Luminor Holding
Pillar 3 Report
2022

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Luminor Group is disclosing information which is not (a) regarded as immaterial, proprietary, or confidential in accordance with Article 432 of the CRR, (b) protected under the law, (c) related to operational events that could threaten the security of Luminor's operational processes, (d) undermining the market position of Luminor or result in an increase of reputational risk. The Pillar 3 report is approved by the Supervisory Council of Luminor Holding.

About us

Luminor is the leading independent bank in the Baltics and the third-largest provider of financial services in our region. We serve the financial needs of individuals, families, and companies. We are here to improve the financial health of our customers and our home countries, and to support their growth. Further information about us can be found at www.luminor.ee

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Cover image: Our headquarters office in Tallinn, Estonia

SCOPE OF DISCLOSURE

Luminor Holding AS is a financial holding company incorporated in Estonia which solely owns Luminor Bank AS. Both Luminor Holding AS and Luminor Bank AS are directly supervised by the European Central Bank (the ECB). In this report, Luminor Holding AS together with Luminor Bank AS and its subsidiaries are referred to as the Group, Luminor Group or Luminor Holding, and Luminor Bank AS with its subsidiaries is referred to as the Bank or Luminor.

The Risk Management and Capital Adequacy Disclosure ('Pillar 3') report is prepared according to the EU Regulation No 575/2013 (the CRR) Titles II and III of Part Eight, European Commission implementing regulations as well as the Implementing Technical Standards on public disclosures by institutions EBA/ITS/2020/04. The Pillar 3 report is part of the capital adequacy framework requiring to disclose comprehensive information about Luminor's risks, risk management policies, and associated capital.

The following table illustrates the pages on which the qualitative Pillar 3 reporting requirements are disclosed. The regulatory requirements have been fulfilled to the extent applicable to Luminor.

Regulatory disclosure requirements	**CRR Article(s)**	**Page(s)**
ICAAP information (EU OVC)	438(a,c)	9-10
Institution risk management approach (EU OVA)	435(1)	5-23
Disclosure on governance arrangements (EU OVB)	435(2)	5-7, 11, 16, 19, 26-28
Disclosure of LR qualitative information (EU LRA)	451(1)(d,e)	10
Liquidity risk management (EU LIQA)	435(1), 451a(4)	18-21
General qualitative information about credit risk (EU CRA)	435(1)(a,b,d,f)	5-6, 11-15
Additional disclosure related to the credit quality of assets (EU CRB)	442(a,b)	12
Qualitative disclosure requirements related to CRM techniques (EU CRC)	453(a-e)	11-13
Qualitative disclosure requirements related to standardised model (EU CRD)	444(a-d)	15
Qualitative disclosure related to CCR (EU CCRA)	439(a-d)	13-15
Qualitative disclosure requirements related to securitisation exposures (EU SECA)	449(a-i)	17
Qualitative disclosure requirements related to market risk (EU MRA)	435(1)(a-d)	16-17
Qualitative information on operational risk (EU ORA)	435(1), 446, 454	22
Remuneration Policy (EU REMA)	450(1)(a-f,j,k), 450(2)	24-25, 27
Accompanying narrative information (EU AE4)	443	21
Qualitative information on interest rate risks of non-trading book activities (EU IRRBBA)	448(c-g)	16-17
Qualitative information on Environmental, Social and Governance risks	449a	29-35

The Pillar 3 report is focused on the description of policies and strategies for managing risks within Luminor Group and should be read in conjunction with the Luminor Holding Annual Report 2022 and the quantitative tables disclosed in accordance with the Implementing Technical Standards EBA/ITS/2020/04 and Commission implementing regulation (EU) 2022/2453 in the Excel format as follows:

1. EU OV1 Overview of risk-weighted exposure amounts
2. EU KM1 Key metrics template
3. EU LI1 Differences between accounting and regulatory scopes of consolidation and mapping of financial statement categories with regulatory risk categories
4. EU LI2 Main sources of differences between regulatory exposure amounts and carrying values in financial statements
5. EU LI3 Outline of the differences in the scopes of consolidation (entity by entity)
6. EU LIB Other qualitative information on the scope of application
7. EU PV1 Prudent valuation adjustments (PVA)
8. EU CC1 Composition of regulatory own funds
9. EU CC2 Reconciliation of regulatory own funds to balance sheet in the audited financial statements
10. EU CCA Main features of regulatory own funds instruments and eligible liabilities instruments

11. EU CCyB1 Geographical distribution of credit exposures relevant for the calculation of the countercyclical buffer
12. EU CCyB2 Amount of institution-specific countercyclical capital buffer
13. EU LR1 LRSum: Summary reconciliation of accounting assets and leverage ratio exposures
14. EU LR2 LRCom: Leverage ratio common disclosure
15. EU LR3 LRSpl: Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures)
16. EU LIQ1 Quantitative information of LCR
17. EU LIQB Qualitative information on LCR, which complements template EU LIQ1
18. EU LIQ2 Net Stable Funding Ratio
19. EU CR1 Performing and non-performing exposures and related provisions
20. EU CR1-A Maturity of exposures
21. EU CR2 Changes in the stock of non-performing loans and advances
22. EU CR2a Changes in the stock of non-performing loans and advances and related net accumulated recoveries
23. EU CQ1 Credit quality of forborne exposures
24. EU CQ2 Quality of forbearance
25. EU CQ3 Credit quality of performing and non-performing exposures by past due days
26. EU CQ4 Quality of non-performing exposures by geography
27. EU CQ5 Credit quality of loans and advances to non-financial corporations by industry
28. EU CQ6 Collateral valuation - loans and advances
29. EU CQ7 Collateral obtained by taking possession and execution processes
30. EU CQ8 Collateral obtained by taking possession and execution processes – vintage breakdown
31. EU CR3 CRM techniques overview: Disclosure of the use of credit risk mitigation techniques
32. EU CR4 Standardised approach – Credit risk exposure and CRM effects
33. EU CR5 Standardised approach
34. EU CCR1 Analysis of CCR exposure by approach
35. EU CCR2 Transactions subject to own funds requirements for CVA risk
36. EU CCR3 Standardised approach – CCR exposures by regulatory exposure class and risk weights
37. EU CCR5 Composition of collateral for CCR exposures
38. EU SEC1 Securitisation exposures in the non-trading book
39. EU SEC2 Securitisation exposures in the trading book
40. EU SEC3 Securitisation exposures in the non-trading book and associated regulatory capital requirements - institution acting as originator or as sponsor
41. EU SEC4 Securitisation exposures in the non-trading book and associated regulatory capital requirements - institution acting as investor
42. EU SEC5 Exposures securitised by the institution - Exposures in default and specific credit risk adjustments
43. EU MR1 Market risk under the standardised approach
44. EU IRRBB1 Interest rate risks of non-trading book activities
45. EU OR1 Operational risk own funds requirements and risk-weighted exposure amounts
46. EU AE1 Encumbered and unencumbered assets
47. EU AE2 Collateral received, and own debt securities issued
48. EU AE3 Sources of encumbrance
49. EU REM1 Remuneration awarded for the financial year
50. EU REM2 Special payments to staff whose professional activities have a material impact on institutions' risk profile (identified staff)
51. EU REM3 Deferred remuneration
52. EU REM4 Remuneration of 1 million EUR or more per year
53. EU REM5 Information on remuneration of staff whose professional activities have a material impact on institutions' risk profile (identified staff)
54. COVID-19 disclosure Template 1 Information on loans and advances subject to legislative and non-legislative moratoria
55. COVID-19 disclosure Template 2 Breakdown of loans and advances subject to legislative and non-legislative moratoria by residual maturity of moratoria
56. COVID-19 disclosure Template 3 Information on newly originated loans and advances provided under newly applicable public guarantee schemes introduced in response to COVID-19 crisis
57. ESG Template 1 - Banking book - Indicators of potential climate change transition risk: Credit quality of exposures by sector, emissions and residual maturity
58. ESG Template 2 - Banking book - Indicators of potential climate change transition risk: Loans collateralised by immovable property - Energy efficiency of the collateral
59. ESG Template 4 - Banking book - Indicators of potential climate change transition risk: Exposures to top 20 carbon-intensive firms
60. ESG Template 5 - Banking book - Indicators of potential climate change physical risk: Exposures subject to physical risk
61. ESG Template 10 - Other climate change mitigating actions that are not covered in Regulation (EU) 2020/852

RISK MANAGEMENT OBJECTIVES AND POLICIES

General information

Risk statement

The Management Board has approved the following risk statement as an accurate reflection of the relationship between Luminor's business model and its overall risk profile.

Luminor

Luminor is the leading independent bank in the Baltics and the third-largest provider of financial services in our region. Luminor serves the financial needs of individuals, families, companies and governments across Estonia, Latvia, and Lithuania. The Baltic banking market is competitive but profitable. We are the third largest bank with a market share of 17% in lending. We are here to improve the financial health of our customers and our home countries, and to support their growth.

Luminor is strongly capitalised with own funds of 19.4% composed entirely of Common Equity Tier 1 (CET1) capital and 9.6% leverage ratio. In 2022, Luminor paid a dividend of 90.0 million EUR and maintained its capital strength. During 2022, Luminor acquired 99% of Maksekeskus AS, the leading Baltic e-commerce payment service provider, which strengthened the Bank's presence in the fast-growing e-commerce payments market, broadened our product base, and supported our digital evolution.

Risk Management in Luminor

Luminor has established a comprehensive and robust internal control framework that underpins a strong focus on risk management and controls throughout the organisation. This includes a risk management framework which extends across all business lines and internal units, specifying policies, procedures, risk limits and controls that ensure adequate, timely, and continuous identification, assessment, measurement, monitoring, mitigation, and reporting of all material risks.

The risk management framework is designed in accordance with Luminor's objective to balance the rewards of taking risk to generate income with the risk of loss. The key principles, roles and responsibilities for risk management within Luminor are established and communicated via Luminor Risk Policy and Strategy. Detailed information on the risk management principles and policies applied to each material risk type is provided in the Luminor Holding Annual Report 2022, Note 2. General Risk Management Policies.

The Risk Appetite Framework is an integral component of the risk management framework and captures the aggregate level of risk that Luminor is willing to assume in pursuit of its strategic objectives. Luminor's risk appetite is reviewed and approved by the Supervisory Council at least annually to ensure that it reflects its financial plan as well as its business and risk strategy. The risk appetite is translated into overall risk appetites for each material risk type of solvency, credit, model, market, liquidity, operational, and business risks.

As per the internal methodology, each risk appetite is set to one of five different levels: low, low-to-medium, medium, medium-to-high, or high. Risk appetites, which are closely monitored at least once per quarter, are further described in risk appetite statements. Luminor's overall risk appetites range from low to medium classifications for all material risk types, reflecting the Bank's conservative risk profile and commitment to only assume risks which can be adequately assessed, managed, and monitored. Luminor does not participate in any activity nor provide products or services within the Bank which entail a material risk of contributing to unethical conduct, infringement of human or labour rights, corruption or serious environmental harm.

Luminor's conservative risk appetite translates to a firm commitment to preventing and detecting financial crime. The Bank regularly reviews its anti-financial crime (AFC) practices and invests in the requisite human and technological resources for managing and reporting any potential risk of financial crime. Furthermore, Luminor's policy of predominantly serving residents of the Baltic states and customers with strong personal or business connections to the region acts as an additional safeguard against money laundering.

In 2022, Luminor continued to incorporate ESG considerations into its business model and risk framework, as outlined in Luminor's Governance Policy and Sustainability Policy. Luminor has defined its ESG ambitions, which are to act responsibly and attain carbon neutrality, to support the transition to a low carbon economy, and care for Baltic social and environmental challenges. Many activities were executed in 2022 to realise Bank's ambitions.

To strengthen Luminor's ESG risk governance, the Bank updated its Sustainability Policy and ESG Risk Assessment Procedure and developed ESG Due Diligence Guidelines. Furthermore, to identify the ESG risks particularly associated with specific industries and to avoid deterioration of the existing and future creditworthiness of customers, Luminor developed an Industry ESG Risk Management Procedure, which includes sector guidance for the industries that have elevated ESG risks. During 2022, Luminor updated its Risk Policy and Strategy considering climate-related and environmental risks impact on its risk taxonomy by assessing ESG risk drivers and their transmission channels on existing risks on a best-effort basis. Luminor has committed to further improve the ESG risk driver analysis in line with improved data availability and analysis capabilities.

Luminor proactively fosters a sound, consistent, and deeply embedded risk culture as the foundation for effective risk management across the organisation. The management bodies' communication of risk management as a pillar of Luminor's strategy, combined with mandatory risk and compliance-based trainings across its business lines and internal units, ensures that risk management is perceived as a shared responsibility among all staff. Luminor's Risk Committee convenes at least quarterly and held 23 meetings during 2022.

