From Risk to Opportunity

Thanks to efficient and proactive risk management, which strives to transform every risk into an opportunity, Bank Saint Petersburg is always profitable and resistant to external shocks.

RISK MANAGEMENT

The strategic objective of risk management is to ensure the Bank's financial stability. The existing risk management framework comprises a set of measures and solutions designed to identify, monitor and assess all material risk types, to determine their acceptable level, and to mitigate/limit each type of risk.

Pursuant to current legislation and the Bank's Charter, the Supervisory Board approves the Risk and Capital Management Policy, which covers the coordination of actions taken to enhance the risk management framework, to improve methodology consistently, as well as to standardize and automate risk management processes.

The Supervisory Board has a dedicated Risk Management Committee that assists the Supervisory Board in overseeing the Bank's risk management system, and the efficient identification, quantification, and control of risk.

For each type of banking risk, a management system has been established that ensures an adequate risk assessment and includes measures to mitigate and limit it. The Bank measures its assumed risks against its equity, supporting the capital adequacy ratio required by the Bank of Russia, which allows the Bank to meet its obligations (including contractor covenants), and to maintain its efficient utilization of capital.

Risk	Description	Key Mitigating Actions
Credit Risk	The risk of losses if a borrower or counterparty fails to meet its contractual obligations.	The economic state of the most companies in 2020 was affected by global coronavirus pandemic. Limitations imposed since 2Q in order to curb the spread of the virus lead to decreased revenues of some of SMEs and their workers. Raw materials prices drop and decrease in economic activity also affected large corporates. As a response to increased credit risk, the Bank employed a stricter policy on loan approval and support for customers in difficult financial state in terms of federal as well as own support programs. By the end of the 2020, the most of the credit holidays ran out, with the maximum of approvals falling on 2Q, and, from the preliminary data 93% of customers with credit holidays came back to normal loan service. This signifies the efficiency of the support measure. Approximately starting with June 2020, new federal lending support programs were launched for the populace and business by subsidizing interest rates, which were the main factor for development of standard lending programs to the retail customers and SMEs in 2H 2020. By the end of 2020, the Bank partly removed limitations of credit policy commenced in 2Q 2020, but even so it remains more moderate as compared with the beginning of 2020. High level of coronavirus sickness rate indicates stronger credit risk both in retail and corporate segments, despite the expectations of 2021 economic recovery. In large corporate lending the Bank strives to increase the share of high credit quality loans. In SME lending the Bank develops internal statistic risk evaluation models and, despite the increase in credit risk, in 2020 a new outer customer lending program was launched based not only on the official financials analysis, but also on the turnover on settlement accounts. This product was previously available only for the customers already being serviced in the Bank. In retail lending mortgage loans and unsecured loans to payroll customers are prevalent. During 2020 these segments were less affected as compared to car lending and unsecured lending to the non-payroll customers. In order to manage credit risks related to customers (credit organizations, financial enterprises and corporates), the Bank employs the limit system, curbing the maximal credit risk amount during: — lending / deposit placement operations; — financial assets sales/purchases, including currency, where the counterparty credit risk arises; — repurchase agreements; — non-exchange derivative contracts; — placement of funds on corresponding or other accounts of the counterparty credit organization; — other operations exposing the Bank to the credit risk. Corresponding counterparty limits are set according to the authorizes bodies' decisions as a result of a remote credit quality analysis (financials and other available financial and non-financial information). During the limit's course of action counterparty credit quality is being monitored. Data accrued as a result of the monitoring is used to evaluate the counterparty risk. The Bank practices conservative approach for counterparty risk evaluation, credit risk minimization is mostly achieved through prevalent collaboration with customers of high credit ratings. When conducting collateralized deals liquid collaterals are favored.

