



Rakuten Europe Bank S.A.

## Pillar III Report

2016 Financial Year End

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## 1. Introduction

Rakuten Europe Bank S.A. ('REB' or the 'Bank') is a fully licensed credit institution which provides financial services specialized in e-commerce, established in Luxembourg and supervised by the Commission de Surveillance du Secteur Financier (CSSF). It is a wholly-owned subsidiary of Rakuten Europe, itself a wholly-owned subsidiary of Rakuten Inc., which is listed on the Tokyo stock exchange. The Rakuten Group is also present with entities in other countries in Europe. In Japan, Rakuten is regulated by the JFSA, and Rakuten Cards is the second largest issuer of credit cards.

### 1.1. Recent Events

REB, formerly named Rakuten Payment Services S.A. ('RPS'), activated its banking license on 20 January 2016, and is thus authorized to act as a credit institution. It is now governed by the Law of 5 April 1993, as amended, on the financial sector, and by the Law of 10 August 1915 regarding commercial companies, as amended.

Key events during the period covered the closure of the Spain and United Kingdom marketplaces as of 30 September 2016, resulting in the implementation of a Social Plan, making eight employees redundant.

On 30 December 2016, REB launched its commercial deposit products.

In January 2017 the Bank raised capital of €15 million.

### 1.2. Impact on Risk Profile

The increase in capital strengthened REB's resources, replenishing losses that took place last year and are expected to continue this year. The Bank's new activities with NTT DOCOMO and PriceMinister will increase its balance sheet and are expected to lead to continued growth. These businesses are in line with the risk profile of REB's existing business.

### 1.3. Pillar III Disclosures

REB publishes a Pillar III disclosure report (the 'Pillar III Report') annually in line with the requirements in Part Eight, *Disclosures by Institutions*, of Regulation (EU) No 575/2013 (known as the Capital Requirements Regulation or 'CRR') and CSSF Regulation 14-01 on the implementation of certain national discretions set out in the CRR.

The objective of the Pillar III Report is to promote market discipline through disclosure. In preparing it, REB has sought to ensure that this objective be achieved. In addition to the CRR requirements, the Bank has also taken into consideration on a voluntary basis the guidelines on disclosure requirements under Part Eight of the CRR issued by the European Banking Authority ('EBA')(EBA/GL/2016/11, as amended on 9 June 2017 – hereinafter referred to as the 'Guidelines'). With due recognition of the need for proportionality, REB does not purport to comply with the Guidelines — nor is it required to — but REB has used the Guidelines as a benchmark when crafting disclosures for the benefit of the readers of the Pillar III Report.

The scope of the Pillar III Report is Rakuten Europe Bank S.A., which received its authorization as a credit institution on 20 January 2016. REB operates under the prudential requirements set out in the CRR, the European implementation of the capital adequacy framework adopted by the Basel Committee on Banking Supervision. This framework consists of three pillars, each of them concentrating on different aspects of banking regulation:

- Pillar I sets out the rules for the determination of own funds (regulatory capital) and the calculation of minimum capital requirements;
- Pillar II sets out the key principles of supervisory review and the internal capital adequacy assessment process ('ICAAP'); and
- Pillar III complements the first two pillars by requiring a range of disclosures on capital and risk assessment processes, aimed at encouraging and reinforcing market discipline.

The Pillar III Report is divided into seven sections and three appendices:

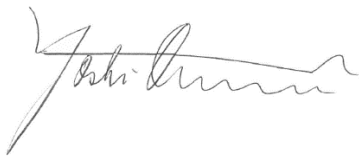
- Section 1 covers the introduction to the Pillar III Report;
- Section 2 covers REB's capital management and capital adequacy;
- Section 3 describes the Bank's risk organisation and governance;

- Section 4 focuses on credit risk management;
- Section 5 focuses on operational risk management;
- Section 6 discusses other risks; and
- Section 7 covers the remuneration policy and practices.

The appendices include a glossary of relevant terms, the leverage ratio disclosure template and the countercyclical capital buffer disclosure template.

Unless otherwise stated, the figures in this report are expressed in Euros.

Luxembourg, July 2017



Toshihiko Otsuka  
CEO



Thomas Belousek  
CRO and CAO

## 2. Capital Management and Adequacy

The aim of capital management is to guarantee REB's solvency and maximise its profitability, while ensuring compliance with internal capital objectives and regulatory capital requirements. The Bank's ratios compare the amount of regulatory capital with REB's total weighted risks, and comfortably exceed the required levels.

### 2.1. Own Funds Structure

REB's regulatory capital consists entirely of Common Equity Tier 1 Capital, and was €13.598 million at 31 December 2016.