Risk declaration

The Management Board confirms that Luminor's risk management arrangements are adequate and aligned with its corporate strategy and conservative overall risk profile.

Internal control framework

Luminor's internal control framework consists of three lines and is organised such that any possible conflicts of interest are avoided or escalated. Each line has a distinct role in promoting sound and effective risk management across Luminor.

- The first line, Luminor business and supporting divisions, are responsible for managing their risks according to Luminor's policies, procedures, and controls. The divisions in the first line must ensure that the aggregated level of risk they assume remains within the set risk appetite limits.
- The second line is a control function, comprising Compliance and Risk Divisions, which verifies that the first line is operating in line with its risk policies, procedures and control, and is independent of the divisions whose activities they are responsible for monitoring and controlling.
- Internal Audit serves as the third line and provides independent assessments of the risk management and controls in the first and second lines.

Please see the Luminor Annual Report 2022, Corporate Governance Report and Note 2. General Risk Management Policies for further details. The heads of Luminor's Compliance, Risk, and Internal Audit functions did not change during 2022.

Risk management framework

As part of the overall internal control framework, Luminor maintains a group-wide risk management framework which extends across all business lines and internal units, including internal control functions. The risk management framework provides an overview of all material risks and enables fully informed decisions on risk taking.

Risk identification

Risk identification is performed continuously and utilises various tools and processes. These include regular internal capital and liquidity adequacy assessment processes, stress tests, credit risk assessments, risk and control self-assessments, ESG and its individual risk drivers' materiality assessments, compliance risk assessments, enterprise-wide financial crime and sanctions assessments, business continuity and crisis management, as well as change risk management and operational risk incident management. Risk identification further serves as input for strategic and financial planning, scenario analysis, and the annual review of Luminor's Risk Taxonomy, where all identified risk types and sub-types are assessed for their materiality, underlying risk drivers (including ESG risk drivers), as well as risk control and mitigating actions are outlined. The outcome of the annual risk materiality assessment is stored in a central inventory and formalized in Luminor's Risk Policy and Strategy.

Risk appetite framework

The Risk appetite framework (RAF) defines the risk profile Luminor is willing to accept given its strategy and establishes limits to ensure that it remains within the set risk tolerance and overall risk appetite levels. It is a central component of Luminor's risk management framework and is applied to all structural units, functional areas, and business processes within the Bank.

The RAF sets Luminor's aggregate risk limits which are applied to the organisation and sets internal requirements which ensure that any limit breaches are reported in a timely manner. Risk exposures and limit utilisation are monitored on an ongoing basis and reported to Luminor's Management Board and Supervisory Council at least once per quarter.

Setting risk appetites

Setting risk appetites begins with Luminor's maximum risk capacity, which is defined as the level of risk Luminor can assume under stressed conditions given its regulatory requirements. The Supervisory Council then establishes Luminor's risk tolerance, which sets quantitative buffers above the risk capacity in both forward-looking stressed scenarios and under normal business conditions, as well as qualitative requirements known as risk tolerance statements. Finally, given the risk tolerance and Luminor's risk strategy, Luminor sets overall risk appetites for each material risk type or decides on adequate management buffers to cover material risk types. The risk tolerance may therefore be interpreted as the frame in which Luminor is willing to operate, while the risk appetite is set within this frame in accordance with its strategic objectives.

Risk tolerance statements

The risk tolerance statements established by the Supervisory Council serve as guiding principles for the entire organisation. These statements are aimed at ensuring compliance with all applicable laws and regulations, minimising the effect of operational risk events on customers, operating in accordance with the interests of consumers, running business in a responsible, sustainable and caring manner, ensuring quality of internal models and quantification methodologies, as well as maintaining sound critical processes and a favourable reputation across the media and other external stakeholders.

Aggregated risk reporting

Luminor maintains continuous and transparent monitoring, reporting, and escalation mechanisms which provide management with aggregated risk reports in a timely manner. The quarterly risk report offers an overview of Luminor's risk profile and is presented to the Management Board, Supervisory Council's Risk Committee, and the Supervisory Council. The report is also shared with the ECB. It includes an assessment of Luminor's prevailing risk profile, including the status of its risk appetite limits and Recovery Plan indicators, as well as information on observed trends and issues pertaining to Luminor's material risk types and emerging risks.

Recovery and Resolution planning

Recovery and Resolution planning are ongoing processes whereby institutions are required to maintain tools and build up capabilities as well as preparedness for crisis situations to facilitate the overall stability of the financial sector. The recovery and resolution framework is established by the EU Bank Recovery and Resolution Directive (BRRD).

Recovery planning

The Recovery Plan is developed in accordance with EU legislation. It is reviewed annually and the ownership of the plan rests with Luminor's Supervisory Council. The Recovery Plan is assessed on a yearly basis by the ECB.

The Recovery Plan i) defines the governance to trigger and carry out the conservation and recovery phase, i.e., escalation and decision-making processes, as well as internal and external communication, ii) establishes an indicator framework to activate the conservation and recovery phases, iii) assures continuation of critical economic functions and business lines during a severe stress situation and iv) assesses the available recovery options, outlines their implementation and quantifies their recovery potential within stress scenarios.

The Supervisory Council can decide to enter Luminor into the conservation / recovery phase consequent to either persistent breaches of RAF statements' red-light limits or a breach of conservation or recovery indicators. In case of material deteriorations of the indicator values that could put Luminor at risk of entering a conservation or recovery phase in a foreseeable period of time, the situation should be monitored closely, and the Recovery Plan can be activated without an explicit indicator breach if deemed reasonable by the Chief Financial Officer or the Chief Risk Officer. The decision to enter the respective phases would aim to conserve or restore Luminor's financial position in terms of capital and/or liquidity.

One of the core objectives of the Recovery Plan is to identify and assess measures to restore the financial viability of Luminor in crisis situations. Such measures represent recovery options, which aim to restore solvency and liquidity positions. Luminor maintains a wide range of recovery options, including financial measures to raise additional liquidity and available funding, implement cost reduction programmes, and to increase capitalisation levels. All recovery options are, in turn, assessed by their feasibility and financial impact and applied to reverse stress testing scenarios.

Resolution planning

Luminor's resolution authority is the Single Resolution Board of the European Banking Union (the SRB). While the SRB is responsible for proactively drafting and updating resolution plans for all banks under its remit, banks are responsible for cooperating with the resolution authority through providing the requisite data and information for resolution plans and ensuring resolvability. Resolution planning is an integral component of Luminor's risk management framework and the Bank maintains close cooperation with the SRB to ensure resolvability.

Solvency risk management

Luminor is well positioned to meet regulatory and internal capital requirements. Moreover, the capital levels are adequate to absorb large additional potential losses stemming from risks to which it is exposed or may be exposed to in the future.

Luminor's solvency risk and capital management aims to ensure that the capitalisation of the Bank is effective and used in an optimal way relative to the scope and risk profile of operations and aiming to comply with capital targets; is adequate to comply with minimum regulatory capital adequacy and buffer requirements; is sufficiently high considering Luminor Group's capital adequacy assessments performed by the Risk Division; ensures compliance with set risk tolerance as defined in the risk appetite framework; allows for consideration of growth opportunities in the market and achieves a competitive return on equity.

Luminor uses the Internal Capital Adequacy Assessment Process (ICAAP) to assess both available Own funds against regulatory capital requirements under the ICAAP's normative perspective as well as available Internal Capital against Economic Capital under the ICAAP's economic perspective.

Internal Capital Adequacy Assessment Process

The ICAAP is performed on a continuous basis and combines various centralised processes, ranging from e.g., risk identification, development of relevant macroeconomic scenarios, scenario analysis and financial planning to stress testing of the financial plan (Scenario Simulation) and risk quantification (Economic Capital). Luminor has set up internal governance arrangements to ensure that the ICAAP is an integral part of Luminor's Risk Management Framework and builds interconnections between various overall management and risk management processes.

Luminor has formulated a Risk Strategy for Solvency Risk, which aims to maintain regulatory and Internal Capital levels high enough to sustain Luminor through prolonged periods of stress. It further requires that Luminor's risk profile, financial plan and RAF ensure that Luminor stays above regulatory capital requirements under stress; tested against a severe adverse scenario with severity of at least 1-in-25 years in the normative perspective as well as that Luminor stays above Internal Capital requirements, which are quantified via designated Economic Capital models and tested against a time horizon of one year and a confidence level of 99.9% (economic perspective).

Regulatory Capital Requirements

Luminor's capital requirements are comprised of the minimum capital requirements, the Pillar 2 requirement set by the ECB, the Other Systemically Important Institution Buffer, the Capital Conservation Buffer, the Systemic Risk Buffer and Countercyclical Capital Buffer requirements set by the supervisory authorities in the Baltic countries per below.

Regulatory capital requirements and capital ratios, 31 December 2022, %	CET1	Tier 1	Total
Minimum capital requirements	4.50	6.00	**8.00**
Pillar 2 requirement	1.24	1.65	**2.20**
Total SREP Capital Requirement (TSCR)	**5.74**	**7.65**	**10.20**
Other systematically important institution buffer	2.00	2.00	**2.00**
Capital conservation buffer	2.50	2.50	**2.50**
Systemic risk buffer[1]	0.24	0.24	**0.24**
Countercyclical capital buffer[2]	0.22	0.22	**0.22**
Overall Capital Requirement (OCR)	**10.69**	**12.60**	**15.15**
Capital ratios	19.42	19.42	19.42
Capital ratios, excluding interim profits[3]	18.38	18.38	18.38

1. A sectoral Systemic risk buffer rate of 2% is applicable to the retail (natural persons) exposures in Lithuania secured by residential property
2. Countercyclical capital buffer of 1% is applicable to Estonian exposures from 7 December 2022. Lithuania raised it to 1% starting from 1 October 2023 and Estonia increased it further to 1.5% starting from 1 December 2023
3. 31 December 2022 excludes third and fourth quarter 2022 retained profit

Actual capital levels as of 31 December 2022 can be found in EU KM1, with the underlying risk-weighted exposure amounts in EU OV1.

In terms of a forward-looking approach, both the Financial Plan, which considers capital developments under a baseline and adverse scenario, as well as the Scenario Simulation approach under a severe adverse scenario show that Luminor's capitalisation stay above the regulatory requirements and the internally defined RAF limits over a three-year horizon.

Internal Capital Requirements

Internal Capital reflects Luminor's own view on how much capital is available to absorb losses using economic value considerations (as compared to the regulatory and accounting Own funds definitions). Economic Capital on the other hand reflects Luminor's internal assessment on how much capital it should hold against identified material risks (as compared to regulatory Pillar 1 capital requirements). For this, Luminor maintains designated models to quantify Credit, Model, Market, Operational, and Business risks. The time horizon to be considered is one year and the capital required is calibrated against a 99.9% confidence level, which is in line with Luminor's envisioned target rating. As of 31 December 2022, the utilisation of Internal Capital by the Economic Capital stood at 37.7%, well below internally defined thresholds to measure Luminor's capital adequacy from an economic perspective.

Considering both regulatory and internal capital requirements, Luminor's management bodies are of the view that the current and targeted capital levels are sufficient to support planned growth of business volumes as well as ensure the resilience of Luminor against severe adverse scenarios (i.e., ability to absorb losses above the TSCR assessed during the ICAAP).

Leverage

The leverage ratio is determined as Tier 1 capital divided by the total exposure measure, defined as the aggregate amount of assets and off-balance sheet items, subject to regulatory adjustments. This ratio ensures an additional level of protection against model risks and assessment errors. Luminor's leverage ratio decreased from 10.3% at the end of 2021 to 9.1% on 31 December 2022. The decrease was driven by a reduction in Luminor's own funds, primarily due to a payment of a 90 million EUR dividend and recognition of goodwill on the acquisition of Maksekeskus AS, as well as a 928 million EUR increase in loans to customers. See EU LR2 for an analysis of Luminor's leverage.

Luminor regularly monitors and evaluates its leverage ratio. Information on the leverage ratio is presented to Luminor's Management Board, the Supervisory Council's Risk Committee, and the Supervisory Council as part of quarterly risk reports. If necessary, the management bodies may decide on appropriate timely actions to decrease the risk of excessive leverage. Such actions may include increasing Tier 1 capital, limiting lending, reducing the offering of capital-consuming markets products to Luminor customers (derivatives in the Trading Book), reducing unused credit limits to decrease off-balance sheet exposures, as well as selling assets.

In line with the ICAAP approach, Luminor projects its Leverage Ratio as part of the Financial Plan under baseline and adverse scenarios as well as part of the Scenario Simulation approach. The latest ICAAP results indicate that the projected leverage ratio under all scenarios and stress tests remains above the regulatory minimum and internally defined limits.