Risk	Description	Key Mitigating Actions
Liquidity Risk	The risk of losses if maturities of assets and liabilities do not match.	The approach to managing liquidity is based on ensuring a level of liquidity provisions that will allow the Bank to sustain a certain period of sudden outflow of customer deposits and a reduction in the Bank's ability to attract resources from the financial market caused by macroeconomic events or any occurrences directly related to the Bank. The Bank has established a multi-level liquidity management system that provides a comprehensive approach to monitoring, forecasting and decision-making in this sphere, as well as uses a scenario approach to determine current and projected liquidity. Throughout 2020, the Bank's total cash and liquidity reserves were adequate enough not only to support its day-to-day operations and cover unplanned liability outflow, but also to support growth in active banking operations, where necessary.
Market risk	The risk of assets devaluation due to market factors.	In 2020 global markets were defined by coronavirus pandemic influence on economies and markets. In order to support financial stability many government regulators developed support measures, including monetary easing, fiscal stimulation, regulatory easing and targeted funding. Epidemic coupled with no deal on oil production decrease in 1Q 2020 led to significant drop in oil prices and increased global markets volatility. WTI oil as of April 20, 2020 was traded in the negative, reaching the minimum of USD -37. However it was only applied to some select contracts of American oil sorts. As compared with December 31, 2019 Brent and Urals prices dropped by 26% and 23% correspondingly. Pandemic, as well as long-term downward trend on oil prices below the budgetary rule level, with geopolitical risks on the rise due to US presidential elections led to ruble devaluing by 20% by the end of the year.

Risk	Description	Key Mitigating Actions
Interest Rate Risk	The risk of losses due to adverse fluctuations of market interest rates.	Analysis of the Bank's exposure to interest rate risk is based on the forecast of unfavorable changes in the current value of the Bank's assets and liabilities. The key criterion for measuring this risk is the sensitivity of capital to the general interest rate level. Another criterion is the sensitivity of annual net interest income to changes in the general level of interest rates. Given the available forecast, if interest rate movements appear unfavorable to the Bank's interest rate risk exposure, the decision is made to regulate the level of risk by undertaking any of the following actions: — modification of transfer prices, basic interest rates and banking product rates aimed at changing the structure of the incoming customer operations flow to manage the asset/liability ratio; — operations on the financial market to change the Bank's interest rate risk position, including the adjustment of the debt securities portfolio duration, medium- and long-term fixed-rate interbank borrowing and lending, interest rate swaps, etc. In 2020 ruble-denominated operations rate decreased significantly. Particularly, the Central Bank of Russia notched the key rate down four times in the total amount of 2%. This trend manifested due to low inflation. Monetary policy easing was necessary to push back against prevalent disinflationary risks on the back of global pandemic. In US dollar-denominated assets interest risk management was analyzed by the Bank in terms of Russia's implicit risk and basal international interest rates levels. Interest rates in terms of Russia's risk margin went down in the course of 2020, revealing high volatility. The Bank kept the gap between assets and risk-sensitive liabilities at a minimum.

Risk	Description	Key Mitigating Actions
Stock Market Risk	The risk of losses due to adverse changes in the market quotations of trading securities and derivatives.	To manage the stock market risk, the Bank uses: — open and total position limits for investments in securities of various issuers and on groups of securities; — limits on sensitivity to stock market risk factors; — limits on maximum daily transaction valuations; — option position limits; — stop-loss limits for groups of securities; — VaR limits; — daily monitoring of the stock market risk and compliance with the fixed limits. In building its securities portfolio, the Bank continues to maintain a conservative approach. The volume of limits on equity securities remains small relative to the total limits on securities. REPO transactions represent a significant proportion of securities transactions. As of January 1 2021, the share of bonds amounts to 96% of the Bank's securities portfolio (total volume of trading and investment securities). In forming its bond portfolio, the Bank gives preference to first-class credit quality securities. The share of bonds included in the Lombard List of the Bank of Russia amounts to 74%.
Currency Risk	The risk of losses due to adverse exchange rate fluctuations.	Currently, management of the currency risk is carried out on a daily basis. The Bank monitors compliance with open currency position limits, as regulated by the Bank of Russia, and calculates the value of currency risk in accordance with procedures established by the Bank of Russia. To manage the currency risk, the Bank uses: — limits on sensitivity to risk factors of currency and money market; — open foreign exchange position limits; — forward foreign exchange position limits; — option position limits; — VaR limits; — stop-loss limit. The principal volume of limits is set on hard currencies. Limits on other currencies are negligible.

