



Rakuten Europe Bank S.A.

## Pillar III Report

2018 Financial Year End

# Table of Contents

<b>1. INTRODUCTION.....</b>	<b>4</b>
1.1. RECENT EVENTS .....	4
1.2. IMPACT ON RISK PROFILE .....	4
1.3. PILLAR III DISCLOSURES .....	5
<b>2. CAPITAL MANAGEMENT AND ADEQUACY .....</b>	<b>5</b>
2.1. OWN FUNDS STRUCTURE AND FINANCIAL POSITION.....	6
2.2. RISK WEIGHTED ASSETS.....	8
2.3. CAPITAL ADEQUACY .....	9
2.4. INTERNAL CAPITAL.....	9
2.5. LEVERAGE RATIO.....	10
<b>3. RISK ORGANISATION AND GOVERNANCE.....</b>	<b>11</b>
3.1. RISK POLICY .....	11
3.2. RISK PROFILE.....	12
3.3. RISK APPETITE .....	12
3.4. GOVERNANCE.....	13
3.5. INTERNAL CONTROL.....	14
3.6. INTERNAL AUDIT .....	14
3.7. RISK MANAGEMENT FUNCTION.....	15
<b>4. CREDIT RISK.....</b>	<b>15</b>
4.1. RISK WEIGHTED EXPOSURES.....	16
4.2. CONSUMER CREDIT.....	16
4.3. MERCHANT LOANS .....	16
4.4. RECEIVABLES PURCHASE .....	17
4.5. POLICY AND GOVERNANCE .....	17
4.6. IMPAIRMENT ANALYSIS.....	17
<b>5. OTHER FINANCIAL RISKS .....</b>	<b>20</b>
5.1. MARKET RISK .....	20
5.2. LIQUIDITY RISK.....	20
5.3. SETTLEMENT RISK.....	21
<b>6. OPERATIONAL RISK .....</b>	<b>21</b>
6.1. OWN FUNDS REQUIREMENT.....	21
6.2. TYPES OF OPERATIONAL RISK.....	22
6.2.1. <i>Payment Risk</i> .....	22
6.2.2. <i>Fraud Risk</i> .....	22
6.2.3. <i>Information Technology Risk</i> .....	22
6.2.4. <i>Outsourcing Risk</i> .....	23
6.2.5. <i>Tax Risk</i> .....	23
6.2.6. <i>Compliance Risk</i> .....	24
6.2.7. <i>Legal Risk</i> .....	25
6.2.8. <i>Privacy / Bank Secrecy Risk</i> .....	26
6.2.9. <i>Product Risk</i> .....	26
6.2.10. <i>Human Resources Risk</i> .....	26
6.2.11. <i>Corporate Governance Risk</i> .....	27
6.2.12. <i>Insurance Risk</i> .....	28
<b>7. OTHER NON-FINANCIAL RISKS.....</b>	<b>28</b>
7.1. REPUTATION RISK.....	28

7.2. COUNTRY RISK ..... 28

7.3. REGULATORY RISK ..... 28

7.4. BUSINESS RISK ..... 29

**8. RISK CONTROL AND MONITORING ..... 29**

**9. ASSET ENCUMBRANCE ..... 31**

**10. REMUNERATION POLICY AND PRACTICES ..... 32**

**APPENDIX 1: OWN FUNDS ADDITIONAL DISCLOSURES ..... 34**

**APPENDIX 2: COUNTERCYCLICAL CAPITAL BUFFER..... 35**

## 1. Introduction

Rakuten Europe Bank S.A. ("REB" or the "Bank") is a fully licensed credit institution which provides financial services specialised 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, which is 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.

REB, formerly named Rakuten Payment Services S.A. ("RPS"), activated its banking license on 20 January 2016, and is thus authorised 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.