Credit risk management

Luminor defines credit risk as the risk that a debtor or counterparty is unable to meet their obligations as they fall due, in part or in full. Credit exposures arise primarily from lending activities, including contingent liabilities, and from purchasing debt securities. The objective of credit risk management in Luminor is to maintain a low to medium risk profile of the loan portfolio that ensures profitability in the short and long term. Credit risk (including counterparty credit risk and credit valuation adjustment risk) is Luminor's largest risk type, representing 90.8% of risk-weighted exposure amounts at the end of 2022.

Luminor has developed a credit risk framework consisting of internal regulations governing credit risk management. The definition of credit risk, taxonomy, and risk appetite are described in the Risk Policy and Strategy and the Risk Appetite Framework. The principles of Luminor's credit risk management are outlined in Luminor's Credit Policy, Credit Strategies for Private Individuals, Legal Entities and Financial Institutions. Application of these principles and decision-making processes are regulated by relevant internal regulations.

Credit risk management within Luminor is performed across three lines. The business units representing the first line are primarily responsible for their assumed risks. Each business unit is responsible for daily credit risk management and maintaining the quality of the portfolio within the set risk appetite limits. The second line is the Credit Risk Department, which performs independent oversight, monitoring, and control of credit risk, and reports on credit risk management. The Compliance Division is also part of the second line. The Compliance Division controls and monitors Luminor's compliance with internal and external requirements. As the third line, Internal Audit reviews governance, credit risk management practices, and control processes as per risk-based audit plans.

The Credit Risk Department owns the credit risk framework, participates directly in the decision making for larger exposures, and performs post control activities based on samples of decisions made in the first line. The Credit Risk Department also ensures regular presentation of credit risk developments to Luminor's management bodies. Some controls, which are related to operational risk but affect credit risk, are performed by the Operational Risk Department. Credit risk modelling is performed by the Risk Analytics Department and credit risk model validation activities are the responsibility of the separate Model Risk Management and Validation Department. All aforementioned Departments report directly to the Chief Risk Officer.

Regular reports are prepared and presented to different management bodies to monitor the composition of the portfolio, to follow the level and development of the assumed credit risk, including adherence to risk appetite statements and credit strategy limits, and to manage the quality of the credit portfolio.

Credit decisions are made by credit committees and by authorised individuals according to defined decision-making authorisations which are risk-adjusted. The decision of the credit committee to grant a loan must be unanimous. Decision-making authorisations for individuals (credit officers, employees from business units, and the Credit Advisory and Restructuring Division) are personal and based on the competence level. Decision-making authorisation levels are listed in the Credit Manuals for Legal Entities, Private Individuals and Financial Institutions.

Strategies and policies to manage credit risk are described in the Luminor Holding Annual Report 2022, Note 2, General Risk Management Policies, Credit Risk.

Risk appetite and credit strategy limits

The overall risk appetite for credit risk is derived from the overarching solvency risk appetite. The overall credit risk appetite is further translated into risk appetite statements and risk appetite limits and cascaded to lower-level credit strategy limits, which business units must follow in their day-to-day operations. Quantitative credit strategy limits for legal entities, individual customers, and financial institutions are approved and followed up constantly with the aim to maintain the quality of the existing loan portfolio at an acceptable level, including by limiting the share of high risk and non-performing exposures in the portfolio. At the end of 2022, 94% of the loan portfolio had low or medium risk as per the internal risk classification.

Concentration risk management

Luminor manages, limits and controls concentration of credit risk – in particular, to individual counterparties and groups of associated counterparties as well as to economic sectors. In addition to the regulatory requirements to limit large exposures to a single customer or a group of connected customers, Luminor implements limits to economic sectors. Luminor's activity regarding risk concentrations is defined in the Risk Appetite Framework, Credit Strategy for Legal Entities and Credit Strategy for Financial Institutions.

Measurement of credit risk

In its capital adequacy calculations to calculate risk-weighted exposure amounts for credit exposures, Luminor uses the standardised approach, though risk models are essential elements of the credit process and tools for the management of Luminor's credit risk. Luminor measures credit risk using rating models within the internal ratings-based approach that estimate probability of default (PD), loss given default (LGD), and Exposure at Default (EAD). Luminor's internal ratings-based approach experience test period started in August 2021. The PD assessment is made by using the customer segment/product specific rating models for six homogeneous groups of customers. The LGD models calculate LGD for legal entities and private individuals based on the product types and collateralisation level if collateral exists. The EAD models estimate Exposure at Default and are segmented across customer types and facility groups. For more details, please refer to the Luminor Holding Annual Report 2022, Note 2, General Risk Management Policies, Credit Risk Measurement.

Rating models, which estimate PD and risk grade, are used to estimate the default risk of the counterparty, determine compliance of customers and exposures with the Credit Policy, determine the required decision-making level, and set requirements for the frequency of the follow-up within the regular monitoring process. In addition to credit decision-making, outputs of internal risk models are also used in credit pricing, loan portfolio quality monitoring, and risk reporting, as well as for the economic capital (risk-adjusted capital (RAC)) calculations. RAC is used for decision-making with respect to strategic capital allocation, i.e., for determining strategic segments in lending activity, capital planning for Luminor, and stress testing.

Luminor identifies default on an individual customer level when either a customer is past due more than 90 days on any material overdue amount to Luminor or the customer is considered unlikely to pay its credit obligations to Luminor, or both. For exposure to banks, the default is recognised when payments are overdue by more than 7 days. For default identification purposes, Luminor recognises the customer as past due if the sum of all unpaid overdue amounts of principal, interest, and/or credit related fees breaches absolute and relative materiality thresholds: in case of private individuals, more than 100 EUR and more than 1% of their on-balance sheet credit obligations to Luminor, and in case of legal entities, more than 500 EUR and more than 1% of its on-balance sheet credit obligations to Luminor. For more detailed information, please refer to the Luminor Holding Annual Report 2022, Note 2, General Risk Management Policies. Luminor equates "defaulted", "non-performing", and "credit-impaired" exposures for accounting and regulatory purposes. For some specific external and internal reports, Luminor recognises the exposures as past due if any unpaid overdue amount exists without application of the materiality threshold.

One of the unlikeliness to pay indications applied by Luminor is distressed restructuring of the exposure, where this is likely to result in a diminished financial obligation caused by the material forgiveness or postponement of principal, interest or, where relevant, fees. It has the same meaning as forbearance triggering non-performing status in accordance with financial reporting instruction requirements.

Credit risk mitigation

Credit risk mitigation is an integral part of the credit risk management process in Luminor. The main credit risk mitigation measures and other risk mitigation techniques are provided in the Credit Strategies for Legal Entities, Private Individuals and Financial Institutions. For an overview of the use of credit risk mitigation techniques see also EU CR3.

Luminor mitigates credit risk through collaterals or other measures. The types of collateral and mitigation measures considered by Luminor as the most acceptable for securing credit facilities to customers or other counterparties are: mortgages (mainly residential properties, commercial real estate); business assets (equipment, inventory, transport vehicles, receivables); guarantees; property rights over financial instruments (debt securities, equities, cash); and for counterparty credit risk management – transaction settlement via Delivery versus Payment principle ("DVP"), ISDA agreement with Credit Support Annex (CSA), requirements for financial collateral.

Collateral is the main credit risk mitigation measure applied. Collateral pledge is treated as a safety measure but never replaces the sustainable debt servicing capacity. When deciding on the type of collateral, the maturity of the loan is considered. Long-term financing and lending to business customers are generally secured. Long-term loans preferably should be covered by long-term property. Revolving facilities and consumer loans to private individuals are usually unsecured. To minimise the credit loss, Luminor may seek additional collateral from the counterparty in case of worsening credit quality.

Luminor has a dedicated internal regulation on collateral valuation. All collaterals in Luminor have to be evaluated and reviewed on a regular basis. Valuations performed by external valuers (or purchase price, whichever is lower) are used to define the real estate collateral value. Internal valuations of real estate properties are provided primarily for private individuals and are rather rare. In addition to valuation of real estate collaterals, internal valuers are responsible for quality control of valuations performed by external valuers in respect of credit transactions with private individuals. Credit analysts are responsible for quality control of valuations performed by external valuers in respect of credit transactions with legal entities. Internal valuers and credit analysts are part of the first line. The Credit Risk Department performs control of collateral values based on the information presented in the credit materials, and ensures second line internal controls through the collateral valuation back-testing process. For movable assets' external valuation, the purchase price of new assets, or the book value for existing assets is accepted. External valuation must be provided for movable assets with the book value exceeding the defined threshold.

Asset type-specific discounts are applied to determine the possible realisation value of the collateral. The haircuts are adjusted depending on the specific circumstances related to the particular collateral. Considering the rule that all assets pledged as collateral, except for land, debtors and financial assets, must be insured, 100% haircut (value of zero) is applied for non-insured collateralised assets. As a rule, Luminor does not accept real estate collateral located outside the Baltic countries. In general, there is no value assigned for collateral located abroad. In exceptionally rare cases, when a value is assigned for collateral located abroad, significant haircuts are applied as compared to the standard realisation rates.

The value of collateral is reconsidered periodically. The approach and frequency mostly depend on the type of collateral, the performing/non-performing status and amount of exposure. The value of residential real estate is recalculated periodically by applying relevant real estate indices. For leased assets after origination, the market value is adjusted by depreciation of the movable asset. The revaluation of collateral for non-performing exposures follows the ECB Guidance to banks on non-performing loans.

Additionally, Luminor mitigates credit risk of certain corporate exposures via a synthetic securitisation agreement with the European Investment Bank and European Investment Fund. The agreement provides credit risk protection under severe economic circumstances. Under the guarantee, Luminor would be compensated for losses above the agreed Excess Spread and the First Loss Piece amounts. In Luminor, financial asset and liability netting is not used as a credit risk mitigation technique. Except for the synthetic securitisation of certain corporate exposures, Luminor does not use credit derivatives as a credit risk mitigation technique in the Banking Book.

For further details see the Luminor Holding Annual Report 2022, Note 2, General Risk Management Policies, in particular sections Collateral and Information about Collaterals of Loans.

Credit quality evaluation and impairment

The impairment calculation process is based on the IFRS 9 impairment requirements. The principles adopted and applied by Luminor are described in the IFRS 9 Framework Policy and the Procedure on Assessment of Loss Allowance for Expected Credit Losses under IFRS 9. A three-stage model is followed.

On each reporting date, Luminor assesses whether credit risk on a financial instrument has increased significantly since the initial recognition by analysing the change in the risk of a default occurring over the expected life of the financial instrument. The part of the portfolio for which no significant deterioration in credit quality has occurred since the initial recognition is assigned to Stage 1. The part of the portfolio for which significant deterioration in credit quality has occurred since the initial recognition is moved to Stage 2. Stage 3 is reserved for the credit-impaired part of the portfolio. If either or both events – more than 90 days past due on any material overdue amount and identification of unlikeliness to pay criteria – have materialised for a customer, the customer's entire exposure is treated as credit-impaired.

For financial assets without a significant increase in credit risk since the initial recognition, loss allowances equal 12-month expected credit losses. For financial assets for which a significant increase in credit risk was observed, lifetime expected credit losses are calculated. Loss allowances based on lifetime expected credit losses are also calculated for credit-impaired assets and for purchased or originated credit-impaired assets (POCI) – regardless of the changes in credit risk during the lifetime of a POCI instrument.

Management of watch list exposures

Ongoing credit monitoring is an integral part of the credit process, and it is performed during the entire lifetime of exposures. As part of the credit monitoring process, an assessment of whether an exposure corresponds to any watch list criteria and should therefore be put on a watch list is performed. Decisions on whether an exposure shall be included in the watch list, as well as exceptions for not placing it on the watch list, are made by the relevant decision-making body.

Watch list exposures are exposures exceeding 500 thousand EUR on a customer group level, which mainly are high risk customers according to Luminor's internal risk classification. These exposures are characterised by various negative developments that have led or might lead to financial difficulties. For example, changes in the geopolitical situation, worsened industry conditions, loss of the main customer or supplier, owners' conflict, constrained liquidity, reduced debt service capacity, insufficient capitalisation, etc.

The purpose of the watch list is to identify performing customers that require special follow-up due to the aforementioned negative developments on a timely basis in order to perform proactive management of an exposure by implementing necessary remedial measures, discontinuing the customer relationship, and implementing relevant measures to prevent or reduce losses. Watch list exposures have a high risk of migrating to non-performing status and are, therefore, closely monitored (a quarterly review procedure is followed as a general rule). A customer may be removed from the watch list when the basis for putting the exposure on the watch list no longer applies or the exposure and Luminor's position have improved due to other factors. In addition to the aforementioned removal criteria from the watch list, there must be no substantial concerns that the customer's financial situation will deteriorate in the foreseeable future. The decision regarding removal is made by the relevant decision-making body.

