metrics

		a	b
		30 June 2024	31 December 2023
	Available own funds (amounts)		
1	Common Equity Tier 1 (CET1) capital	25,292,746.81	27,570,678.34
2	Tier 1 capital	25,292,746.81	27,570,678.34
3	Total capital	39,292,746.81	41,570,678.34
	Risk-weighted exposure amounts		
4	Total risk exposure amount	224,987,768.26	220,095,237.86
	Capital ratios (as a percentage of risk-weighted exposure amount)		
5	Common Equity Tier 1 ratio (%)	11.24%	12.53%
6	Tier 1 ratio (%)	11.24%	12.53%
7	Total capital ratio (%)	17.46%	18.89%
	quirements to address risks other than the risk of excessive leverage (as a percentage of risk-weig		
EU 7d	Additional own funds requirements to address risks other than the risk of excessive leverage (%)	3.25%	3.25%
EU 7e	of which: to be made up of CET1 capital (percentage points)	1.83%	1.83%
EU 7f	of which: to be made up of Tier 1 capital (percentage points)	2.44%	2.44%
EU 7g	Total SREP own funds requirements (%)	11.25%	11.25%
	Combined buffer and overall capital requirement (as a percentage of risk-weighted exposure		
8	Capital conservation buffer (%)	2.50%	2.50%
EU 8a	Conservation buffer due to macro-prudential or systemic risk identified at the level of a Member State (%)	-	-
9	Institution specific countercyclical capital buffer (%)	0.10%	0.03%
EU 9a	Systemic risk buffer (%)	0.18%	0.09%
11	Combined buffer requirement (%)	2.78%	2.62%
EU 11a	Overall capital requirements (%)	14.03%	13.87%
12	CET1 available after meeting the total SREP own funds requirements (%)	2.80%	4.09%
	Leverage ratio		
13	Total exposure measure	515,058,823.32	496,076,664.51
14	Leverage ratio (%)	4.91%	5.56%
	Additional own funds requirements to address the risk of excessive leverage (as a percentage of		
EU 14a	Additional own funds requirements to address the risk of excessive leverage (%)	-	-
EU 14b	of which: to be made up of CET1 capital (percentage points)	-	-
EU 14c	Total SREP leverage ratio requirements (%)	3.00%	3.00%
	Leverage ratio buffer and overall leverage ratio requirement (as a percentage of total exposure		
EU 14d	Leverage ratio buffer requirement (%)	-	-
EU 14e	Overall leverage ratio requirement (%)	3.00%	3.00%
	Liquidity Coverage Ratio		
15	Total high-quality liquid assets (HQLA) (Weighted value - average)	122,133,439.12	103,472,202.30
EU 16a	Cash outflows - Total weighted value	18,736,262.08	21,252,210.01
EU 16b	Cash inflows - Total weighted value	55,817,922.08	49,086,739.95
16	Total net cash outflows (adjusted value)	4,684,065.52	5,313,052.50
17	Liquidity coverage ratio (%)	2607.42%	1947.51%
	Net Stable Funding Ratio		
18	Total available stable funding	425,688,426.24	385,800,326.48
19	Total required stable funding	281,190,854.86	254,243,315.98
20	NSFR ratio (%)	151.39%	151.74%

EU KM2 below shows that as at June 2024, the Group's own funds and eligible liabilities as percentage of the total risk exposure amount (TREA) amounted to 17.46 % while the own funds and eligible liabilities as percentage of total exposure measure (TEM) amounted to 7.6%. Consequently, the Bank's position is above the regulatory minimum requirements in relation to MREL. Furthermore, the transition adjustment due to IFRS 9 was not material to the Bank.