### 1.1. Recent Events

In January 2018, the Bank raised capital of €19.2 million, following a capital injection of €15 million in 2017, resulting in strong solvency and prudential ratios. Key events in 2018 were the completion of the project to migrate the intellectual property of Rakuten's Global Payment Gateway (GPG) to REB. The application was successfully filed with the CSSF. The Global Payment Gateway is a key service for the Rakuten Group. It enables one connection for various services in the group through which they have access to various payment service providers. When a new service is launched or a new service provider is required to be connected, the GPG will connect the new service or the new payment provider, making it an efficient solution for the Rakuten Group.

During 2018 REB on boarded new merchants for the Docomo-Finetrade factoring programme and completed the purchase of a portfolio of receivables from the German entity net-m PrivatBank 1891 AG for a value of EUR 3.5 million. REB also continued to manage its intra-group deposits, developed a new loan product launched as a proof of concept in early 2019 and aimed at providing financial resources to a selected set of merchants participating in the Rakuten France's e-commerce platform. REB conducted a detailed strategy and compliance analysis of Payment Services Directive (PSD) 2 in order to define a potential new operating model that would be compliant with this new regulatory framework and potential business opportunities.

### 1.2. Impact on Risk Profile

The increase in capital strengthened REB's resources. The transfer of the Global Payment Gateway has become one of the main revenue sources of REB, where a commission-based fee structure has

permitted a faired cost allocation of this service across the Group. This structure also opens the potential to sell services outside the Rakuten Ecosystem. Hence, the revenue risk of the company has significantly been reduced. REB's risk management activities continued enhancement during 2018, through the improvement of the overall risk governance process, increased subject matter expertise and further refined REB's risk policies, reporting and escalation processes. As a result, the risk profile of the company remains within the bounds defined by the Board of Directors.

## 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, as repealed by the CSSF Regulation 18-03 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 authorisation 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.

## 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.

Following CRR Article 437 and Article 438, REB discloses Own Funds structure and capital requirements. Specifically,

## 2.1. Own Funds Structure and Financial Position

REB's regulatory capital consists entirely of Common Equity Tier 1 Capital and was €32,346 million at 31 December 2018.

OWN FUNDS	
Item	Amount
<b>OWN FUNDS</b>	32,346,044.74
<b>TIER 1 CAPITAL</b>	32,346,044.74
<b>COMMON EQUITY TIER 1 CAPITAL</b>	32,346,044.74
<b>Capital instruments eligible as CET1 Capital</b>	60,346,086.75
Paid up capital instruments	8,700,000.00
Share premium	51,646,086.75
<b>Retained earnings</b>	-17,668,979.81
Previous years retained earnings	-14,721,339.81
Profit or loss eligible	-2,947,640.00
Profit or loss attributable to owners of the parent	-2,947,640.00
<b>(-) Other intangible assets</b>	-10,331,062.20
(-) Other intangible assets before deduction of deferred tax liabilities	-10,331,062.20

Details of REB's own funds disclosure, in accordance with the Annex VI of the Regulation (EU) No1423/2013, are provided in Appendix 1. The Bank's balance sheet as of 31 December 2018 is shown in the next table:

## BALANCE SHEET

Assets	Carrying amount
<b>Cash and cash equivalents</b>	<b>69,385,899.84</b>
Cash balances at central banks	6,550,387.32
Other demand deposits	62,835,512.52
<b>Loans and receivables</b>	<b>7,169,810.68</b>
Loans and advances	7,169,810.68
<b>Held-to-maturity investments</b>	<b>-</b>
Debt securities	-
<b>Tangible assets</b>	<b>758,355.28</b>
Property, Plant and Equipment	758,355.28
<b>Intangible assets</b>	<b>10,331,062.20</b>
Other intangible assets	10,331,062.20
<b>Other assets</b>	<b>6,821,077.00</b>
<b>TOTAL ASSETS</b>	<b>94,466,205.00</b>
<b>Liabilities</b>	
<b>Financial liabilities measured at amortised cost</b>	<b>45,436,068.56</b>
Deposits	13,900,615.78
Other financial liabilities	31,535,452.78
<b>Provisions</b>	<b>4,733,988.00</b>
Pending legal issues and tax litigation	-
Other provisions	4,733,988.00
<b>Other liabilities</b>	<b>1,619,041.50</b>
<b>TOTAL LIABILITIES</b>	<b>51,789,098.06</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>51,646,086.75</b>
<b>Retained earnings</b>	<b>-14,721,339.81</b>
<b>Profit or loss attributable to owners of the parent</b>	<b>-2,947,640.00</b>
<b>TOTAL EQUITY</b>	<b>42,677,106.94</b>
<b>TOTAL EQUITY AND TOTAL LIABILITIES</b>	<b>94,466,205.00</b>