Management of non-performing loans

Luminor's strategy is to reduce the level of non-performing loans (NPL) in line with the separate NPL strategy and operational plan which is approved by the Supervisory Council. The NPL strategy seeks to manage the reduction of Luminor's existing NPL portfolio across the NPL lifecycle and provide proactive measures to control and manage new inflow. Besides the overall NPL management objective to minimise the NPL portfolio, Luminor also aims to minimise economic losses. Where it is possible to develop a viable solution, Luminor seeks to restructure loans rather than take possession of collateral. This primarily involves adjusting the payment schedule to match the customer's financial capacity (temporarily reducing principal repayments, extending payment terms) and agreeing on new loan conditions. For an overview of the NPL portfolio, see also EU CR1.

Counterparty credit risk management

Counterparty credit risk (CCR) is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. Counterparty credit risk management aims to avoid potential losses and is an integral part of credit risk management in Luminor. High level guidance for counterparty credit risk management is specified in the Credit Manual for Legal Entities, in the Credit Strategy for Financial Institutions and further described in the Credit Manual for Financial Institutions.

Counterparty credit risk is primarily managed through selecting high-quality counterparties, limiting exposures to each counterparty, establishing settlement limits, regularly valuing exposures, and collateralising exposures. Luminor does not have any triggers for posting additional collateral given a credit rating change. At least once a year, Luminor reviews the credit limits set for each counterparty. On a quarterly basis, Luminor monitors developments of the external ratings of counterparties, and a review of credit limits is initiated as soon as the respectively defined early warning signals occur. For counterparties, which are financial institutions and where external ratings are available, own funds requirements for credit risk are calculated based on the external ratings. For further details, see also Luminor Holding Annual Report 2022, Note 2, General Risk Management Policies, Due from Banks and Other Credit Institutions.

Counterparty credit risk reporting specifics

Luminor reflects counterparty credit risk and uncertainty around the valuation in fair values of over-the-counter derivative positions. Considering CCR exposure, the market value of individual OTC derivatives can be reduced by credit valuation adjustment.

Market risk management

By conducting banking and trading activities, Luminor generates open positions which are sources of market risk. Banking operations include lending, funding, and operations related to customer business. In Luminor, trading activities involve transactions in debt securities or derivative instruments.

The Bank assumes market risks according to its business and risk strategy, and the level of market risks the Bank is willing to assume is defined in the Risk Appetite Framework. Luminor has a low risk appetite for market risk. Market risk represented 0.4% of risk-weighted exposure amounts at the end of 2022 (EU MR1, EU OV1). The most significant parts of market risk for Luminor are interest rate risk and credit spread risk. The significance of other risks is lower as Luminor does not have open positions in commodities, nor equity instruments for trading. Customer related foreign exchange flow is managed through daily hedging activities, and all derivative deals with customers are equally hedged.

The materiality of all types of market risk for Luminor is assessed on an ongoing basis. The maximum acceptable level of specific risk is defined in the Risk Appetite Framework, as well as in the lower-level internal limits below the Risk Appetite Framework which business units must follow in their day-to-day operations.

Market risk management and control is organised in three lines, as per Luminor's internal control framework. The first line is the ongoing risk management and internal control by the business units. Each business unit is responsible for daily risk management within their area and for ensuring risks remain within the defined risk appetite and set limits. The second line is the Market and Liquidity Risk Unit, which serves as independent control function. Luminor's Internal Audit Division performs validation of all related processes as the third line.

Luminor has defined and manages market risk based on a clearly defined Market Risk Management Framework (MRMF), and additionally supported by a Limit Framework, which defines the governance, infrastructure, tools and processes required to manage market risks adequately and effectively. A comprehensive set of policies and guidelines has been implemented to aid operational effectiveness. Market risk stress testing is an integral component of the MRMF. Stress tests are performed regularly, reviewed for potentially required actions which are timely implemented when needed.

Market risk reporting specifics

Regular reporting, including daily and ad-hoc reports are performed to ensure that management, the Management Board, the Supervisory Council, and other relevant internal bodies receive transparent and complete information on market risk exposures. A comprehensive report on market risk is regularly prepared, reviewed and discussed by the Management Board and Supervisory Council. This report includes the review of compliance with the prevalent risk appetite and all limits, as well as qualitative comments on relevant changes during the reporting period.

In addition, targeted risk reports for relevant market risk types are regularly produced and distributed by the first line for management purposes. The set of reports includes such topics as interest rate risks in the Banking Book and Trading Book, Banking Book bond portfolio, which contains high quality liquid assets for liquidity management purposes, reports on credit spread risk, foreign exchange and commodity risks.

Interest rate risk

Interest rate risk in the Banking Book

Interest rate risk in the Banking Book arises from core banking activities such as lending, deposit taking and debt issuance. IRRBB can materialise through changes in the net present value of future cash flows from the Banking Book or changes in net interest rate income. Corresponding to the Bank's Risk Policy and Strategy, the Bank follows a conservative approach to IRRBB and seeks to balance assets, liabilities, and off-balance sheet items according to their maturity/repricing schedule to keep a low risk profile according to the internal limits approved by the Management Board and the Supervisory Council.

Based on the EBA guidelines EBA/GL/2018/02 on the management of interest rate risk arising from non-trading book activities, Luminor measures its exposure to IRRBB in terms of stressed economic value of equity (EVE) and net interest income (NII). Eight different interest rate shocks are applied for measuring EVE and NII sensitivity, six scenarios based on the above-mentioned EBA guidelines, and two own developed bank-specific scenarios, which are based on forward-looking implied volatilities derived from interest rate markets. In addition, Luminor has implemented early warning indicators in the form of Basis Point Value (BPV) time bucket limits to further monitor the repricing risk in the Banking Book.

For IRRBB modelling, a constant balance sheet is assumed for the NII perspective, and a run-off balance sheet is used for EVE modelling. Luminor has a quantitative approach for non-maturing deposits (NMD) modelling which is split into three different stages: i). volatility analysis for defining stable and non-stable deposits; ii). interest rate sensitivity analysis to capture price sensitivity; and iii). decay rate analysis to define behavioural maturity structure for core deposits. Average NMD maturity is 0.83 years, and the longest repricing maturity assigned to NMD is 15 years.

Moreover, respective limits for measuring EVE and NII impact to IRRBB are defined in the limit framework. Treasury is responsible for managing IRRBB exposures and keeping them within the levels approved by the Management Board and/or the Supervisory Council.

In terms of hedging, interest rate swaps are used to hedge the legacy bond portfolio designated at Fair Value through Profit and Loss (both swaps and bonds are shown at market value in accordance with IFRS requirements to decrease accounting mismatch, swaps are on the liability side) and to hedge issued bonds (swaps are on asset side) by applying hedge accounting. To manage the IRRBB, Luminor also uses natural hedges such as fixed rate bonds as well as interest rate swaps for macro hedge.

Interest rate risk in the Trading Book

Interest rate risk in the Trading Book (IRRTB) is relatively small in Luminor, as all open positions coming from over-the-counter derivatives are closed by the Markets Department with back-to-back transactions, while exposures of sovereign and corporate bonds must fit within conservative internal limits and correspond to strict quality requirements as well as Luminor's business and risk strategies.

The interest rate risk in the Trading Book is measured in terms of BPV, i.e., the change in the net present value of cash flows given a one basis point (0.01%) parallel shift in the market interest rates for different currencies. There is a dedicated limit set in the risk management framework for IRRTB. The limits for trading activities are approved by the Management Board.

Credit spread risk

Credit spread risk for Luminor arises from debt securities valued at Fair Value through Profit and Loss / Fair Value through Other Comprehensive Income in the Banking Book bond portfolio and exposures in the Trading Book debt portfolio.

Debt securities investments for the Banking Book are conducted in line with Luminor's internal investment, liquidity, and risk strategies. The main objective of Trading Book bond desk activities is to serve customers or counterparties originating from the Baltic countries or trading in Debt Instruments with Baltic origin by providing execution services in both primary and secondary markets. It is achieved either by executing back-to-back transactions or by taking short-term positions and building inventory in Luminor's fixed income trading portfolio.

Securitisation

Risk sharing transactions enable Luminor to free up capital for redeployment into its core business activities. The risk transfers are structured as a synthetic securitisation, performed through a collateralised financial guarantee structure where no assets are derecognised from Luminor´s balance sheet. Under such agreement, the counterparty to the transaction is covering a pre-agreed amount of incurred credit losses of the reference portfolio in accordance with the relevant regulations so that Significant Risk Transfer is achieved. The volume of positions Luminor has subjected for securitisation is illustrated in EU SEC5.

Securitisation positions are subject to the regulatory accounting treatment defined in the CRR. Such positions held in the regulatory Banking Book are given risk weights from 0% to 1250%, depending on their credit quality and subordination rank.

Synthetic securitisations are defined as transactions where an institution buys protection using financial guarantees or credit derivatives where the exposures are not derecognised from the balance sheet. For loans not derecognised, provisions are recognised for the expected losses on the loans without considering the protection bought. The protection is recognised separately, either as a derivative or a reimbursement right for guarantees.

Liquidity risk management

Liquidity Risk is the risk of Luminor being unable to fulfil its obligations in a timely manner or to the full extent when they fall due, without incurring significant costs in the process. The objective of liquidity risk management is to ensure that Luminor can always meet cash flow obligations, including on an intraday basis and across market cycles, and during periods of stress.

Luminor has defined and manages liquidity risk on the basis of a clearly defined Liquidity Risk Management Framework (LRMF), and additionally supported by a Limit Framework, which defines the governance, infrastructure, tools and processes required to adequately and effectively manage liquidity risks. A comprehensive set of policies and guidelines has been implemented to aid operational effectiveness. Liquidity risk stress testing is an integral component of the LRMF. Stress tests are performed regularly, reviewed for potentially required actions which are timely implemented when needed.

The liquidity risk management framework is aligned with Luminor's strategy and integrated into its enterprise-wide risk management process. The Liquidity Risk Management Policy and Liquidity Risk Management Strategy are approved by the Supervisory Council. Key elements of the liquidity risk strategy are:

- Liquidity Risk Appetite – as part of the RAF, expressing the tolerance for liquidity risks as anchor for other LRMF components, not least the Limit Framework
- Funding Strategy – ensuring all tools are defined and tailored to fulfil the Funding Plan and to meet strategic goals
- Funding Plan – ensuring that funding is adequately structured, liquidity tools and management are planned to meet the annual budget (especially funding structure, volume, price)
- Funds Transfer Pricing (FTP) – steering funding and liquidity generation and allocation by means of pricing
- Contingency Funding Plan – ensuring a clear governance and set of measures and tools to successfully navigate through possible adverse and stressed times
- Internal Liquidity Adequacy Assessment Process (ILAAP) – ensuring regular review of liquidity adequacy and review of the framework ensuring adequacy of liquidity at all times.

The risk appetite for liquidity risk is expressed for short-term and long-term liquidity horizons. The Liquidity Coverage Ratio (LCR) and the survival horizon analysed across different stress scenarios capture the short-term liquidity risk. The Net Stable Funding Ratio (NSFR) and loan-to-deposit ratio capture the long-term liquidity risk. The risk appetite is cascaded down to risk limits that business units must follow in their day-to-day operations.

Liquidity risk is managed across the three lines. The first line comprises all Luminor business divisions and supporting divisions. Treasury Department is responsible for daily liquidity management and FTP. To ensure funding in situations should Luminor need cash urgently and the normal funding sources do not suffice, Luminor holds a liquidity buffer that consists of cash deposits with central banks and high-quality securities that can be readily sold or used as collateral in funding operations. Market and Liquidity Risk acts as the second line and is responsible for providing independent oversight of liquidity risk. As the third line, Internal Audit is responsible for assessing the respective processes within the first and second lines.

Liquidity risk management is divided into short-term (up to one year) and long-term (over one year) risk management and intraday liquidity management. As mentioned above, Luminor holds a liquidity buffer for short term-liquidity needs. The buffer's size is subject to regular stress testing to ensure alignment with the liquidity risk appetite.