Table 2: EU KM2 - Key metrics – MREL requirements for own funds and eligible liabilities

		Minimum requirement for own funds and eligible liabilities (MREL)
		T
Own funds and eligible liabilities, ratios and components		
1	Own funds and eligible liabilities	39,292,747
EU-1a	Of which own funds and subordinated liabilities	39,292,747
2	Total risk exposure amount of the resolution group (TREA)	225,061,694
3	Own funds and eligible liabilities as a percentage of the TREA	17.46%
EU-3a	Of which own funds and subordinated liabilities	17.46%
4	Total exposure measure (TEM) of the resolution group	515,058,823
5	Own funds and eligible liabilities as percentage of the TEM	7.63%
EU-5a	Of which own funds or subordinated liabilities	7.63%
6a	Does the subordination exemption in Article 72b(4) of Regulation (EU) No 575/2013 apply? (5% exemption)	
6b	Aggregate amount of permitted non-subordinated eligible liabilities instruments if the subordination discretion in accordance with Article 72b(3) of Regulation (EU) No 575/2013 is applied (max 3.5% exemption)	
6c	If a capped subordination exemption applies in accordance with Article 72b (3) of Regulation (EU) No 575/2013, the amount of funding issued that ranks *pari passu* with excluded liabilities and that is recognised under row 1, divided by funding issued that ranks *pari passu* with excluded liabilities and that would be recognised under row 1 if no cap was applied (%)	
Minimum requirement for own funds and eligible liabilities (MREL)		
EU-7	MREL expressed as a percentage of the TREA	17.46%
EU-8	Of which to be met with own funds or subordinated liabilities	17.46%
EU-9	MREL expressed as a percentage of the TEM	7.63%
EU-10	Of which to be met with own funds or subordinated liabilities	7.63%

Capital Management

Internal Capital Adequacy Assessment Process

In line with template EU OVC of the EBA Pillar 3 disclosures Template Annex II, the Bank performs an Internal Capital Adequacy Assessment Process (ICAAP) in compliance with the Pillar 2 requirements of Banking Rule BR/12/2022 – The Supervisory Review Process of Credit Institutions Authorised Under the Banking Act 1994 and the CRR. Article 73 of Directive 2013/36/EU ("CRDIV") requires Izola Bank plc ("the Bank") to have developed strategies and processes to carefully identify, assess, control and monitor the material risks to which the Bank's business model is exposed to and has documented these processes in its Internal Capital Adequacy Assessment Process ("ICAAP").

The ICAAP document also determines whether the Bank has sufficient capital during a stressed period. An idiosyncratic stress scenario and a market-wide stress scenario are analysed to evaluate the effects on the Bank's capital position, whilst sensitivity analysis is used to explore the sensitivity of the Bank's capital position to isolated shocks of specific variables.

The Bank's ICAAP is a fundamental component of its risk management framework and is aligned with the rest of the components which form part of the framework. This document is prepared by the Risk and Compliance department and is approved by the Board of Directors of the Bank.

The Bank's Board of Directors plays a key role in the development, challenge and ultimately the adoption of the Bank's ICAAP. Firstly, the Board conducts a risk identification exercise which identifies those risks that could pose a threat to the Bank's capital profile on the basis of its business model. Secondly, the Board makes use of the exercise to certify that risks which arise during the ordinary course of business, or which may arise in future potential business activity, are being mitigated by a robust internal control framework. Where this is not the case, the Board ensures that the necessary actions are taken to further enhance controls, in an effort to reduce the Bank's overall residual risk.
Thirdly, the Board assures itself that the process satisfactorily determines the adequacy of the Bank's capital profile, in light of its overall risk exposure. Finally, the Board of Directors decides as to whether the Bank is in fact holding a sufficient amount of capital which would enable it to cover its overall risk exposure and for it to sustain its forecast business plan.

The ICAAP document is referred to on a frequent basis, whenever the need arises. It is a crucial tool for the Bank's Management when mitigating risk and taking decisions with regards to anything which affects the Bank's operations.

The Bank assesses the impact of a number of risks, namely Business and Strategic Risk, Market Risk, Operational Risk, ESG Risk, Liquidity Risk and Credit Risk on a regular basis to ensure these risks remain in line with the Bank's risk appetite. These risks are reviewed within respective committees. The Bank also ensures calibration with future plans and projections to ensure that these risks are factored within the risk appetite. Monitoring is crucial to ascertain that the Bank's Management takes the necessary capital charges whilst remaining with adequate levels of excess capital. Monitoring of key metrics is also periodically conducted and presented to the Audit and Risk Committee through the Risk and Compliance Report and the BOD through the Board Review Pack.