The Bank's 2018 income statement is presented in the next table:

<b>INCOME STATEMENT</b>	<b>Current period</b>
<b>Interest income</b>	<b>1,934,798.08</b>
Financial assets at amortised cost	1,934,798.08
<b>(Interest expense)</b>	<b>(36,179.03)</b>
(Interest expense on assets)	(36,179.03)
<b>Fee and commission income</b>	<b>3,791,800.46</b>
<b>(Fee and commission expenses)</b>	<b>(34,917.45)</b>
<b>Other operating income</b>	<b>806,042.95</b>
<b>(Other operating expenses)</b>	<b>0.00</b>
<b>TOTAL OPERATING INCOME, NET</b>	<b>6,461,545.01</b>
<b>(Administrative expenses)</b>	<b>(6,516,447.53)</b>
(Staff expenses)	(3,591,754.00)
(Other administrative expenses)	(2,924,693.53)
<b>(Depreciation)</b>	<b>(1,893,832.48)</b>
(Property, Plant and Equipment)	(277,399.32)
(Other intangible assets)	(1,616,433.16)
<b>(Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss)</b>	<b>(998,905.00)</b>
(Financial assets at amortised cost)	(998,905.00)
<b>PROFIT OR (-) LOSS BEFORE TAX FROM CONTINUING OPERATIONS</b>	<b>(2,947,640.00)</b>
<b>PROFIT OR (-) LOSS AFTER TAX FROM CONTINUING OPERATIONS</b>	<b>(2,947,640.00)</b>
<b>PROFIT OR (-) LOSS FOR THE YEAR</b>	<b>(2,947,640.00)</b>
Attributable to equity holders of the parent	(2,947,640.00)

## 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 2018. The Bank's total RWAs were €28.2 million.

<b>OWN FUNDS REQUIREMENTS</b>	
<b>Label</b>	<b>Amount</b>
<b>TOTAL RISK EXPOSURE AMOUNT</b>	28,281,162.34
<b>RISK WEIGHTED EXPOSURE AMOUNTS FOR CREDIT, COUNTERPARTY CREDIT AND DILUTION RISKS AND FREE DELIVERIES</b>	25,480,981.10
<b>Standardised approach (SA)</b>	25,480,981.10
SA exposure classes excluding securitisation positions	25,480,981.10
Institutions	12,567,102.79
Corporates	5,081,302.38
Retail	3,335,518.01
Exposures in default	1,998,928.50
Other Items	2,498,129.42
<b>TOTAL RISK EXPOSURE AMOUNT FOR POSITION, FOREIGN EXCHANGE AND COMMODITIES RISKS</b>	1,379,949.36
<b>Risk exposure amount for position, foreign exchange and commodities risks under standardised approaches (SA)</b>	1,379,949.36
Foreign Exchange	1,379,949.36
<b>TOTAL RISK EXPOSURE AMOUNT FOR OPERATIONAL RISK (OpR)</b>	1,420,231.88
<b>OpR Basic indicator approach (BIA)</b>	1,420,231.88

## 2.3. Capital Adequacy

REB had a capital ratio of 114% at 31 December 2018. This is well above the regulatory limit of 8%