The liquidity buffer consists of central bank cash and central bank-eligible high-quality liquid securities that can be readily sold or used as collateral in monetary operations. The aim of short-term liquidity management is to meet the required level of funds to secure daily business operations and to ensure compliance with the reserve and liquidity requirements as well as with internal liquidity limits. Short-term liquidity is maintained through daily monitoring of Luminor's liquidity status - mainly cash balances with the central banks in all three countries and correspondent banks. Luminor operates in the euro area, but as local customers are dealing in the international markets, certain part of liabilities and subsequently assets, are denominated in other currencies, the largest of which is the US dollar followed by Scandinavian currencies and the British pound. None of these currencies exceeds 10% of the balance. To manage daily liquidity, follow Nostro limits, and generate additional NII from the difference in interest rates, Treasury enters into short-term swaps (usually shorter than 1 year) where the euro is bought, and the other currency is sold. The goal is to maintain non-euro balances at a level sufficient to cover daily business operations of customers without creating excessive exposures towards counterparts. Long-term liquidity risk management is supported by analysing the estimated future cash flows, taking into account deposit and loan portfolio growth as well as possible refinancing sources, and is an essential part of the Bank's long-term financial plan (which also includes funding needs among others).

The funding strategy forms an important element in Luminor's liquidity risk management framework and considers diversification of funding in terms of investor types, regions, products, and instruments. A key objective of the funding strategy is to ensure the sustainability of a self-funded banking group. Deposits are and will remain the main funding source for Luminor, supported by wholesale funding from third parties, and the Bank will continue to optimise its deposits towards a stable and diversified deposit base. The funding strategy considers market conditions, such as market capacity and credit rating. To that end, the strategy strives to preserve and improve Luminor's credit rating, enabling access to customer deposits and wholesale funding both in periods of stress and at an attractive cost.

Intraday liquidity risk arises from intraday timing mismatches of payments, where Luminor sends payments and expects to receive funds back later in the day to meet other outgoing payment obligations. Luminor mitigates intraday risk by effective operational management of intraday liquidity e.g., via position monitoring, payment and collateral management, customer and product management, and settlement limits. In addition, intraday liquidity risk can be mitigated by having access to a surplus of intraday liquidity, such as balances at central banks, unencumbered liquid assets that can be converted to intraday liquidity by pledging with the central banks, or balances with other banks that can be used for intraday settlement.

A top-down approach is used for liquidity management purposes, where the main liquidity risk metrics mentioned below are maintained on a Group level, while daily operations are executed and maintained on a country level where appropriate. Information about payments and nostro and central bank balances is available in each country. Therefore, deviations from the expected levels are investigated and their impact is assessed. Direct accounts with the central banks on a country level allow for access to monetary operations provided by the ECB, subject to the availability of eligible collateral, but there is also a set minimum reserve requirement for each country. Deposits and loans are offered in each country, so liquidity levels and needs might depend on both internal and external factors, and country-based activity can impact the liquidity metrics of the whole group. Wholesale funding in the form of bonds and bilateral loans with international organisations and other banks is attracted via Estonia only considering the liquidity position and needs of the entire Group and redistributed further if needed.

Liquidity risk reporting specifics

Liquidity risk is a part of Luminor's risk report, which is prepared and presented to the Management Board and the Supervisory Council on a quarterly basis. This report includes a follow-up on the status of risk appetite levels, limit utilisation, and qualitative comments on major changes during the reporting period. The Management Board also receives information on the liquidity situation on a regular basis from the Treasury Department. In order to support the identification process of increased risk in the liquidity risk position or potential funding needs, Luminor has developed early warning indicators which are monitored on a daily basis and reported to management as soon as a breach is noticed.

Measurement of liquidity risk

Liquidity risk is measured and monitored through the LCR, the NSFR, Survival Horizon and liquidity gap. The minimum regulatory requirement set in the CRR for LCR is 100%, however, Luminor has limits for a higher ratio in place to maintain a buffer for short term fluctuations. The LCR is intended to promote the short-term resilience of Luminor's liquidity risk profile and requires the Bank to hold risk-free assets that may be easily liquidated on markets in order to meet required payments for outflows net of inflows during a thirty-day crisis period without support from the central bank.

The NSFR is defined as the amount of available stable funding relative to the amount of required stable funding over a one-year time horizon. The minimum regulatory requirement set in the CRR for NSFR is 100%. However, Luminor holds a substantial buffer through a designated NSFR limit as part of the RAF.

The Survival Horizon is defined as a period with a positive net cumulative cash flow using liquidity reserves under assumed stress scenarios. This figure is calculated regularly and reported to Luminor's management bodies to ensure that the Bank has adequate liquidity against contractual and potential stressed outflows. Assumptions include but are not limited to a loss of a volatile portion of deposits, decrease in asset value of the liquidity portfolio, decrease in income from planned customer loan repayments, drawdown of undrawn credit lines, and withdrawal of balances from top depositors.

For the purposes of the liquidity risk-assessment, the liquidity gap is analysed taking into account the maturity of cash flows. Liquidity risk is restricted by imposing internal limits on the liquidity gap. Utilisation of this limit is subject to regular monitoring and reporting to various management bodies in Luminor. The liquidity gap is calculated by analysing Luminor's net refinancing situation within one week, one month, and three months applying a "business as usual" approach. Liquid assets and short-term liabilities are included in liquidity gap calculations for the respective terms (1 week to 3 months).

Liquidity stress testing

Liquidity stress testing is conducted to identify liquidity risk drivers and stress scenarios, which could impair Luminor's ability to meet cash-flow obligations when due, either because of scarce liquidity resources or significantly increased costs of required funding. Liquidity stress testing is an important tool for evaluating the impact of exceptional, but plausible events on the liquidity position of Luminor.

Liquidity stress-testing is conducted according to at least three scenarios: idiosyncratic, market-wide, and a combination of the two. The assumptions of these scenarios are detailed in the table below. The stress-testing period Luminor considers includes at least two phases: a short-term acute phase and a prolonged but less acute phase. To the extent practical, Luminor seeks to analyse the behavioural characteristics of its assets, liabilities and off-balance sheet items, including those that are non-contractual in nature, to facilitate Luminor's understanding of how these items may contribute to, or place demands on, its liquidity under stress scenarios.

A reverse stress test starts with the identification of a pre-defined outcome, and then explores scenarios and circumstances which may cause this outcome.

Scenario	Description
Idiosyncratic	Based on either real or perceived problems facing Luminor, which affect public confidence (e.g., asset quality problems, solvency concerns, rumours regarding Luminor's credibility). The essence of the scenario is a loss of a volatile portion of deposits and an inability to roll-over or replace many of Luminor's liabilities, resulting in the need to utilise the liquidity buffer. In this scenario, the rest of the financial sector is not directly affected.
Market-wide	Associated with an event, such as global financial distress, local government crisis, sudden and deep economic recession, a set of negative economic indicators, etc. The essence of the scenario is a decline in the liquidity value of some assets and deterioration in funding-market conditions.
Combined	Combines the worst assumptions from the idiosyncratic and market-wide scenarios.

Pricing of liquidity risk

Luminor maintains appropriate funds transfer pricing mechanisms to ensure that transactions are subject to market-based charges or benefits and incentivise behaviours that ultimately drive the balance sheet and liquidity profile according to the Bank's strategy. The internal funds transfer pricing framework indicates how Luminor's funding costs, as well as those costs associated with maintaining liquidity buffers, are allocated to specific business or product areas.

Contingency Funding Plan

The Contingency Funding Plan addresses the strategy for managing a liquidity crisis. The plan ensures that the Management Board can make well-informed, timely, and effective decisions in the event of a liquidity crisis. The plan sets out an approach for protecting Luminor from the negative and potentially damaging consequences of a liquidity crisis. The plan describes the activities to be performed and measures that will be applied during such a crisis as well as monitoring and reporting of events that would lead to the implementation of the Contingency Funding Plan.

Asset encumbrance

An asset shall be 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. At end 2022, Luminor's encumbered assets represented 13.2% of its total assets. An overview of encumbered and unencumbered assets is provided in EU AE1. The current level of asset encumbrance does not constitute any limitations and capacity constraints on potential bond issuances.

The largest share of encumbered assets in Luminor are used for the issuance of Covered Bonds, while the remaining encumbered assets are used as a collateral for central bank. Required over-collateralisation levels for the Covered Bond issuance programme are defined according to the relevant statutory regimes and rating agency requirements. Part of the assets are encumbered as collateral for the central bank and can be utilized in any standard operation with the central bank. The unencumbered assets that could be used for generating liquidity are limited to the unencumbered debt securities, equity instruments, and rated loans eligible for central bank financing operations. Luminor could potentially issue additional Covered Bonds for own use and pledge it to the central bank to receive funding in return.

Internal Liquidity Adequacy Assessment Process

The Internal Liquidity Adequacy Assessment Process (ILAAP) is a continuous process within Luminor. The ILAAP provides an assessment of liquidity adequacy through a comprehensive analysis of liquidity risk management practices in Luminor. It is integrated in the risk management framework and closely connected to the risk identification and assessment processes. Next to the ongoing assessment, Luminor prepares a fully comprehensive annual ILAAP documentation. Liquidity stress testing results as of the end of 2022 are assessed as acceptable and indicate a low to medium liquidity risk profile.

Liquidity risk statement

The Management Board confirms that Luminor`s liquidity risk is managed in accordance with the liquidity risk profile defined in the Risk Appetite Framework. The liquidity risk framework is set considering Luminor's strategy and establishes limits to ensure that it remains within the set risk tolerance and overall risk appetite levels. This framework includes the definitions of liquidity ratios that are measured and monitored on a regular basis e.g., the LCR, NSFR, Survival Horizon etc. Apart from the RAF, there are lower-level liquidity metrics, early warning indicators, and limits, which are also used to measure and monitor liquidity risk. During 2022, all regulatory liquidity metrics were within the approved limits and Luminor`s liquidity position remained strong.

In addition to the LCR, NSFR, and Leverage ratio disclosed in EU LIQ1, EU LIQ2, and EU LR2, respectively, the survival horizon is a key liquidity indicator which measures future cash flows and Luminor's liquidity position under stressed adverse scenario conditions. According to the Bank's liquidity profile, the survival period is set to be longer than 270 days. During 2022, the survival horizon remained stable across different stress scenarios and is longer than 365 days. Liquidity ratios and the Survival Horizon stress test results outlined above, make it evident that Luminor's liquidity position remains solid and adequate.

Liquidity risk declaration

The Management Board maintains that Luminor's liquidity risk management arrangements and governance systems are adequate considering the Bank's risk profile and strategy.

Operational risk management

Luminor defines operational risk as the risk of a negative impact (including financial loss, regulatory non-compliance, reputational damage, impact to customers, and/or process disruption) resulting from inadequate or failed internal processes, people, and systems or from external events. Operational risk in Luminor comprises of twelve sub-risks: Compliance risk, Conduct risk, Data management and protection risk, External theft and fraud risk, Information and communications technology risk, Information security risk, Legal risk, Money laundering, terrorism financing, sanctions and proliferation financing risk, Operational continuity and resilience risk, People risk, Process and reporting risk, Third party and outsourcing risk.

Operational risk represented 8.8% of risk-weighted exposure amounts at the end of 2022. Risk-weighted exposure amounts are calculated using the Basic Indicator Approach, with an overview of these in EU OR1. Luminor's operational risk appetite and corresponding limits are defined in Luminor's RAF. The overall risk appetite for operational risk is derived from the overarching solvency risk appetite and is further translated into risk appetite statements and cascaded down to lower-level limits. Luminor's operational risk limits have been validated and verified by quantitative and qualitative operational risk analysis tools.

Operational risk management in Luminor is governed by the Risk Policy and Strategy, Operational Risk Management Standard, and other relevant operational risk management framework documents. The Operational Risk Management Framework establishes requirements for identifying, managing, assessing, treating, monitoring, and reporting operational risks. The prime responsibility for the management of operational risk and compliance with framework requirements rests within the business and functional units where the risk arises. All of Luminor's business and functional units are responsible for fostering a sound risk culture in their respective reporting lines to ensure that employees understand the operations they perform, the risks inherent in these, and the importance of the controls they execute or oversee the execution of.