The limits imposed within the ICAAP serve as a road map to ascertain that the policies, principles and risk limits adopted by the Bank via the ICAAP are adhered to.
The pillars on which the ICAAP document are based are identifying, measuring, monitoring and aggregating risks while ascertaining enough capital is held in relation to the accepted risk.

Through the ICAAP, the Bank ensures that each material risk is being accounted for in either Pillar 1, Pillar 2 or stress testing, and subsequently: (a) confirms whether Pillar 1 Capital is underestimating risks or not; (b) considers other risk sub-categories that are not fully captured under Pillar 1 Capital; and (c) assesses risks that are not at all captured under Pillar 1 Capital. Ultimately, the Bank compares its individual assessment results with the minimum Regulatory Requirements and determines the necessity for any additional capital. As part of its ICAAP, the Bank adopts the following methodologies:

- The use of the Standardised Approach to calculate capital requirements for credit risk.
- The use of the Standardised Approach, to calculate capital requirements for market risk on its foreign exchange risk positions.
- The use of the Basic Indicator Approach (BIA) to calculate the capital requirements for operational risks.
- Pillar 2
- The use of a model similar to the Foundation Internal Rating Based (FIRB) approach, to analyse whether credit risk in Pillar 1 is underestimated or not.
- The use of the Herfindahl-Hirschman Index (HHI), with reference to the Bank of England guidelines for single name, country and sector concentration risk.
- The use of the Interest Rate Risk in the Banking Book (IRRBB). The Bank analyses different scenarios for both earnings and economic outlook. The shocks are based on the EBA Guidelines on the management of interest rate

risk arising from non-trading activities (EBA/GL/2015/08; "EBA Guidelines on IRRBB").
- The use of the Standardised Approach (SA) to analyse whether operational risk in Pillar 1 is underestimated or not.

Stress and scenario testing analysis.

The Bank capital stress and scenario testing was revised from previous years' iterations. This covers both idiosyncratic and market-wide event considerations, including the impact of a stressed business model. Sensitivity analysis evaluates the isolated impact of fluctuations in relevant stress and scenarios under mild, severe and extreme implications. Furthermore, reverse stress testing is analysed to understand any possible events that could lead the Bank to breach regulatory ratios
The Bank's internal stress testing framework aims at assessing the sensitivity of the Bank's capital and liquidity positions to conditions of stress. Stress testing is a tool that supplements other risk management approaches and measures and plays a particularly important role in:

- Providing forward-looking assessments of risk;
- Overcoming limitations of models and historical data;
- Supporting internal and external communications;
- Feeding into capital and liquidity planning procedures;
- Informing the setting of a Bank's risk tolerance; and
- Facilitating the development of risk mitigation or contingency plans across a range of stressed conditions.

The main types of stress tests performed at the Bank are the following:

- Scenario and sensitivity analysis: The Bank assesses the sensitivity of its financial position, performance as well as capital and liquidity adequacy to stress scenarios. ICAAP's horizon is based on the 3-year projected period of 2024-2026.
- Reverse stress tests: The Management employs the technique of reverse stress testing to calibrate the severity of scenarios. This is achieved by applying reverse stress testing in its sensitivity analyses as well as the Recovery Plan.

The Bank's stress testing framework is built in line with EBA stress testing guidelines, and it employs both static and dynamic balance sheet approaches for ICAAP and ILAAP.

Governance around the stress testing framework

The Bank's Risk and Compliance department as well as the Finance & Treasury department actively take part in scenario design along with guidance from the Bank's CEO. Furthermore, the Board of Directors and the Bank's Management actively challenge scenario assumptions in all areas and finally approve the scenario.
The results from stress tests are compared with the Bank's thresholds used for the monitoring of risk, namely the Bank's BAUs, EWIs and Triggers in respect of key ratios for the Bank. If the results indicate a breach in the Bank's thresholds, the Board of Directors determines whether remedial actions and other forms of risk treatment are necessary, depending on the severity of the impact and the probability of the breach.