Risk	Description	Key Mitigating Actions
Commodity Risk	The risk of losses due to adverse fluctuations of the commodity market instruments prices.	The following measures are applied to limit this risk: — limits on sensitivity to risk commodities market; — open and aggregate position limits on investments in certain types of underlying assets and on investments in underlying assets with certain specifications; — option position limits; — stop-loss limits on commodity market instruments; — VaR limits; — daily commodity risk and limit compliance monitoring. The majority of the limits were established for oil-related instruments.
Operational Risk	The risk of losses due to inadequate or erroneous internal processes, actions of employees and systems or external events.	The Bank's approach to operational risk management is aimed at reducing the risk to an acceptable level by carrying out measures to prevent situations that could be a source of the risk, as well as by insuring against operational risks that are beyond its control. The Bank employs two main approaches to operational risk (OR) management: — top-down approach — OR management in terms of consequences caused by OR. This approach implies statistical data gathering in terms of OR events in the set format, aggregation and analysis; — bottom-up approach — OR management in terms of divisions, banking products and processes. New (and changing) products risk factors analysis is essential in this approach. The Bank's OR management process implies: — OR identification; — data registration concerning internal OR events and OR events database losses; — OR evaluation; — choice and implementation of OR reaction approach as a result of the evaluation; — OR monitoring. In order to minimize the operational risk, the Bank establishes limits of loss from operational risk incidents for its major activities. A number of measures have been developed to ensure continuity of the Bank's operations and/or recovery of the Bank's operations in case of critical and emergency situations. The Bank established backup sites, where backup workstations are set up and equipped to ensure continuity of the critical business processes.

Risk	Description	Key Mitigating Actions
Strategic Risk	The risk of losses due to errors in strategic decision-making.	In order to mitigate the strategic risk, the Bank has adopted a system of strategic planning and analysis which comprises drafting and approval of the development strategy, ongoing implementation monitoring and, if applicable, adjustment/revision of the strategy. The Bank's strategy is drafted in accordance with its strategic development priorities in general and by particular business area, defining specific efforts required to successfully attain the strategic goals. In accordance with the Bank's Charter, the strategy and business priorities must be approved by the Supervisory Board. To ensure greater efficiency and transparency of strategic decisions, the Supervisory Board has established the Strategy Committee. Continuous monitoring of the strategy implementation progress includes various feedback tools designed to adjust and revise the strategic goals and priorities, as well as macroeconomic and competitive analysis. To successfully implement the strategy, the Bank has introduced a key performance indicator (KPI) management system designed to support the link between the strategic and operative levels of planning, as well as a strategic projects system channelling major qualitative changes.

WORKING WITH FOREIGN TAXPAYING CUSTOMERS

In full compliance with the current legislation, Bank Saint Petersburg makes all reasonable efforts available under present circumstances among its customers to identify legal entities and individuals that are subject to foreign laws on foreign account taxation (for foreign taxpayer accounts), including Chapter 4 of the US Internal Revenue Code of March 18, 2010 (Foreign Account Tax Compliance Act, or FATCA).

Bank Saint Petersburg is registered with the US Internal Revenue Service as a Participating Foreign Financial Institution under the Global Intermediary Identification Number (GIIN) TQQXV5.99999.SL.643.

The Bank has internal regulations in place, including criteria for classifying customers as foreign taxpayers, and methods for obtaining relevant information from them. The Bank conducts its customer identification procedures within the time limits stipulated by the FATCA.

The Bank systematically briefs its employees on various issues related to identifying foreign taxpayers among its customers.

ANTI-MONEY LAUNDERING PROCEDURES

The Bank's policies and procedures for counteracting money laundering are based on the applicable legislation of the Russian Federation. The Bank has developed the necessary internal regulations and procedures to prevent money laundering and financing of terrorism. These procedures are aimed at, among other things, minimizing the risk of the Bank, being used as a money laundering tool, protecting the Bank from financial and reputational risks and increasing the confidence that its banking services are available only to bona fide customers.