A key objective of the operational risk management function is to oversee operational risk management in Luminor and identify any deviations of Luminor's operational risk profile from the desired risk level stated in the risk appetite framework, so that any deviations can be effectively managed without significant detriment to Luminor, its customers, or other stakeholders. Luminor manages operational risk through the following tools:

- Operational risk incident management – Luminor's operational risk management framework includes processes to identify, analyse, manage, assess, and report operational risk incidents by maintaining a comprehensive incident dataset that includes all material incident experience.
- Risk and control self-assessments – Luminor performs bottom-up and top-down risk assessments to identify and assess non-financial risks, evaluate the existing control system, and define risk treatment activities. Assessments evaluate inherent risk, the effectiveness of the control environment, residual risk, and contain both quantitative and qualitative elements.
- Change risk management – Luminor's change risk management includes processes to identify, assess, and comprehensively manage potential risks related to the implementation of changes, and to define risk treatment activities before change decisions are made.
- Operational risk stress-testing and scenario analysis – the process to identify, analyse and measure a range of scenarios on capital and the profit-and-loss account to inform Luminor of the potential risk impacts that could materialise under extreme conditions.
- Business continuity and crisis management – activities that are designed to improve the ability of Luminor to respond to business interruptions and to restore its key activities, systems, and processes within an agreed period, while maintaining the critical processes and operational resilience of Luminor.
- Operational risk metrics – Luminor collects and assesses operational risk data against defined limit and key risk indicator thresholds. These metrics serve to inform Luminor of potential changes to its risk profile and risk levels.
- Operational risk benchmarking and comparative analysis – Luminor performs regulatory horizon scanning and monitors external developments and industry news.
- Operational risk assurance – the process of challenge, evaluation, review, and ongoing monitoring and testing of key controls, operational risk management tools, measurement activities, and reporting systems.
- Operational risk management framework implementation control – risk-based activities aimed to assess the relevance, consistency, adequacy, and effectiveness of the relevant operational risk management framework element implementation.
- Group insurance program – achieved through Luminor group-level insurance contracts, which are implemented to limit the financial consequences of undesirable events that may occur despite the Bank's control environment.

Model risk management

Model risk is the risk of adverse effects on capital adequacy, financial loss, poor business, or strategic decision-making from the use of inadequate or deficient quantitative models. The key principles and strategy for model risk management within Luminor are established in the Risk Policy and Strategy.

Periodical validation and proactive model risk management of Luminor's Credit Risk, IFRS 9, ICAAP, and ILAAP models is performed by the Model Risk Management and Validation Department according to the Model Risk Standard which is implemented through validation methodologies for specific model areas. Independent validation activities following yearly model identification, model inventorying and validation planning are conducted involving all other roles related to the models' life cycle stages. Identified model risks are registered in the internal system and addressed following the defined mitigation actions and deadlines.

During 2022, Luminor continued to implement an internal model risk management framework that was established in 2021. Also, continuous work has been done to update internal model risk regulation to ensure it is up to date, tailored to regulatory expectations and best industry standards. Quarterly model risk related reporting was updated as well by introducing additional metrics.

Business risk management

Business risk in Luminor constitutes the risk of not fulfilling internal strategic or financial objectives, caused by risks not covered by other risk types in Luminor's Risk Taxonomy. While for example, credit risk management deals with the mitigation of potential credit losses, business risk deals with the aspect of not fulfilling credit portfolio growth targets. As such, business risk in Luminor is managed through strategic and financial planning processes.

In its strategic and financial planning processes, Luminor ensures that the assumptions used consider an adequate assessment of i) the overall economic climate in its home markets, ii) its standing compared to its direct and indirect (e.g., non-traditional) competitors, e.g., in terms of branding, margins, product offering, iii) ongoing market trends and potential changes in consumer preferences and their impact on volumes and income generated from products, and iv) cost projections both in terms of necessary investments to reach strategic initiatives as well as considering domestic and foreign market developments.

While the above ensures an adequate business strategy and financial plan, business risk may arise if the organisation does not operate according to its strategy or financial plan. To manage this risk, Luminor ensures an adequate performance management framework and monitoring and reporting of relevant Key Performance Indicators on an ongoing basis.

In addition, group-wide strategic activities and other financial targets are established to drive Luminor's business and operations towards strategy implementation. Luminor's targets are further cascaded into division targets and strategic activities. The quarterly performance review process follows up on Luminor's performance and gauges whether it is on track to deliver its annual profitability target, as well as group-wide strategic activities and other financial targets.

The Performance Management and Strategy Department prepares an update on the status of financial targets and each division submits the status of the implementation of its respective strategic activities according to a green/yellow/red classification. Detailed discussions are organised at the Management Board to plan further steps, including corrective actions if needed. Additionally, discussions about peers and market developments are held to place Luminor's performance in the context of the broader business environment.

REMUNERATION POLICY AND GOVERNANCE ARRANGEMENTS

Remuneration policy

Luminor Group's strategy and objectives regarding remuneration are defined in its Remuneration Policy. The Remuneration Policy pertains to all staff and aligns their pay with the prevailing strategies, values, and objectives of the Group while promoting sound risk management. It is developed in accordance with the EU Capital Requirements Directive V (CRD V) and the CRR, among other applicable regulations. The Remuneration Policy is reviewed and approved by the Supervisory Council on an annual basis following the recommendation of the Supervisory Council's Remuneration Committee.

The Supervisory Council's Remuneration Committee ensures that Luminor Group's remuneration systems are consistent with effective risk management and deter excessive risk-taking. For the composition and mandate of the Remuneration Committee, including number of meetings held during 2022, please refer to the Luminor Annual Report 2022, Corporate Governance Report.

The People and Culture Division operate in close coordination with the Compliance and Risk Divisions to support the design and application of the Remuneration Policy and related processes, where:

- the People and Culture Division participates in the development and evaluation of Luminor's Remuneration Policy, with the aim of structuring remuneration levels and incentive schemes such that they attract and retain employees while remaining aligned with Luminor's risk profile.
- the Compliance Division advises on the consistency of the Remuneration Policy with regulatory requirements, reports on all identified compliance risks and issues of non-compliance, and provides input for performance criteria, severance payments, and setting variable remuneration pools. The Compliance Division may also provide input for individual variable remuneration based on the outcome of conduct cases. This would, for example, also include ex-post adjustments (malus and clawback) in case of severe misconduct.
- the Risk Division supports the definition of performance criteria which reflect Luminor's objectives, strategy, corporate culture, values, long-term interests, and risk appetite, assesses risk-taking of business units and, where possible, individual performance along risk-based criteria as input for calculating the actual variable remuneration pool and individual reward. The consideration of risk appetite limits in performance criteria ensure that identified current and future material risks are incorporated when determining variable remuneration.

At least once per year, the Internal Audit verifies the implementation of the requirements specified in the Remuneration Policy, in addition to reviewing the effects of Luminor's remuneration policies on its risk profile and how these are managed. The general meeting of Luminor's shareholders approves the remuneration for members of the Supervisory Council, and decisions setting the ratio between the variable and fixed component of remuneration of up to 200%. Luminor Group-wide provisions of the Remuneration Policy are implemented by all subsidiaries in their remuneration policies, practices, and processes.

Variable remuneration

Variable remuneration promotes a culture focused on performance and long-term company value within Luminor. The award of variable remuneration factors in risk-taking and supports Luminor in achieving and maintaining a sound capital base, in line with applicable regulatory enactments. Variable pay promotes Luminor's long-term interests, which are in line with the legitimate interests of depositors and other customers and is determined by: i) financial and non-financial targets set to Luminor's staff, ii) an overall assessment of the staff's compatibility with Luminor's values, leadership principles, and the Code of Conduct, iii) the staff's contribution to sustainable performance of Luminor. Therefore, the award of variable remuneration is conditional, discretionary, and contingent upon sustainable and risk-adjusted performance.

The system for awarding variable remuneration is based on a methodology that defines principles for calculating and allocating the variable remuneration pool, as well as the individual reward. Group-level and structural unit performance are considered to estimate and distribute the variable remuneration pool, while the individual reward is based on the results of the individual performance evaluation.

The following principles aim to align variable remuneration with sound risk management:

- The amount of variable remuneration cannot exceed 100% of the annual fixed remuneration for a staff member. The variable remuneration of staff members of Luminor's internal control functions (the Risk Division, Compliance Division, and Internal Audit) cannot exceed 75% of their annual fixed remuneration and does not depend on performance of the business units they control.
- Severance payments should reflect performance over time and not reward failure or misconduct.
- Material Risk Takers are identified in accordance with the criteria set in Commission Delegated Regulation (EU) 2021/923 of 25 March 2021 supplementing Directive 2013/36/EU of the European Parliament and of the Council.

With regard to the potential risk related to the performance of Material Risk Takers, payment of at least 40% of their variable remuneration is deferred over a period no less than 4 to 5 years and is paid out in suitable instruments which are subject to an appropriate retention policy designed to align incentives with the longer-term interests of Luminor. Before paying out the deferred portions of variable pay, Luminor Group evaluates risk-taking and performance once more to determine the need for ex-post adjustments i.e., malus during deferral and clawback after vesting.

Variable Remuneration in Luminor Group is based on two pillars. First, focus on performance: variable remuneration is based on the company's and employee's structural unit results, as well as individual performance. Performance at all levels is evaluated using both quantitative and qualitative criteria, as well as risk-adjusted measures to ensure alignment with the Bank's long-term business strategy, risk strategy, stakeholders' interests, and compliance with applicable regulatory enactments. Second, annual cycle: the financial year corresponds to the calendar year, which is used as the period for which variable remuneration is awarded. Generally, Luminor Group does not permit Guaranteed Variable Remuneration, with exceptions approved by the Supervisory Council.

Equality and diversity commitments

To support diversity, Luminor has developed an Equality, Non-discrimination and Diversity Policy (ENDD), approved by the Supervisory Council. The ENDD has been developed in accordance with legislation of labour relations, as well as other legal acts, to promote and support an environment which values and affirms equal opportunity, diversity, and inclusion in accordance with the universal principles of equality, fairness, and social justice.

Luminor fosters an environment which appreciates individual differences and the contributions of each team member, and promotes dignity and respect for every employee. Furthermore, the Bank is firmly committed to advancing equality among its staff, recognising the role of equality in facilitating collaboration and value creation for customers, stakeholders, employees, and society.

Luminor promotes equality in the workplace by applying equal selection criteria and conditions for recruitment, using equal performance evaluation criteria, setting equal salary ranges for equal work, creating equal working conditions and providing equal privileges, providing equal opportunities for improvement, professional development, requalification, and acquiring practical working experience, not tolerating any form of intimidation, bullying, scapegoating, harassment, sexual harassment or any other form of discrimination at the workplace, encouraging anyone who feels they have been subject to discrimination to raise their concerns and avoiding victimisation and protecting employees from adverse treatment or negative consequences as a reaction to complaints against discrimination or involvement in proceedings against discrimination when such situations arise.

To maintain independent opinions, critical thinking and to allow for a variety of views, management bodies, including the Management Board and Boards of Subsidiaries, are formed in line with local law and must be sufficiently diverse, including with respect to gender, age, geographical origin, education, and experience.

Directorships held by management body members

The members of the management body may not hold more than one of the following combinations of directorships at the same time: either one Management Board position and two Supervisory Council positions or four Supervisory Council positions. The restrictions provided shall not apply if the appointment is to: i) a position for representing the contracting state, ii) a position in an association, organization or another entity which is not established for the purpose of making profit through economic activities, or iii) if the Estonian Financial Supervision and Resolution Authority (Finantsinspektsioon) has granted authorization for assumption of an additional position. The number of directorships held by members of Luminor Holding's management bodies as of 31 December 2022 is:

Name	Number of directorships		
	Luminor	External	Total
Supervisory Council			
Nils Melngailis (Chair)	2	3	5
Maria Elena Cappello	2	1	3
Ottar Ertzeid	2	5	7
Mathias Patrick Laurent Favetto	2	2	4
Nadim Diaa El Din El Gabbani (Recalled effective 3 February 2023	2	1	3
Elanor Rose ('Elly') Hardwick	2	2	4
Michael Richard Jackson	2	2	4
Bjørn Erik Naess	2	4	6
Elizabeth Jane Nelson	2	0	2
Andreas Treichl	2	12	14
Management Board			
Mari Mõis (Chief Executive)	2	0	2

Material risk takers

Luminor Group is required to identify all staff members who can materially influence the risk profile of the Bank (Material Risk Takers) and Luminor's Asset Management Company (subsidiary). This process is conducted in accordance with the Estonian Credit Institutions Act, Commission Delegated Regulation (EU) 2021/923, ESMA Guidelines on sound remuneration policies under the UCITS Directive, and the specific sectoral regulatory enactments applicable to the Bank and the Asset Management Company.

Individuals are identified as Material Risk Takers based on qualitative and quantitative criteria. Qualitative criteria are linked to the role and decision-making power of the individual. For example, members of the management body and senior managers of material business units have the authority to significantly influence credit risk exposures and other. Quantitative criteria are associated with the actual remuneration of the individual e.g., high earners.

The identification of Material Risk Takers is performed annually by the People and Culture Division in collaboration with the Compliance and Risk Divisions, among other. The categorisation process and identified roles are approved by the Supervisory Council. There were 86 positions identified in 2022 as the Material Risk Takers.

Suitability and succession planning

Luminor Group has established a Suitability and Succession Planning Policy (Suitability Policy), approved by the Supervisory Council of the Bank and Holding. The Suitability Policy specifies principles which ensure that members of the management body, employees representing critical business or support function areas (Key Function Holders), Managing Director, and Officer possess the requisite knowledge, skills and experience and are suitable for their positions, and ensures an adequate reserve of staff for the Holding's and Bank's Management Board or Key Function Holder positions in the event of a vacancy.