OWN FUNDS	
Item	Amount
<b>OWN FUNDS</b>	13,597,843.00
<b>TIER 1 CAPITAL</b>	13,597,843.00
<b>COMMON EQUITY TIER 1 CAPITAL</b>	13,597,843.00
<b>Capital instruments eligible as CET1 Capital</b>	26,150,000.00
Paid up capital instruments	8,700,000.00
Share premium	17,450,000.00
<b>Retained earnings</b>	-10,880,620.00
Previous years retained earnings	-3,747,610.81
Profit or loss eligible	-7,133,009.00
Profit or loss attributable to owners of the parent	-7,133,009.00
<b>(-) Other intangible assets</b>	-1,671,537.00
(-) Other intangible assets before deduction of deferred tax liabilities	-1,671,537.00

Following is the Bank's balance sheet as of 31 December 2016:

Balance Sheet Statement [Statement of Financial Position]	Carrying amount
<b>Assets</b>	
<b>Cash and cash equivalents</b>	<b>15,602,825.00</b>
Cash balances at central banks	199,336.00
Other demand deposits	15,403,489.00
<b>Loans and receivables</b>	<b>3,610.00</b>
Loans and advances	3,610.00
<b>Held-to-maturity investments</b>	<b>1,002,060.00</b>
Debt securities	1,002,060.00
<b>Tangible assets</b>	<b>888,819.00</b>
Property, Plant and Equipment	888,819.00
<b>Intangible assets</b>	<b>1,671,537.00</b>
Other intangible assets	1,671,537.00
<b>Other assets</b>	<b>993,673.00</b>
<b>TOTAL ASSETS</b>	<b>20,162,524.00</b>
<b>Liabilities</b>	
<b>Financial liabilities measured at amortised cost</b>	<b>3,200,588.00</b>
Deposits	3,200,588.00
<b>Provisions</b>	<b>402,818.00</b>
Restructuring	76,923.00
Other provisions	325,895.00
<b>Other liabilities</b>	<b>1,289,738.00</b>
<b>TOTAL LIABILITIES</b>	<b>4,893,144.00</b>
<b>Equity</b>	
<b>Capital</b>	<b>8,700,000.00</b>
Paid up capital	8,700,000.00
<b>Share premium</b>	<b>17,450,000.00</b>
<b>Retained earnings</b>	<b>-3,747,611.00</b>
<b>Profit or loss attributable to owners of the parent</b>	<b>-7,133,009.00</b>
<b>TOTAL EQUITY</b>	<b>15,269,380.00</b>
<b>TOTAL EQUITY AND TOTAL LIABILITIES</b>	<b>20,162,524.00</b>

Following is the Bank's 2016 income statement:

Income Statement	Current period
Interest income	4,468.00
Loans and receivables	4,468.00
(Interest expense)	1,866.00
(Interest expense on assets)	1,866.00
Fee and commission income	302,935.00
(Fee and commission expenses)	122,394.00
Other operating income	632,309.01
TOTAL OPERATING INCOME, NET	815,452.01
(Administrative expenses)	5,032,439.01
(Staff expenses)	3,618,399.00
(Other administrative expenses)	1,414,040.01
(Depreciation)	709,765.00
(Property, Plant and Equipment)	244,414.00
(Other intangible assets)	465,351.00
PROFIT OR (-) LOSS BEFORE TAX FROM CONTINUING OPERATIONS	-4,926,752.00
PROFIT OR (-) LOSS AFTER TAX FROM CONTINUING OPERATIONS	-4,926,752.00
Profit or (-) loss after tax from discontinued operations	-2,206,257.00
Profit or (-) loss before tax from discontinued operations	-2,206,257.00
PROFIT OR (-) LOSS FOR THE YEAR	-7,133,009.00
Attributable to equity holders of the parent	-7,133,009.00

## 2.2. Risk Weighted Assets

The following table shows REB's risk-weighted assets ('RWA') and capital requirements for each type of risk at 31 December 2016. The Bank's total RWA was €10.438 million.

OWN FUNDS REQUIREMENTS	
Label	Amount
<b>TOTAL RISK EXPOSURE AMOUNT</b>	10,437,735.30
<b>RISK WEIGHTED EXPOSURE AMOUNTS FOR CREDIT, COUNTERPARTY CREDIT AND DILUTION RISKS AND FREE DELIVERIES</b>	7,639,549.55
<b>Standardised approach (SA)</b>	7,639,549.55
SA exposure classes excluding securitisation positions	7,639,549.55
Institutions	3,080,697.80
Corporates	221.00
Retail	2,541.75
Collective investments undertakings (CIU)	1,002,060.00
Other Items	3,554,029.00
<b>TOTAL RISK EXPOSURE AMOUNT FOR POSITION, FOREIGN EXCHANGE AND COMMODITIES RISKS</b>	544,799.00
<b>Risk exposure amount for position, foreign exchange and commodities risks under standardised approaches (SA)</b>	544,799.00
Foreign Exchange	544,799.00
<b>TOTAL RISK EXPOSURE AMOUNT FOR OPERATIONAL RISK (OpR)</b>	2,253,386.75
<b>OpR Basic indicator approach (BIA)</b>	2,253,386.75



## 2.3. Capital Adequacy

REB had a capital ratio of 1.3028 at 31 December 2016.