<b>CAPITAL RATIOS AND CAPITAL LEVELS</b>	
<b>Item</b>	<b>Amount</b>
<b>CET1 Capital ratio</b>	1.1437
<b>Surplus(+)/Deficit(-) of CET1 capital</b>	31,073,392.43
<b>T1 Capital ratio</b>	1.1437
<b>Surplus(+)/Deficit(-) of T1 capital</b>	30,649,175.00
<b>Total capital ratio</b>	1.1437
<b>Surplus(+)/Deficit(-) of total capital</b>	30,083,551.75

## 2.4. Internal Capital

REB's 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 2018, 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 input was provided by the Risk and Finance representatives, then reviewed by the Authorised Management, 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;
- Regulatory Risk;
- Concentration Risk;

- Business Risk; and
- Investment Risk.

## 2.5. 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). Following CRR Article 451, REB discloses the Leverage Ratio. At 31 December 2018, REB's leverage ratio was at a level of 38.45%, comfortably above the regulatory minimum level of 3%.

<b>LEVERAGE RATIO CALCULATION</b>	
<b>Exposure Values</b>	<b>LR Exposure</b>
Other assets	94,466,205.84
(-) Asset amount deducted - Tier 1 - fully phased-in definition	-10,331,062.20
(-) Asset amount deducted - Tier 1 - transitional definition	-10,331,062.20
Total Leverage Ratio exposure - using a fully phased-in definition of Tier 1 capital	84,135,143.64
Total Leverage Ratio exposure - using a transitional definition of Tier 1 capital	84,135,143.64
<b>Capital</b>	
Tier 1 capital - fully phased-in definition	32,346,044.74
Tier 1 capital - transitional definition	32,346,044.74
<b>Leverage Ratio</b>	
Leverage Ratio - using a fully phased-in definition of Tier 1 capital	0.3845
Leverage Ratio - using a transitional definition of Tier 1 capital	0.3845

### 3. Risk Organisation and Governance

Following CRR Article 435, REB discloses risk management objectives and policies for each separate category of risk. From a holistic point of view, REB has set up its organisation to provide sound risk management and culture. This is detailed as follows:

#### 3.1. Risk Policy

In order to accomplish its objectives, REB has adopted an approach to Enterprise Risk Management (ERM) that is in line with the business strategy, it frames the way management runs REB, and it is fully integrated with the management process. The main components of REB's approach to ERM are:

1. Risk Identification – Internal and external events affecting achievement of an entity's objectives must be identified, distinguishing between risks and opportunities. Opportunities are channelled back to management's strategy or objective-setting processes;
2. Risk Assessment – Risks are analysed, considering the likelihood and impact, as a basis for determining how they should be managed. Risks are assessed on an inherent and a residual basis and the process must initially consider which risks are controllable and uncontrollable;
3. Risk Response – Management selects risk responses – avoiding, accepting, reducing, transfer or sharing risk – developing a set of actions to align risks with the entity's risk tolerances and risk appetite;
4. Control Activities – Policies and procedures are established and implemented to help ensure the risk responses are uniformly and effectively carried out across the institution.
5. Monitoring – The entirety of enterprise risk management is monitored and modifications made as necessary. Monitoring is accomplished through a continuous reporting system of ongoing management activities, separate evaluations, or both;
6. Information and Communication – Relevant information is identified, captured, and communicated in a form and timeframe that enable people to carry out their responsibilities. Effective communication also occurs in a broader sense, flowing down, across, and up the entity.

In addition, REB considers the following elements in setting its ERM approach:

- Internal Environment – The internal environment encompasses the tone of an organization, and sets the basis for how risk is viewed and addressed internally, including risk

management philosophy and risk appetite, integrity and ethical values, and the environment in which they operate.

- Objective Setting – Objectives must exist before management can identify potential events affecting their achievement. Enterprise risk management ensures that management has in place a process to set objectives and that the chosen objectives support and align with the entity's mission and are consistent with its risk appetite.