The Bank's procedures for preventing money laundering and financing of terrorism include the Know Your Customer (KYC) procedures, detection of suspicious transactions and information storage. All the information obtained in the process of counteracting money laundering is confidential, except for the cases when it is supplied to the Federal Service for Financial Monitoring, in accordance with the applicable legislation. The Bank's employees receive training on counteracting money laundering at least once a year.

The Bank's Financial Monitoring Department monitors customer transactions and the activities of all units with regard to compliance with the applicable Russian legislation on counteracting money laundering and financing terrorism.

COST OF RISK DYNAMIC ANALYSIS

The Bank's risk management system has undergone significant changes, addressing new challenges of the last 10 years.

The period from the early 2000s until 2008 was marked by absence of any considerable defaults in the market and the resulting lack of required statistics for development of efficient risk management models, thus there was no regular risk management in Russia in those years. The Bank created major part of its provisions on the growth of the loan portfolio, which doubled every year until 2008. High net interest margin excessively covered any risks, for this reason the provisions did not put pressure on the Bank's financial results.

The crisis of 2008–2009 demonstrated existing problems and the necessity of changes to be introduced into the risk management approach. Problem loans provisions started to contribute a major part of created provisions.

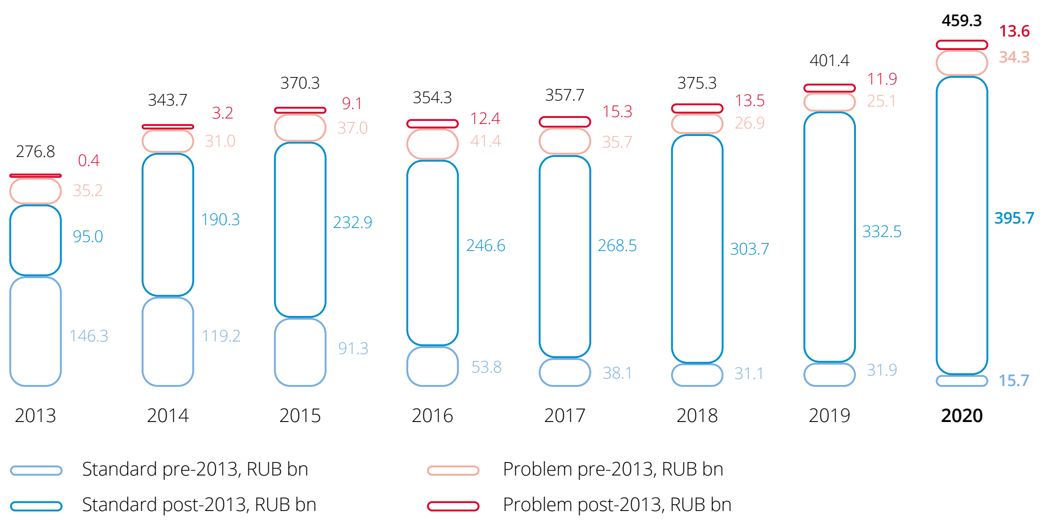
Starting from 2009, a significant work has been carried out for building a new risk management culture, including implementation of the corporate customers ratings model. Within a few years, the best practice was implemented in the daily risk management procedure of Bank Saint Petersburg and started to be used for evaluation of each loan project.

After implementation of leading risk management practices based on the accumulated expertise and loss record, since 2013 a "new" quality of the loan portfolio has been established with an integrated risk assessment system. "Old" problem loans granted before 2013 continued to contribute a major share to the total cost of risk for the last five years and kept providing a significant negative impact on the Bank's financial results.

Due to consistent establishment of the new risk management culture, starting from 2013 the Bank has obtained a "new" quality of the loan portfolio, which accounted for 89% of the loan portfolio as of January 1, 2021. To sum up, due to both repayment and writing off of problem loans granted before 2013, their share in the total loan portfolio is decreasing every year (accounted for 7% as of January 1, 2021), and the remaining problem loans were covered by provisions to a great extent.

For five years, starting with 2016, the cost of risk for pre-2013 loan vintages decreased from a peak of 2.7% to 0.4%, while the cost of risk for new loans granted after 2013 remains stable at around 1.0-1.1%.

Loan portfolio dynamics



Cost-of-Risk dynamics