<b>CAPITAL RATIOS AND CAPITAL LEVELS</b>	
<b>Item</b>	<b>Amount</b>
<b>CET1 Capital ratio</b>	1.3028
<b>Surplus(+)/Deficit(-) of CET1 capital</b>	13,128,144.91
<b>T1 Capital ratio</b>	1.3028
<b>Surplus(+)/Deficit(-) of T1 capital</b>	12,971,578.88
<b>Total capital ratio</b>	1.3028
<b>Surplus(+)/Deficit(-) of total capital</b>	12,762,824.18

## 2.4. Internal Capital

REB's Internal Capital Adequacy Assessment Process (ICAAP) is a set of sound, effective and comprehensive strategies and processes to assess and maintain on an ongoing basis the amounts, types and distribution of internal capital that it considers adequate to cover the nature and level of the risks to which it is or might be exposed. The purpose of the ICAAP is to inform senior management (the Executive Committee) and the Board of Directors of the on-going assessment of REB's risks, detail how the Bank intends to mitigate those risks, identify how much current and future capital is necessary, demonstrate the robustness of the assessment, and show all relevant information necessary for senior management and the Board of Directors to make an informed decision on the appropriate capital level and risk management approach.

For 2016, the following key processes were performed for the ICAAP: assessment of the major sources of risks existing, production of financial forecasts including the evaluation of the current and future risk capital requirements and resources to enable capital adequacy forecasts for five years, and stress tests to ensure capital adequacy in stressed situations. The key processes were performed by the Risk and Finance representatives, then reviewed by the Executive Committee members responsible for Finance, Risk and Compliance and the Internal Control System Committee ('ICSC'), and finally approved by the Board of Directors. The Board is satisfied that the internal capital assessment covers all material risks to its current business as well as known and planned activities.

The risks for which REB has allocated internal capital include:

- Credit Risk;
- Operational Risk;
- Market Risk;
- Business Risk; and
- Investment Risk.

### 3. Risk Organisation and Governance

REB has set up its organisation to provide sound risk management and culture.

#### 3.1. Policy

REB's Enterprise Risk Management ('ERM') system includes as a component its Risk Policy, which is to put appropriate measures in place, report potential risks that might affect the Bank, consider risks arising from business obligations, and take measures to identify, analyse and communicate risks.

#### 3.2. Appetite

The risk appetite is the amount of risk exposure or potential adverse impact from a risk event that REB is willing to accept. Risk management does not mean risk elimination; through the appetite statement management sets and communicates the profile of risk that accompanies its targeted business. As the risk appetite threshold is approached, risk mitigations or operational controls are implemented.

#### 3.3. Governance

Three Functions are involved in Risk Governance: Compliance and Risk Management, together making the second line of defense (after Operational Management, the first line of defense), and Internal Audit, representing the third line of defense.

REB's Risk Committee has met 12 times, and the Internal Control System Committee (ICSC) has met four times in 2016.

The number of Directorships held by the Bank's Board of Directors members as of 31 December 2016 were:

- Masayuki Hosaka: 6
- Toshihiko Otsuka: 9
- Hiroyuki Nagai: 3
- Jerome Dave: 0
- Ken Takano: 0

- Nigel Bath: 0

REB's current Procedure on the Appointment and Revocation of Key Function Holders was approved by the Board of Directors on 15 January 2016. It implements the requirements of CSSF Circular 12/552, as amended.

### 3.4. Control

Internal Control, made up of the Risk, Compliance and Internal Audit functions, is performed under the framework of the Internal Control System Committee (ICSC). The Bank's technical infrastructure is reviewed regularly and upgrades are executed, if necessary, for the Bank's control objectives.

### 3.5. Audit

The Internal Audit function has been outsourced to BDO Luxembourg. An audit plan is prepared and presented to the Board of Directors, and the projects in accordance with the plan are followed up quarterly by the ICSC. Senior management of the Bank regularly monitors the internal audit resources and their qualifications to ensure they are appropriate.

The auditor provides independent assurance to the Bank's management that the internal controls, established by management, are functioning appropriately. The audit reviews that: there is a segregation of duties; business activities are conducted in a controlled manner; legal and professional requirements and management instructions are complied with; decisions are made by authorized personnel, based on adequate and sound information; transactions, income, expenditure, liabilities and assets are completely and accurately recorded; and assets are safeguarded.