The ERM Approach is a logical and systematic way to enable REB to minimize losses and maximize opportunities associated with any activity, function or process. ERM is as such about identifying opportunities as avoiding or mitigating losses. As a result of this approach, REB

- Ensures that all appropriate measures are put in place;
- Reports potential risks that might affect the company;
- Considers risks arising from other business obligations; and,
- Takes all measures to identify, analyse and communicate risks.

## 3.2. Risk Profile

REB's overall risk profile is set by the Board of Directors in a manner consistent with the business strategy. In this regard, REB's business model shall focus on revenues earned from commission on payment transactions and interest from loans and low risk investments. Its customer base and the underlying customer base of investments is highly diversified across a large number of small and medium enterprises.

Accordingly, there is a mandate from the Board of Directors not to earn revenues through actions that over expose the company to Credit Risk, or expose on Market Risk, Interest rate mismatches or Foreign Exchange Risk. REB shall hold all customer funds only in highly rated and liquid assets with reputable and creditworthy financial institutions.

The above disclosure is in accordance with CRR Article 335 1.(f).

## 3.3. Risk 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. REB's Risk Appetite consists of the following requirements:

- Any material exposure, either exceeding the lower amount of:
  - 5% of REB's own funds or
  - 5% of REB's revenue, but
  - A minimum of €500,000.
- This amount is in addition to the planned and budgeted deficit to launch and expand banking activities;
- REB's own funds must be a minimum of 120% of the total Pillar II risk capital.

## 3.4. Governance

REB has in place a Risk Management Charter that defines the fundamental principles, roles and responsibilities of the Risk Management function as well as its relationship with REB Board of Directors ('BoD'), Authorized Management, the business and operational functions. Internal and Risk Governance requirements are defined in the CSSF Circular 12/552, amended by Circulars 13/563, 14/597, 16/642, 16/647 and 17/655.

The responsibility for risk management resides at all levels within REB, that uses a three lines of defence model as follows:

- The first line of defence rest with all divisions involved in the actual running of the bank, including business divisions, as well as other supporting and enabling functions such as Finance, Operations and IT. These units shall set up proper control systems, identifying issues and taking remedial actions when required.
- The second line of defence comes from the Risk Management function directed by the Chief Risk Officer (CRO), as well as the Compliance function, under the responsibility of the Chief Compliance Officer (CCO).
- The third line of defence is the Internal Audit, which provide an independent risk assessment, controls and corporate governance structure.

The ultimate responsibility for the management of risks relies on the Board of Directors (BoD) with the support of REB's Authorized Management. Specifically, the BoD is responsible for defining the Risk Management principles to which REB has to adhere. It has to demonstrate a clear commitment by ensuring that an appropriate Enterprise Risk Management ('ERM') Policy is in place and that all risks are managed appropriately. The composition of the bank's Board of Directors is the following:

Name	Residence	Number of directorships	Member since
Koichi Nakamura (chairman)	Japan	3	1 August 2017
Toshihiko Otsuka	Luxembourg	10	27 January 2016
Ken Takano	Japan	1	15 July 2016
Nigel Bath	USA	0	15 July 2016
Nabil Meziani	Luxembourg	0	31 January 2017
Thomas Belousek	Luxembourg	0	1 August 2017

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.

### 3.5. Internal 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)., reporting to Authorised Management the Bank's technical infrastructure is reviewed regularly and upgrades are executed, if necessary, for the Bank's control objectives.

### 3.6. Internal Audit

The internal audit function is outsourced to BDO Luxembourg. An audit plan is prepared and presented to the Board of Directors and the CSSF. The internal audit projects in accordance with the audit plan are followed up by quarterly ICSC meetings with the internal audit function. The Authorised Management of REB determines and regularly monitors the internal audit resources and their qualifications to ensure they are appropriate.

REB's technical infrastructure is reviewed regularly, and upgrades are executed, if necessary, to ensure achievement of REB's objectives. REB complies with relevant CSSF reporting requirements and provides reliable financial and management information to the Authorised Management on a regular basis.