Principles for selection, election, and re-election

While selecting, electing, or re-electing the members for the management body, a Key Function Holder, or Managing Director, Luminor's business and risk strategies, risk appetite, and governance framework must be considered. Luminor aims to achieve an adequately diverse composition of managing bodies, complying with the principles of diversity, as well as avoiding conflicts of interest. Appointees may not be discriminated against based on his/her gender, race, colour, ethnic or social origin, genetic features, religion or belief, membership of a national minority, property, birth, disability, age, or sexual orientation.

Criteria for assessing the suitability of members of the Management Body

All members of the management body, Key Function Holders, Managing Director, or Officer must be suitable at all times, individually and the management body collectively. Whilst assessing suitability, the following principles apply: i) the individual is considered to be suitable for the position, if he/she holds higher education (at least a bachelor's degree from a recognised university), has adequate skills (including soft skills), previous professional experience, and a proven track record of qualification by having attended different courses and trainings, ii) he/she must have an impeccable reputation (not only limited to business reputation) and has to be able to act with honesty and integrity, iii) to facilitate independent opinions and challenge groupthink, should have an independence of mind and perform his/her duties objectively, iv) absence of conflicts of interests is always required, v) understand Luminor's business, its main risks, and implications of the business, he/she should allocate sufficient time for the position and must take accountability for his/her actions within his/her area of responsibility. The level and nature of the required knowledge, skills and experience may differ for members of management bodies within the Bank and the Holding, Key Function Holders, Managing Director and Officers. Luminor has embedded climate-related and environmental risks as one of the areas to be assessed in the course of annual suitability re-assessment.

Principles for overseeing the suitability of key personnel

Luminor oversees the suitability of the management body members, Key Function Holders and Officers on an ongoing basis to ensure continuous suitability of the members of the management body individually and the management body collectively, in addition to Key Function Holders and Officers in accordance with internal and external regulations.

The responsible unit in Luminor performs the re-assessment of individual suitability and / or collective suitability in the following cases: i) one year has passed from the last collective suitability assessment, ii) the member of the management body, Key Function Holder or Managing Director assumes an additional position internally or externally, iii) there are concerns regarding the suitability or collective suitability, iv) in the event of a material impact on the reputation of a member of the management body, or Luminor, including cases where the members do not comply with Luminor's conflict of interest principles, v) where there are reasonable grounds to suspect that money laundering or terrorist financing has been or is being committed or attempted by a member of the management body, Key Function Holder, Managing Director or an Officer or there is an increased risk thereof in connection with Luminor, vi) as part of the review of internal governance arrangements e.g., changes of strategies, business model, shifts in responsibilities, etc.), vii) any event that can otherwise materially affect the Suitability of members of the management body, Key Function Holders, Managing Director, or Officers. The suitability assessments are documented.

Principles for succession planning

Succession planning is part of the talent management process, which builds a pool of trained employees who are prepared to fill key roles in the Management Board or assume positions as Key Function Holders when current leaders step down. These employees have the requisite skills, energy and leadership qualities to benefit Luminor across its spectrum of roles, departments and seniority levels.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE RISKS

Business strategy and processes

Integration of ESG risks into business model, strategy and processes

Luminor is committed to running business in a responsible and sustainable manner by setting objectives for reaching positive impact and reducing and / or mitigating the negative impact on the environment and society while developing financial products and openly disclosing achievements. Luminor is determined to integrate ESG-related arrangements and consider sustainability risks while organizing its business model, risk management framework, decision making, financing and other activities. Luminor is determined to identify, assess and monitor the current and forward-looking impact of climate-related and environmental factors on its business environment and Bank's impact on the environment to ensure the sustainability and resilience of its business model.

To strengthen the ESG governance Luminor has developed a Sustainability Strategy describing activities designed to foster sound implementation of the sustainability-related arrangements, achievement of the prioritized United Nations Sustainable Development Goals (UN SDGs) and engagements stipulated in the Sustainability Policy. Sustainability Strategy has three core elements: 1) to be responsible – with regards to conduct, consumption, and waste – and CO2 neutral in Bank's own operations, 2) to support the transition to a low-carbon economy and 3) to care for local Baltic issues, including employee wellbeing, diversity and inclusion and measurable community engagement.

Luminor's Sustainability Policy establishes general principles, roles and responsibilities, and measures that must be followed in all Luminor's business activities to ensure sound implementation of the sustainability-related arrangements, consideration of risks, and integration of ESG risk drivers into governance frameworks. It outlines the main sustainability principles and values Luminor follows in its business activities, decision making, remuneration, and relationships with Luminor stakeholders.

Climate-related and environmental risks are integrated in the Risk Policy and Strategy and Risk Appetite Framework, and Luminor's ESG principles defined in the Sustainability Policy shall be an integral part of risk management. In 2022, to strengthen Luminor's ESG risk governance, the Bank updated the Sustainability Policy and ESG Risk Assessment Procedure, as well as developed ESG Due Diligence Guidelines, Industry ESG Risk Management Procedure and ESG risk assessment tools. During the year, Luminor carried out a qualitative assessment of individual climate and environmental risk drivers impact on Luminor business areas and customers and defined mitigation measures for high impact areas. Moreover, Luminor initiated the development of a Climate and environmental risk related disclosure standard that establishes general principles, roles and responsibilities, that must be followed with regards to the sustainability-related disclosures, the underlying ESG and climate and environmental risk related materiality assessments and the risk drivers' integration into regular business strategy update.

In its activities, Luminor complies with international guidelines and principles and promotes inclusive, equal and diversity driven workplaces. For more details, please refer to the Equality and Diversity Commitments section of this report. The Bank's internal processes incorporate the requirements of legislation and best market practices. This is supported by Luminor's Code of conduct, Equality, non-discrimination and diversity policy, Remuneration Policy and Base salary management standard, and Luminor recruitment and development practices.

To contribute to sustainable development, Luminor prioritizes three of the UN SDGs: #8, sustained, inclusive, and sustainable economic growth; #13, climate action, and #16, peaceful and inclusive societies.

Luminor is committed to support its customers as they transition to a low-carbon economy and implement more sustainable practices, to reduce negative impacts of its business activities, and to become climate neutral in its own operations. To foster implementation of the obligations stemming from regulations and to contribute to lowering the effect of own activities, Luminor has set objectives for creating positive impacts on the environment and customers it serves. The following table presents these targets, as well as performance assessment against them.

Target	Description
Committed to Paris Agreement aiming to reach a net zero greenhouse gas emissions by 2050	Luminor has made progress on commitment to be carbon neutral by 2050 in its own activities for Scope 1, Scope 2 and Scope 3 operating emissions. In addition, Luminor has set an intermediate target of a 50% net reduction in greenhouse gas emissions by 2025. In 2022, Luminor's overall emissions were reduced by almost 10% compared to the previous year. Greenhouse gas emissions for Scope 1, Scope 2 and Scope 3 are provided in the Luminor Holding Annual Report 2022, section Environmental, Social and Governance (ESG).
50% reduction of operational CO2 emissions per FTE by 2025 and offset the remaining operational emissions	In 2022, Luminor's carbon emissions intensity of own operations in tCO2e per employee were decreased by 13% compared to the previous year.
By 2025, all facilities are using 100% renewable energy	Luminor has set a target to switch to renewable energy sources in all Bank's facilities by the end of 2025. In 2022, Luminor increased the usage of renewable energy to 41% of its total energy consumption. In the same period, the total energy consumption has been decreased by 19%.
Commitment to set Science-Based Targets (SBTs)	Luminor is committed to calibrate its corporate lending activities on science-based scenarios and to set Science Based Targets for the sectors where the emissions are high and Science Based Targets initiative methodologies are available. During 2022, Luminor has calculated its initial internal Science Based Targets to familiarize itself with the methodologies and understand data gaps. Luminor aims to submit them to Science Based Targets initiative for validation by the end of 2023.
By 2027, mortgage portfolio with EPC rating A shall constitute 30% of total mortgage exposure	In 2022, 23% of Luminor private mortgage loans were provided for A, A+ or A++ energy efficiency certificates buildings (data used for calculation is comprised of 7% real customer data, while the rest is estimated based on PCAF proxies). The Bank has established a target to support the green growth and is determined to increase the share of lending exposures to A, A+, A++ EPC labelled housing to 30% in 2027.
Increase the lending to energy efficient real estate and renewable energy related projects to 700 million EUR by 2030	In 2022, Luminor continued to finance lower-carbon energy projects and issued over 94 million EUR for renewable energy projects and over 166 million EUR for various real estate projects where the energy efficiency certification (EPC) assessed class was A or higher.
At least 20% of the total volume of bonds to be green or sustainability-linked by 2025	In 2022, 122 million EUR corresponding to 8.5% of the total volume of bonds Luminor managed was green, social or sustainability linked.

Luminor aims to direct more funding towards environmentally sustainable activities. The Bank has completed an analysis of the EU Taxonomy alignment criteria and their transposition into local legislation for six economic activities. Based on this analysis, Luminor developed tools for these sectors to determine the EU Taxonomy alignment of loans that the Bank issues and prepared a pilot for customers that do not fall under mandatory reporting obligations.

Engagement policies with counterparties on their strategies to mitigate ESG risks

Luminor is determined to assess adverse or potential adverse impacts on the society and the environment as a result of Bank's operational activities (including within its investment decision making processes to the extent provided by the Sustainable investment guidelines developed in 2022). In order to identify and address any adverse or potential adverse impacts from ESG risk drivers of own activities, Luminor has established the ESG Due Diligence Guidelines to be followed when the ESG Due Diligence process is applied in the Bank's business activities, decision making and relationships with employees, customers, vendors, and suppliers. The ESG Due Diligence Guidelines are developed in accordance with the OECD Due Diligence Guidance for Responsible Business Conduct and are aligned with Luminor's Risk Policy and Strategy and Sustainability Policy. Luminor conducts risk-based due diligence, taking the severity, nature and likelihood of the impact from ESG risk drivers into account. Luminor aims to identify adverse or potential adverse impact of its activities related to human rights, environment, social and governance, and their likelihood to affect Luminor. Luminor expects its customers, vendors and suppliers to adopt practices as Luminor to the extent possible to better integrate ESG risk driver management in their value chain and by taking responsibility for the impact of their business conduct on human rights, governance, society, and environment.

Luminor expects its suppliers to apply the same principles of responsible business conduct as the Bank does, thus in all vendor and supplier contracts Luminor includes the Code of Responsible Business Conduct for Third Parties (the Code). The Code outlines Luminor principles on responsible business conduct and fair social conditions, and requires third parties i) to have a written environmental policy and environmental management system, if required by applicable regulations, that is appropriate to the size, nature and risks of the third party's operations, ii) to implement an effective system to identify and minimize potential hazards to the environment, iii) to ensure fair employment practices and treatment of employees and iv) to commit to include the requirements specified in this Code in the contracts the third parties conclude with their cooperation partners.

Luminor is determined to engage within its decision-making processes, in innovative financing solutions to support no/low-carbon investments and climate change mitigation and adaptation opportunities, as well as to identify opportunities to avoid, minimise or reduce the greenhouse gas emissions in projects. Luminor also supports customers in developing climate adaptation measures and climate resilient investments as well as in managing the risks caused by climate change. Engagement with counterparties on their strategies to mitigate and reduce environmental risks is an integral part of the ESG risk assessment and management process, described in Risk management section below.

Governance

ESG risk governance model

Luminor has defined governance model, roles and accountabilities relating to ESG risk drivers and has integrated them into the existing policies. Luminor ensures that its governance structure considers both environmental and social factors to facilitate due identification, assessment and management of the ESG risks, to take appropriate strategic decisions, to set goals and targets and to report the progress to relevant stakeholders.

The Supervisory Council oversees and monitors that Luminor's strategic objectives and risk strategy are sound, effective, efficient and implemented in a consistent manner, oversees Luminor's risk culture and Risk Appetite Framework, setting and monitoring Luminor's Risk Tolerance and Risk Appetite. The Supervisory Council approves the Sustainability Policy and the Sustainability Strategy and monitors their implementation in Luminor. The Management Board regularly reviews the implementation of the ESG related requirements and ensures the reporting of the results to the Supervisory Council. The Supervisory Council oversees the Sustainability (ESG) risk management as defined in the Risk Policy and Strategy and considers the ESG risk drivers in its decisions following a risk-based approach.

The Management Board is responsible for developing and maintaining an effective Internal Control Framework and Risk Management Framework for Luminor and for regular assessments of the effectiveness of respective internal control and risk management processes. The Management Board develops and maintains the Sustainability Strategy and determines the responsibilities of those engaged in pertaining processes, main targets, and measures for achieving the set objectives. The Management Board ensures that strategic decisions implementation related to the ESG risk drivers are consistent with Luminor's risk tolerance and within the risk appetite limits established in the Risk Appetite Framework.