### 3.6. Function

The Risk Management function ensures that senior management's risk strategy, guidelines and policies are properly implemented and adhered to, risk exposures are independently monitored and tracked, and exceptions are reported regularly and adequately to senior management. Regular risk updates are provided to the Bank's Board of Directors; there are

monthly updates to the Internal Control System Committee; and potential and actual issues are highlighted in the Bank's Quarterly Risk Report and followed up to ensure satisfactory resolution. REB's Chief Risk Officer ('CRO') is responsible for managing the function.

## 4. Credit Risk

Credit risk represents the potential loss (reduction in value of an asset or payment default) that REB may incur as a result of a deterioration in the solvency of any counterparty. REB calculates its Pillar I capital requirements for credit risk according to the Standardized Approach ('SA').

REB's Finance department monitors the respective exposures and counterparty/customer balances regularly. The Bank's business model focuses on revenues earned from commissions on payment transactions and interest from loans and low risk investments. Its customer base is highly diversified across a large number of Small and Medium Enterprises ('SMEs') and sole traders. REB holds all customer funds only in highly rated and liquid assets with reputable and creditworthy financial institutions.

### 4.1. Risk Weighted Exposures

At 31 December 2016, REB had total credit exposures of €20.163 million and risk weighted exposures of €7.640 million.

The following table displays the breakdown of the Bank's total exposures by Risk Weight, SA Exposure Class and country.

CREDIT AND COUNTERPARTY CREDIT RISKS AND FREE DELIVERIES: STANDARDISED APPROACH TO CAPITAL REQUIREMENTS							
	ORIGINAL EXPOSURE PRE CONVERSION FACTORS	EXPOSURE NET OF VALUE ADJUSTMENTS AND PROVISIONS	NET EXPOSURE AFTER CRM SUBSTITUTION EFFECTS PRE CONVERSION FACTORS	FULLY ADJUSTED EXPOSURE VALUE (E')	EXPOSURE VALUE	RISK WEIGHTED EXPOSURE AMOUNT PRE SME-SUPPORTING FACTOR	RISK WEIGHTED EXPOSURE AMOUNT AFTER SME-SUPPORTING FACTOR
<b>TOTAL EXPOSURES</b>	20,162,524.00	20,162,524.00	20,162,524.00	20,162,524.00	20,162,524.00	7,639,549.55	7,639,549.55
On balance sheet exposures subject to credit risk	20,162,524.00	20,162,524.00	20,162,524.00	20,162,524.00	20,162,524.00	7,639,549.55	7,639,549.55
<b>BREAKDOWN OF TOTAL EXPOSURES BY RISK WEIGHT:</b>							
0%	199,336.00	199,336.00		199,336.00	199,336.00	0.00	0.00
20%	15,403,489.00	15,403,489.00		15,403,489.00	15,403,489.00	3,080,697.80	3,080,697.80
75%	3,389.00	3,389.00		3,389.00	3,389.00	2,541.75	2,541.75
100%	4,556,310.00	4,556,310.00		4,556,310.00	4,556,310.00	4,556,310.00	4,556,310.00
<b>BREAKDOWN OF TOTAL EXPOSURES BY SA EXPOSURE CLASS:</b>							
Central Governments and Central Banks	199,336.00	199,336.00	199,336.00	199,336.00	199,336.00	0.00	0.00
Claims in the Form of CIU	1,002,060.00	1,002,060.00	1,002,060.00	1,002,060.00	1,002,060.00	1,002,060.00	1,002,060.00
Corporates	221.00	221.00	221.00	221.00	221.00	221.00	221.00
Institutions	15,403,489.00	15,403,489.00	15,403,489.00	15,403,489.00	15,403,489.00	3,080,697.80	3,080,697.80
Other items	3,554,029.00	3,554,029.00	3,554,029.00	3,554,029.00	3,554,029.00	3,554,029.00	3,554,029.00
Retail	3,389.00	3,389.00	3,389.00	3,389.00	3,389.00	2,541.81	2,541.75
<b>BREAKDOWN OF CREDIT EXPOSURES RELEVANT FOR THE CALCULATION OF THE COUNTERCYCLICAL BUFFER BY COUNTRY AND INSTITUTION-SPECIFIC COUNTERCYCLICAL BUFFER RATE</b>						Total own funds requirements for CCB	Own funds requirements for relevant credit exposures – Credit risk
ES	2,954.54	2,954.54	2,954.54	2,954.54	2,954.54	179.70	179.70
GB	655.95	655.95	655.95	655.95	655.95	41.36	41.36
LU	2,649,574.68	2,649,574.68	2,649,574.68	2,649,574.68	2,649,574.68	211,965.97	211,965.97

There are External Credit Assessment Institutions ('ECAIs') in use by REB. Koalaboox, the sole investment of Koolafund as of 31 December 2016, has informed REB that they are in the process of having a rating, which is currently unknown to REB.