The internal auditor provides independent assurance to REB's management that the internal controls, established by management, are functioning appropriately.

The review consists of providing management with assurance 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 authorised personnel, based on adequate and sound information;
- Transactions, income, expenditure, liabilities and assets are completely and accurately recorded; and
- Assets are safeguarded.

## 3.7. Risk Management Function

As per Circular CSSF 12/552 6.2.4, a Risk Management function, independent from Internal Audit, provides a second line of defence by ensuring that:

- Executive Management's risk strategy, guidelines and policies are properly implemented and adhered to;
- Risk exposures are independently monitored and tracked;
- Exceptions are reported regularly and adequately to Executive Management.

REB's Risk Management function is undertaken by the Chief Risk Officer, who reports to the Board of Directors. To ensure efficient Risk Management in line with the respective risk treatment and investment,

- Regular Risk updates are provided to REB's Board of Directors;
- Monthly updates are provided to the ICSC;
- Potential/actual issues are highlighted in REB's Quarterly Risk Report and followed up to ensure satisfactory resolution.

REB's CRO is responsible for managing its risk monitoring and reporting system. However, the functional heads have primary responsibility and accountability for managing the risks.

## 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.

The Pillar I calculation is based on Risk Weighted Assets and the Standardised Approach, whereas for Pillar II, the effect of two simultaneous elements is added: additional capital requirements defined by type of risk (estimates based on the size of the activity), and the reduction of capital due to three stress scenarios.

REB's Finance department monitors its 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 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 20198, REB had total credit exposures of €85.1 million and risk weighted exposures of €25.4 million.

The following table displays the breakdown of the Bank's total exposures by risk weight, exposure class and by geographic location.

CREDIT AND COUNTERPARTY CREDIT RISKS							
	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>	85,162,206.42	84,135,143.64	84,135,143.64	84,135,143.64	84,135,143.64	26,523,357.84	25,480,981.10
<b>On balance sheet exposures subject to credit risk</b>	85,162,206.42	84,135,143.64	84,135,143.64	84,135,143.64	84,135,143.64	26,523,357.84	25,480,981.10
<b>BREAKDOWN OF TOTAL EXPOSURES BY RISK WEIGHTS:</b>							
0%	6,550,387.32	6,550,385.88		6,550,385.88	6,550,385.88	0.00	0.00
20%	62,835,532.30	62,835,513.96		62,835,513.96	62,835,513.96	12,567,102.79	12,567,102.79
75%	6,524,692.00	5,837,193.00		5,837,193.00	5,837,193.00	4,377,894.75	3,335,518.01
100%	7,579,437.80	7,579,431.80		7,579,431.80	7,579,431.80	7,579,431.80	7,579,431.80
150%	1,672,157.00	1,332,619.00		1,332,619.00	1,332,619.00	1,998,928.50	1,998,928.50
<b>BREAKDOWN OF TOTAL EXPOSURES BY SA EXPOSURE CLASS:</b>							
Central Governments and Central Banks	6,550,387.32	6,550,385.88	6,550,385.88	6,550,385.88	6,550,385.88	0.00	0.00
Exposures in default	1,672,157.00	1,332,619.00	1,332,619.00	1,332,619.00	1,332,619.00	1,998,928.50	1,998,928.50
Institutions	62,835,532.30	62,835,513.96	62,835,513.96	62,835,513.96	62,835,513.96	12,567,102.79	12,567,102.79
Other items	2,498,129.42	2,498,129.42	2,498,129.42	2,498,129.42	2,498,129.42	2,498,129.42	2,498,129.42
Retail	6,524,692.00	5,837,193.00	5,837,193.00	5,837,193.00	5,837,193.00	4,377,894.75	3,335,518.01
Corporates	5,081,308.38	5,081,302.38	5,081,302.38	5,081,302.38	5,081,302.38	5,081,302.38	5,081,302.38
<b>GEOGRAPHICAL BREAKDOWN OF EXPOSURES BY RESIDENCE OF THE OBLIGOR:</b>							
DE	23,675,781.88				22,648,740.51	9,875,397.54	8,833,020.80
ES	999,990.24				999,989.95	199,997.99	199,997.99
FR	21,059,556.21				21,059,545.05	6,911,895.56	6,911,895.56
GB	4,500,034.05				4,500,032.74	900,006.55	900,006.55
JP	1,110,080.68				1,110,080.68	1,110,080.04	1,110,080.04
LU	18,787,960.91				18,787,956.64	4,483,310.24	4,483,310.24
BR	9,625.41				9,625.41	9,625.41	9,625.41
BE	14,982,664.56				14,982,660.19	2,996,532.04	2,996,532.04
TW	36,512.48				36,512.48	36,512.48	36,512.48