To manage the business integrity and sustainability matters on the Luminor Group level, a structural unit, Group Sustainability Department, has been established. Group Sustainability Department is responsible for Luminor Sustainability Policy and Strategy and for building up subject matter expertise in the ESG related areas.

The Committees of the Supervisory Council and of the Management Board support the management bodies in specific areas, including ESG risk related matters according to the responsibilities outlined in respective regulations of committees. The Supervisory Council Risk Committee is responsible for advising and supporting the Supervisory Council in setting and monitoring of Luminor's Risk Tolerance, Risk Appetite, risk strategy and other matters related to risk management according to the regulations of the committee. The Conduct Risk Committee is chaired by the Chief Compliance Officer and is managing and overseeing the development, implementation, and review of Luminor business integrity and sustainability matters, ensures the integration of ESG-related requirements into the Code of Conduct and advises the Management Board and / or Supervisory Council in raising awareness of Luminor's employees on the ESG risks through a strong risk culture. The Credit Committee ensures that the ESG risk drivers are considered in the customer credit decision making process according to the established risk-based approach. The Remuneration Committee verifies that the remuneration system of the Luminor conforms to effective risk management and reduces the risk of excessive risk-taking, including but not limited to the effective risk management with respect to sustainability risks, and assesses the achievement of performance targets and the need for ex post risk adjustment.

All Luminor divisions are responsible for following the Sustainability Policy and for the development of products and services by taking into consideration the principles established in the Sustainability Policy, considering the ESG risk drivers and adverse or potential adverse impacts to or from ESG risk drivers. Respective Luminor divisions (for their own activities) implement the risk management framework and bear the primary responsibility for assessing, managing and monitoring their risk levels in all risk categories, including ESG related risks. The Risk Division defines the Risk Appetite in collaboration with the Finance Division and the business divisions / Group functions and establishes a risk management and monitoring system. ESG related risk limits and key risk indicators (KRIs) / early warning indicators (EWIs) shall be established by the first and second lines.

The management of ESG risks through the risk drivers impacting existing risk types and sub-types is integrated into Luminor's risk governance process with roles and responsibilities allocated in accordance with Luminor's internal control framework consisting of three lines.

Reporting

Luminor is working on integrating climate-related and environmental risks into its risk reporting processes. In 2022, the Bank has extended its quarterly risk report with an additional section under credit risk related to the ESG risks where data regarding the GHG financed emissions from corporate lending loan portfolio and carbon intensity are being disclosed. It is planned to continue to enhance reporting capabilities with other data attributes.

In 2022, Luminor published its first Sustainability report, compiled in reference to the Global Reporting Initiative's ('GRI') Sustainability Reporting Guidelines. The report covers material topics, identified during Bank's ESG materiality assessment among its key stakeholders considering double materiality aspects. The assessment revealed eight key areas that stakeholders consider material for Luminor that were discussed and approved by the Supervisory Council.

Luminor aims to develop appropriate key risk indicators (KRIs) and to set appropriate limits for effective management of the ESG risks in line with their regular monitoring and escalation arrangements. To enhance transparency and to provide an objective comparison by financial market participants to investors on the proportion of the investments that fund environmentally or socially sustainable economic activities, Luminor aims to establish periodic reporting on key performance indicators (KPIs) on the proportion of the credit activities that fund environmentally sustainable economic activities.

For Luminor ESG related disclosures in its annual reports, the Bank follows the applicable local and European regulatory requirements, including but not limited to the Guidelines on non-financial reporting: Supplement on reporting climate-related information issued by the EU Commission, as well as voluntary frameworks such as the Global Reporting Initiative's Sustainability Reporting Guidelines to the extent applicable and relevant.

During 2022, Luminor developed an ESG data platform that allows to calculate financed emissions, report on various collateral information such as energy efficiency and vehicle specification. In 2023, Luminor will continue its effort to increase data gathering from customers and external data providers, that will allow not only to improve the quality of existing data but also expand the scope and granularity of Climate and Environmental data on the platform. Additionally, as part of Bank's commitment to Science Based Targets initiative, Luminor is in the process of developing sectoral alignment metrics and targets for sectors where the Science Based Targets initiative methodologies are available.

Alignment of the remuneration policy with environmental risk-related objectives

The EBA Guidelines on sound remuneration policies under Directive 2013/36/EU require institutions to design their remuneration policies such that they are consistent with and promote sound and effective risk management. This entails incorporating a risk-based performance assessment in the determination and allocation of variable remuneration across the organisation. The risk-based assessment contains performance evaluation criteria defined for i) all divisions, ii) all individuals and iii) all material risk takers within Luminor and provides a structured approach to assess the extent to which risks were managed effectively throughout the year. This inter alia includes a qualitative assessment performed on division level of implementation of risk management activities in line with ambition targets on climate-related and environmental risks. Thereby ESG risk is integrated into Remuneration Policy to promote the adherence of employees to Luminor commitments and standards including ESG risk related behaviour.

Risk management

Luminor treats ESG risks as risk drivers that impact existing risk types and sub-types according to Luminor's Risk Taxonomy, thus the management of ESG aspects is integrated into Luminor's risk governance and processes for identifying, monitoring, measuring, and reporting risks. Climate-related and environmental risks are integrated as an underlying risk driver in the Risk Policy and Strategy and the Risk Appetite Framework, and Luminor's ESG principles defined in the Sustainability Policy shall be an integral part of risk management. During 2022, Luminor updated its Risk Policy and Strategy considering climate-related and environmental risks impact on its risk taxonomy by assessing ESG risk drivers and their transmission channels on existing risks.

Definitions of ESG risks, ESG risk drivers and transmission channels in the Luminor's risk management framework are based to the EBA Report on Management and Supervision of ESG risks for Credit Institutions and Investment Firms. The Luminor wide overall established ESG risk management framework is governed by the Luminor Sustainability Policy, Risk Policy and Strategy, Risk Appetite Framework, ESG Due Diligence Guidelines, ESG Risk Assessment Procedure, Industry ESG Risk Management Procedure, Sustainable Investment Guidelines and other binding documentation.

ESG risk driver materiality assessment

Luminor has initiated the development of a Climate and Environment risk driver materiality assessment methodology and performed the qualitative assessment of individual climate risk drivers' impact on its business areas as well as defined an approach to address the high impact areas. An assessment of the climate risk driver impact on the legal entities' portfolio was performed by evaluating risk materiality over the short (up to 3 years), medium (4-10 years) and long (10-30 years) term. The objective of this process is to be able to integrate the climate and environment risk drivers' assessment into Luminor strategy and understand their impact on other risk types by informing and serving as an input in several processes, inter alia, establishing the credit risk and other identified relevant risks mitigation actions in relevant business areas, initiating the development of respective loan offering and as an input in the limit and KRI setting process.

The ESG risk drivers' impact assessment on other risk types and sub-types is part of the annual Risk Materiality Assessment which requires all risk types in the Risk Taxonomy to be assessed from the ESG perspective. The assessment shall be performed considering ESG risk drivers and their transmission channels, including lower profitability, lower real estate value, lower household wealth, lower asset performance, increased cost of compliance, and increased legal costs (established based on EBA Report on Management and Supervision of ESG risks for Credit Institutions and Investment Firms). The qualitative and quantitative ESG risk drivers' impact should be considered for both financial and non-financial risks' materiality assessment.

Processes to identify, measure and monitor ESG risks

ESG risk assessment

Luminor has established risk-based approach assessment process of ESG risks of legal entities as a part of the overall creditworthiness assessment process. ESG risk assessment for customer contains ESG risk assessment to the existing and future operations of the customer. In addition, the customer must follow relevant social and governance aspects.

The Luminor ESG Risk Assessment Procedure considers the transition risks in the lending process for corporate lending according to a risk-based approach, thus assessing the climate-related risks at the loan origination and monitoring processes where applicable. The risks are assessed based on the transition risk heatmap and the completion of the environmental and/or social, governance risk assessment tools by the relationship manager if applicable.

Luminor has classified industries in a Green / Yellow / Red category level based on the environmental impact of the industry the company is operating in. The industry risk classification is developed in accordance with the internationally recognized risk categorisation list provided by the European Bank for Reconstruction and Development, Standard & Poor's Global ESG ratings and also considering the location of Luminor customers (mainly Baltic States). The transition risk heatmap provides a high level risk assessment of transition risks for main industries and sub industries, based on four risk factors: i) direct emissions costs; ii) indirect emissions costs; iii) low-carbon capital expenditures and iv) revenues. If the impact of the company's activity to the environment is high, a more detailed environmental risk assessment is performed using the Environmental risk assessment tool to make sure that the customer has adequate mitigation actions or a transition plan in place to deal with elevated environmental risks it will face in its operations.

As part of the ESG risk assessment process, Luminor performs a social and governance risk assessment. The level of the social and governance risks depends on the industry in which the company operates and is also highly dependent on the performed risk mitigating activities by the company to manage these risks. Thus, Luminor has defined industries where the social and governance risks could be considered high and, based on the publicly available reliable information and the information provided by the customer, performs social and governance risk assessment using the Social and Governance risk assessment tool. The assessment considers governance and transparency aspects, human rights matters and anti-corruption policy.

In addition, Luminor has defined Exclusion list in Sustainability Policy and does not provide services to customers if Bank has identified that they are engaged in the certain environmentally relevant activities, and if there is an identified risk that the customer contributes to or is responsible for systematic violations of human rights or individual rights in wars or conflict situations, violations of basic labour rights or corruption and other particularly critical violations of basic ethical norms.

Industry specific ESG risk management

To identify the ESG risks particularly associated with specific industries and to avoid deterioration of the existing and future creditworthiness of the customer, Luminor has developed an Industry ESG Risk Management Procedure, which includes sector guidance for the industries that have elevated ESG risks. Luminor has defined several high ESG risk industries: i) Construction, ii) Wholesale and retail, iii) Agriculture, forestry and fishing, iv) Manufacturing, v) Electricity, gas, steam and air conditioning supply, vi) Transportation and vii) Commercial real estate (environmental and social risk mapping of Luminor lending portfolio was based on the European Bank for Reconstruction and Development environmental and social risk mapping classification, and assessment of GHG emissions based on the Partnership for Carbon Accounting Financials methodology). For these sectors, a detailed climate risk and risk driver analysis has been done that is divided into the physical risks and the transition risks that can affect Luminor customers in the respective industry across short, medium and long-time horizons, thus identifying industry specific risks and prescribing mitigation measures for customers from these sectors.

Early 2023, Luminor has enhanced its Risk Appetite Framework by incorporating a newly developed Risk Appetite metric to limit carbon-intense exposures to legal entities, thereby integrating climate and environmental risks into the Risk Appetite Framework for the first time. The metric is designed to limit excessive amounts of corporate customers in the corporate loan portfolio with elevated climate and environmental risks that can negatively affect future creditworthiness of these customers.

ESG risk in stress testing and Internal Capital Adequacy Assessment Process

Luminor is in the process of building a climate risk management framework to ensure that climate-related and environmental risks (both physical and transitional) with potential direct impact on the Bank are considered in various ways within Luminor's risk management processes including climate risk rating models and stress testing capabilities. In 2022, Luminor has enhanced its credit spread risk stress testing with considerations for a climate risk factor by introducing additional shocks for securities considered to be exposed to climate risk under climate risk stress testing. In liquidity risk stress testing Luminor uses additional haircuts for securities considered to be exposed to climate risk. When developing macroeconomic scenarios, the scenario simulation approach focuses on current risks and additional potential shocks. Luminor considers climate and environmental risk drivers as one of the sources of additional potential global shocks under a severe adverse scenario. The ICAAP 2023 Luminor will additionally analyze climate specific scenario and sensitivities related to transition risks. The climate risk scenario will analyse short-term vulnerabilities triggered by a sharp and unexpected increase in the price of carbon emissions over a three-year horizon.

In 2022, Luminor participated in the ECB climate related stress test, which was focused on the climate risk stress-testing frameworks, the bank's capacity to produce climate risk factors and stress test projections as well as risks banks are facing from transition and physical risk events. To assess these focus points a set of qualitative and quantitative information was submitted including concentrations of sectoral income, financed greenhouse gas emissions, and portfolio disaggregation by climate-relevant metrics. The performance of banks was assessed based on a four-grade colour coding system (green-yellow-amber-red) and the overall grade assigned to Luminor was "Amber" which is the same as for the average peer group sample. Within two areas Luminor performance was marked as "Green", namely for scenarios considering transition and physical risk impact and data quality in this exercise.

Luminor

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