For Common Reporting (COREP) purposes, three countries were reported: the United Kingdom, Luxembourg and Spain, corresponding to the significance of country exposure according to CRR definitions and COREP reporting requirements, and the calculation of the countercyclical buffer by country. The breakdown of all exposures by country is otherwise not available.

As of 31 December 2016, the maturity of all of REB's exposures was overnight except for its Koalaboox investment, which had a maturity of 12 months.

## 4.2. Consumer Credit

REB plans to issue cash advances and instalment loans to consumers. REB has built its infrastructure to support this business, including a Credit Risk function under the CRO and Asset Liability Management and Credit Risk Committee, Credit Analysts, and support staff in areas such as Finance and Compliance. REB has in place a Credit Risk Policy and a Collection Policy.

## 4.3. Policy and Governance

REB's Credit Policy formalizes and articulates its objectives to measure, monitor and manage risk as it relates to the purchase and management of credit products. Effective communication of the policy goals and standards includes training in Credit Risk Management fundamentals. Guiding principles are that: credit (default) risk shall be minimized wherever possible due to the potential adverse impact, and managed within the established limits for exposure; concentrations of risk are prevented through customer and portfolio limits; the Bank seeks first to avoid credit risk by dealing only with financially sound customers; credit enhancements are to be used only as a secondary risk management technique; the Bank monitors the credit programme performance to ensure that its risk is at a manageable level and within its risk appetite; and potential funding / liquidity exposures are mitigated through the ALM and Credit Committee ('ALMCC').

## 5. Operational Risk

Operational risk is the risk of losses stemming from inadequate or failed internal processes, people, systems or external events. This definition includes legal risk, but excludes strategic risk. It also excludes losses resulting from commercial decisions.

### 5.1. Own Funds Requirement

REB calculates its capital requirements for operational risk according to the Basic Indicator Approach ('BIA').

At 31 December 2016, the Bank had a total operational risk exposure amount of €2.253 million and own funds requirement of €180,271.

OPERATIONAL RISK				
BANKING ACTIVITIES	RELEVANT INDICATOR		OWN FUNDS REQUIREMENT	Total operational risk exposure amount
	YEAR-2	LAST YEAR		
1.BANKING ACTIVITIES SUBJECT TO BASIC INDICATOR APPROACH (BIA)	1,462,323.00	941,289.50	180,270.94	2,253,386.75

### 5.2. Types of Operational Risk

REB's operational risk management is manifested throughout the Bank.

REB has entered into a number of vendor relationships in order to outsource back-end payment processing functions. Transaction monitoring is in place, with both operational monitoring to identify process alerts and operational support to drive internal and third party cross-functional incident resolution before customers experience an impact. As the Bank's transaction processing expands in volume or complexity, monitoring resources and measures will be expanded.

REB defines fraud risk as losses which occur due to fraudulent behavior by an entity's customers (in both sending and receiving money). The Bank deals with fraud in a systematic and rigorous way at several different places in the account and transaction life-cycle.



A Business Continuity Policy and a Business Continuity Plan ('BCP'), covering the critical activities of the Bank and allowing their recovery, are to be set up by the Bank to provide for the case that its building and / or systems cannot be accessed. REB's business systems are redundant, with instances on different physical sites. A dedicated Information Security Policy has been defined and covers information security risks and mitigating measures in detail. Intrusion Prevention Systems ('IPS') are deployed. Systems communicate via encrypted communications and require mutual authentication. Credit card numbers are not stored in REB systems. Passwords are encrypted in the core system.

As REB continues to focus on merchant services/acquiring business, appropriate credit underwriting and monitoring programs are in place to mitigate acquiring risk exposures, such as those due to merchant bankruptcies or fraudulent behaviors.

Outsourcing, including the process to outsource activities and functions, monitoring, risk assessment and mitigating measures, are covered in detail in the Bank's Outsourcing Policy. REB has outsourced some key systems to Rakuten Inc. All (external) outsourcing of critical functionality is backed by appropriate Service Level Agreements ('SLAs') and annual monitoring of such agreements by the Chief Risk Officer. The results of such monitoring are contained in the quarterly reports made available to the Board of Directors and responsible officers.

To mitigate vendor risk such as that associated with REB's outsourced back-end payment processing functions, contracts/SLAs have sufficient termination periods to enable switching services.

REB is committed to complying with all applicable rules and regulations governing its services. The Compliance function is responsible for ensuring that adequate processes are in place. REB's Legal and Compliance departments monitor new regulations applicable to its business activities or the exercise of jurisdiction by a new regulator. REB will also work with external consultants and counsel to keep apprised of legislative and regulatory developments.