#### 4.2. Consumer Credit

As part of its core strategy, the bank intends to issue cash advances and instalment loans to consumers and SMEs. REB has built the corresponding infrastructure to support this business, including a dedicated team in the Risk function under the CRO and with oversight by the Asset Liability Management and Credit Risk Committee, there are additional support staff in areas such as Finance, Compliance and Operations. The Bank has in place a Credit Risk Policy and an Impairment Policy.

#### 4.3. Merchant Loans

REB has been developing a new product related to loans to merchants which are meant to be a convenient way for them to borrow. The underwriting and decision to grant credit is meant to be done

through a scoring engine, connected to internal and external data sources, with manual steps for additional verification. The portfolio performance is to be monitored regularly to adapt underwriting and collection processes.

#### 4.4. Receivables Purchase

REB has a programme to purchase invoices issued by DOCOMO-finetrade (“D-FT”). During 2018, REB continued to factor receivables (payment-upon-invoice and instalments) from D-FT with a discount depending on the associated risk from their merchant partners in Germany, Austria and Switzerland. Following continued process and system enhancements, additional merchants were on-boarded to grow the business.

Credit issuing, servicing and collection are performed by D-FT (i.e., in line with CSSF Circular 12/552 on outsourcing for servicing and collections). REB closely monitors the performance of the portfolio, and monthly updates are presented to the ALMCC. During 2018, REB completed the purchase of a portfolio of receivables from the German entity net-m PrivatBank 1891 AG for a value of € 3.5 million. The portfolio is serviced by D-FT.

#### 4.5. Policy and Governance

REB has in place a Credit Policy that formalises and articulates the approach to measure, monitor and manage credit risk.

The following guiding principles provide a framework for decision-making and are consistent with REB’s overall Risk Management objectives:

- Credit (default) risk should be minimised wherever possible due to its potential adverse impact, and managed within the established limits for credit exposure;
- Concentrations of risk are prevented through customer and portfolio limits;
- REB 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;
- REB monitors the Credit Programme performance to ensure that the its credit risk is at a manageable level and within its risk appetite;
- Potential funding/liquidity exposures are mitigated through REB’s Liquidity Contingency Policy.

#### 4.6. Impairment Analysis

Definitions:

- Impairment: REB records allowances for impairment losses when there is objective evidence that a financial asset or group of financial assets is impaired as a result of one or more events occurring after initial recognition and is evidencing (i) A decline in expected cash flows and (ii) An impact on estimated future cash flows that can be reliably estimated.
- Past-due: For the purposes of the application of point (b) of Article 178(1) of Regulation (EU) No 575/2013, where any amount of principal, interest or fee has not been paid at the date it was due, the bank recognises this as the credit obligation past due.<sup>1</sup>

## Provisioning Approach:

REB follows IFRS 9 accounting rules. Given the incipient nature of the businesses, a simplified approach has been followed by the Bank. A tailor-made IFRS 9 calculation engine is used to perform the expected credit loss and impairment analysis which is reported on a regular basis to the management of the Bank. The assessment is based on the outputs provided by the calculation engine as well as other relevant metrics or relevant factors such as macroeconomic conditions, contractual or legislation changes or other relevant considerations. The results of the analysis and recommendations are presented to the Asset and Liability Management and Credit Committee (ALMCC) for discussion and eventual validation.