To ensure compliance with all legislation relating to Anti-Money Laundering ('AML') and Counter-Terrorism Financing ('CTF'), REB has adopted an AML/CTF infrastructure, and processes, policies and procedures are in place to support the Bank's business, updated and amended as required to meet legislative obligations and described, in particular, in

the Anti-Money Laundering and Counter Terrorism Financing Policy. Processes and procedures are in place within the Bank and various related service providers to ensure compliance with these AML/CTF obligations, including a Suspicious Transaction Reporting Procedure. The Compliance team uses a variety of methods to monitor compliance with the AML/CTF policy.

REB views legal risk management as the maintenance of appropriate corporate governance and codes of conduct, adherence to legal requirements, management of contractual obligations, and managing litigation risk. REB manages these risks through its in-house Legal Department, which also calls on the resources of the broader Rakuten Legal Department in specialist areas such as Intellectual Property ('IP'), real property and competition law. REB is also able to work with international law firms. REB has in place a Code of Conduct and a Conflict of Interest Policy.

Privacy / bank secrecy is a fundamental element of the REB value proposition, and potential issues are being addressed as necessary.

In REB's online system, most customer interaction is via marketplace websites. Its banking license allows it to offer a wider array of financial services to companies and individuals. The Bank is developing its capabilities to define, build, integrate and deliver new products and develop a reliable and scalable system.

REB is growing and expanding its products and services. It does not currently expect to be profitable, but it plans to be in the future. There is a risk that the Bank may not meet its business revenue targets.

Guidelines, documentation, training, monitoring and approvals have been established throughout REB to address human resources risks.

REB operates strong corporate governance and segregation-of-duty controls. The processes are defined in the Manual of Internal Governance.

For certain risks that can be appropriately insured, REB is covered through Rakuten Inc. policies.

## 6. Other Risks

### 6.1. Market Risk Own Funds Requirement

Market risk is the risk of losses resulting from adverse movements of market risk parameters, including interest rate ('IR') risk and foreign exchange ('FX') risk.

It is REB's policy not to speculatively trade any interest rate or foreign exchange exposure. Trading activity occurs to facilitate and cover customer activity and minimize any IR or FX risk. REB does not pay interest on balances and does not invest in interest-backed instruments. REB holds GBP and EUR to cover its liabilities and is not involved in FX transactions.

REB calculates its capital requirements for FX market risk according to the Standardized Approach.

At 31 December 2016 REB had a total market risk exposure amount of €544,799 and own funds requirement of €43,584.

MARKET RISK: STANDARDISED APPROACHES FOR FOREIGN EXCHANGE RISK								
	CURRENCY CODE	ALL POSITIONS		NET POSITIONS		POSITIONS SUBJECT TO CAPITAL CHARGE	OWN FUNDS REQUIREMENTS	TOTAL RISK EXPOSURE AMOUNT
		LONG	SHORT	LONG	SHORT	LONG		
<b>TOTAL POSITIONS IN NON-REPORTING CURRENCIES</b>		2,158,887.78	1,657,034.76	544,799.06	42,946.04	544,799.06	43,583.92	544,799.00
All other currencies (including CIUs treated as different currencies)		2,158,887.78	1,657,034.76	544,799.06	42,946.04	544,799.06	43,583.92	
<b>BREAKDOWN OF TOTAL POSITIONS (REPORTING CURRENCY INCLUDED) BY EXPOSURE TYPES</b>								
Other assets and liabilities other than off-balance sheet items and derivatives		20,162,524.00	20,162,524.00					
<b>Memorandum items: CURRENCY POSITIONS</b>								
EURO	EUR	18,003,636.22	18,505,489.24		501,853.02			
Pound Sterling	GBP	2,157,902.55	1,613,103.49	544,799.06				
Yen	JPY	137.34	41,731.89		41,594.55			
US Dollar	USD	847.89	2,199.38		1,351.49			
<b>Decomposition of calculation</b>								
4 All other currencies (incl. CIUs treated as separate currencies)		2,158,887.78	1,657,034.76	544,799.06	42,946.04			
GBP		2,157,902.55	1,613,103.49	544,799.06	0.00			
JPY		137.34	41,731.89	0.00	41,594.55			
USD		847.89	2,199.38	0.00	1,351.49			
Not Matched Total		544,799.06	42,946.04					

### 6.2. Liquidity, Settlement, Etc.

Liquidity risk management aims to ensure that funds in the system are available for cash flow fluctuations, without causing an undue rise in cost or risk, and without causing a disruption to normal operating conditions of the Bank. Funding and liquidity are maintained in a manner that is consistent with prudent practices. The CFO has oversight responsibilities for the establishment and administration of the Liquidity Policy and

Procedures, as well as for the day-to-day administration and implementation of these policies and procedures and for establishing controls, to develop strategies, to execute trades, and to recommend policy changes to senior management.

Settlement risk is the risk that an entity will not receive the funds it has requested for collection from third parties, thereby resulting in an imbalance in its accounts. The CRO is in charge of the management of the settlement risks that arise for the Bank and the Bank's customers. He is in regular contact with REB's CFO.

Reputation risk is the risk of losing customers, employees and important business opportunities should REB receive true or false adverse publicity or develop a poor company reputation, due amongst other things to the failure to comply with law and regulations. All contingencies are covered by the Public Relations and Government Relations Department of Rakuten Inc.

From REB's perspective, country risk (also referred to as political risk) refers to the likelihood that changes in the business environment adversely affect operating profits or the value of assets in a specific country. Currently REB is operating and plans to operate with marketplaces focused on France and Germany.

Regulatory risk is due to different interpretations of the scope of directives and their implementation within the EU, termination of the banking license, and breach of terms of authorization. REB's Treasury monitors the money float daily to ensure the appropriate ratios; however, REB has committed to keep a minimum Capital ratio of 16%. In case of need, additional capital is funded accordingly. Per BCL requirement, the Bank has to deposit a minimum of 1% of its total customer liabilities plus intra-group deposits.

Business risk refers to the risk of significant investments for which there is a high uncertainty about success and profitability. In order to mitigate strategic risk, Rakuten Inc. has put in place a comprehensive strategy decision process, provides respective assessment metrics to management, and has allocated dedicated resources to support appropriate decisions in the best possible manner.

## 7. Remuneration Policy and Practices

REB's current Remuneration Policy was approved by the Board of Directors on 2 March 2017 and effective as of that date. The policy has been established in line with the law of 23 July 2015 and CSSF Circular 10/496.

The general remuneration principles provided in the policy are applicable to all members of staff independently of their place of work, hierarchical level or function. Specific provisions, however, are applicable to the staff members having a material impact on the Bank's risk profile (the 'Identified Staff').

In line with CSSF Circular 11/505, the Bank does not have a Remuneration Committee; however, it ensures a transparent structure. The Board of Directors is composed of five members, of which four are non-executive and hence are not influenced or impacted by remuneration practices and principles set out by the Bank. Therefore, the governance of REB is structured in a way to avoid conflicts of interest.

REB ensures a balanced ratio between fixed and variable remuneration in order to prevent excessive risk taking, with the aim of increasing the variable component. The total amount of the variable remuneration allocated to a person falling in scope of the present policy may not exceed a maximum of 100% of the fixed remuneration.

The performance analysis criteria rest on "how" and "what" the staff members have contributed to the realization of the Banks's overall strategy and business plan for the year. They include qualitative and quantitative components, both financial and non-financial. Variable remuneration is allocated to the employees according to:

- Collective performance;
- Overall performance of the respective department of the employee; and
- Individual performance, where the bank takes into consideration qualitative criteria (e.g., linked to competencies, personal development, respect for the internal code of conduct and internal procedures, and compliance with legal requirements and obligations to ensure robust risk management) and quantitative measures (e.g., linked to financial performances).

The current policy aims to limit excessive risk taking by assessing the performance of the Identified Staff, taking into consideration prior performances (two previous business cycles as well as the respective evaluation year), hence applying a multi-year framework

appropriate to the life-cycle of the Bank's operations and activities.

This means that the variable remuneration of Rakuten's employees is determined on the basis of individual and collective, financial and non-financial criteria, enabling the alignment of the interests of the employees with those of the Bank.

## Appendix 1: Glossary

### CRM

#### Credit Risk Mitigation

A range of techniques whereby a bank can, partially, protect itself against counterparty default (for example by taking guarantees or collateral, or by buying a hedging instrument).

### CSSF

#### Commission de Surveillance du Secteur Financier

Luxembourg's regulator for financial institutions.

### ECAI

#### External Credit Assessment Institutions

Banking regulators can allow banks to use credit ratings from certain approved credit rating agencies when calculating the risk weight of an exposure. Competent authorities will recognize an ECAI as eligible only if they are satisfied that its assessment methodology complies with the requirements of objectivity, independence, ongoing review and transparency, and that the resulting credit assessments meet the requirements of credibility and transparency.

### FX

#### Foreign Exchange

Transaction of international monetary business, as between governments or businesses of different countries.

### ICAAP

#### Internal Capital Adequacy Assessment Process

The main objective of the Pillar II requirements is to implement procedures that will be more sensitive to an institution's individual risk profile. This is to be achieved through the implementation of internal processes.

### IR

#### Interest Rate

Interest expressed as an annual percentage rate.

### RWA

#### Risk Weighted Assets

Used in the calculation of risk-based capital ratios. This refers to the total assets calculated by applying risk-weights to the amount of exposure.

## Appendix 2: Leverage Ratio

The leverage ratio serves as a simple, transparent and non-risk-based ratio to complete the existing risk-based capital requirements. It is defined as the capital measure (the numerator) divided by the exposure measure (the denominator). At 31 December 2016, REB's leverage ratio was at a level of 8.219%, comfortably above the regulatory minimum level of 3%.

C 47.00 - LEVERAGE RATIO CALCULATION (LRCalc)			
			Column
			LR Exposure: Reporting reference date
Row	Exposure Values		010
010	SFTs: Exposure according to CRR 429 (5) and 429 (8)		
020	SFTs: Add-on for counterparty credit risk		
030	Derogation for SFTs: Add-on according to CRR 429b (4) and 222		
040	Counterparty credit risk of SFT agent transactions according to CRR 429b (6)		
050	(-) Exempted CCP leg of client-cleared SFT exposures		
060	Derivatives: Current replacement cost		
070	(-) Eligible cash variation margin received offset against derivatives market value		
080	(-) Exempted CCP leg of client-cleared trade exposures (replacement costs)		
090	Derivatives: Add-on Mark-to-Market Method		
100	(-) Exempted CCP leg of client-cleared trade exposures (potential future exposure)		
110	Derogation for derivatives: Original Exposure Method		
120	(-) Exempted CCP leg of client-cleared trade exposures (Original Exposure Method)		
130	Capped notional amount of written credit derivatives		
140	(-) Eligible purchased credit derivatives offset against written credit derivatives		
150	Off-balance sheet items with a 10% CCF according to CRR 429 (10)		
160	Off-balance sheet items with a 20% CCF according to CRR 429 (10)		
170	Off-balance sheet items with a 50% CCF according to CRR 429 (10)		
180	Off-balance sheet items with a 100% CCF according to CRR 429 (10)		
190	Other assets		18,215,296.34
200	Grossed-up assets for derivatives collateral provided		
210	(-) Receivables for cash variation margin provided in derivatives transactions		
220	(-) Exempted CCP leg of client-cleared trade exposures (initial margin)		
230	Adjustments for SFT sales accounting transactions		
240	(-) Fiduciary assets		
250	(-) Exemption of intragroup exposures (solo basis)		
260	(-) Exposures exempted according to CRR 429 (14)		
270	(-) Asset amount deducted - Tier 1 - fully phased-in definition		-1,671,537.00
280	(-) Asset amount deducted - Tier 1 - transitional definition		-1,671,537.00
290	Total Leverage Ratio exposure - using a fully phased-in definition of Tier 1 capital		16,543,759.34
300	Total Leverage Ratio exposure - using a transitional definition of Tier 1 capital		16,543,759.34
Row	Capital and regulatory adjustments		
310	Tier 1 capital - fully phased-in definition		13,597,843.00
320	Tier 1 capital - transitional definition		13,597,843.00
Row	Leverage Ratio		
330	Leverage Ratio - using a fully phased-in definition of Tier 1		0.8219
340	Leverage Ratio - using a transitional definition of Tier 1		0.8219
C 47.00			

C 47.00



The countercyclical capital buffer is part of a set of macro-prudential instruments, designed to help counter pro-cyclicality in the financial system. Capital should be accumulated when cyclical systemic risk is judged to be increasing, creating buffers that increase the resilience of the banking sector during periods of stress when losses materialize. This will help maintain the supply of credit and dampen the downswing of the financial cycle. The buffer can also help dampen excessive credit growth during the upswing of the financial cycle.

C 09.04 - BREAKDOWN OF CREDIT EXPOSURES RELEVANT FOR THE CALCULATION OF THE COUNTERCYCLICAL BUFFER BY COUNTRY AND INSTITUTION-SPECIFIC COUNTERCYCLICAL BUFFER RATE (CCB)			
	Country:	Total	
	Amount	Percentage	Qualitative information
	010	020	030
<b>Relevant credit exposures – Credit Risk</b>			
010 Exposure value under the Standardised Approach	2,653,185.17		
020 Exposure value under the IRB Approach			
<b>Relevant credit exposures – Market risk</b>			
030 Own funds requirements for relevant credit exposures – Securitisation positions in the banking book			
040 Value of trading book exposures for internal models			
<b>Relevant credit exposures – Securitisation</b>			
050 Exposure value of securitisation positions in the banking book under the Standardised Approach			
060 Exposure value of securitisation positions in the banking book under the IRB Approach			
<b>Own funds requirements and weights</b>			
070 Total own funds requirements for CCB	212,187.03		
080 Own funds requirements for relevant credit exposures – Credit risk	212,187.03		
090 Own funds requirements for relevant credit exposures – Market risk			
100 Own funds requirements for relevant credit exposures – Securitisation positions in the banking book			
110 Own funds requirements weights			
<b>Countercyclical capital buffer rates</b>			
120 Countercyclical capital buffer rate set by the Designated Authority			
130 Countercyclical capital buffer rate applicable for the country of the institution			
140 Institution-specific countercyclical capital buffer rate			
<b>Use of 2 % threshold</b>			
150 Use of 2 % threshold for general credit exposure			
160 Use of 2 % threshold for trading book exposures			