The Bank closely monitors its financial assets performance at least on a monthly basis and uses several general criteria to monitor a significant increase in the credit risk. Some of the factors used are: changes in the external credit rating for corporates, changes in probability of default (PD), default of the credit exposure (if the customer is delinquent, the PD increases significantly based on the delinquency bucket and therefore the Expected Credit Loss (ECL) is increased).

Also, the Bank considers a financial asset in default when contractual payments are 90 days past due. However, in certain cases, the Bank may also consider a financial asset to be in default when internal or external information indicates that the Bank is unlikely to receive the outstanding contractual amounts in full before taking into account any credit enhancements held by the Bank. A financial asset is written off when there is no reasonable expectation of recovering the contractual cash flows.

## Provision for expected credit losses for Loans and receivables - customers

An impairment analysis is performed at each reporting date using a provision matrix to measure expected credit losses. The provision rates are based on days past due for measured on an individual

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<sup>1</sup> Where the credit arrangement explicitly allows the obligor to change the schedule, suspend or postpone the payments under certain conditions and the obligor acts within the rights granted in the contract, the changed, suspended or postponed instalments are not considered past due, and the counting of days past due is based on the new schedule once it is specified, according to Articles 178(1) and (3) of Regulation (EU) No 575/2013.

basis for each customers. The provision matrix is initially based on the Bank historical observed default rates. The Bank then calibrates the matrix to adjust the historical credit loss experience with forward-looking factors relevant to the debtors and economic environment. At every reporting date, the historical observed default rates are updated and changes in the forward-looking estimates are analysed.

The assessment of the correlation between historical observed default rates, forecast economic conditions and ECLs is a significant estimate. The amount of ECLs is sensitive to changes in circumstances and of forecast economic conditions. The Bank's historical credit loss experience and forecast of economic conditions may also not be representative of customer's actual default in the future.

The following table provides information on defaulted exposures by type of asset. It also shows credit risk adjustments and other relevant information.

	ORIGINAL EXPOSURE PRE CONVERSION FACTORS	Defaulted exposures	Observed new defaults for the period	General credit risk adjustments	Specific credit risk adjustments	Of which: write-offs	Credit risk adjustments/write-offs for observed new defaults	EXPOSURE VALUE	RISK WEIGHTED EXPOSURE AMOUNT PRE SME- SUPPORTING FACTOR	RISK WEIGHTED EXPOSURE AMOUNT AFTER SME- SUPPORTING FACTOR
	010	020	040	050	055	060	070	075	080	090
010 Central governments or central banks	6,550,387.32			1.44				6,550,385.88		
020 Regional governments or local authorities										
030 Public sector entities										
040 Multilateral Development Banks										
050 International Organisations										
060 Institutions	62,835,532.30			18.34				62,835,513.96	12,567,102.79	12,567,102.79
070 Corporates	5,081,308.38			6.00				5,081,302.38	5,081,302.38	5,081,302.38
075 of which: SME										
080 Retail	6,524,692.00	1,672,157.00		687,499.00				5,837,193.00	4,377,894.75	3,335,518.01
085 of which: SME	6,524,692.00	1,672,157.00		687,499.00				5,837,193.00	4,377,894.75	3,335,518.01
090 Secured by mortgages on immovable property										
095 of which: SME										
100 Exposures in default	1,672,157.00			339,538.00				1,332,619.00	1,998,928.50	1,998,928.50
110 Items associated with particularly high risk										
120 Covered bonds										
130 Claims on institutions and corporate with a short-credit assessment										
140 Collective investments undertakings (CIU)										
150 Equity exposures										
160 Other exposures	2,498,129.42							2,498,129.42	2,498,129.42	2,498,129.42
170 Total exposures	85,162,206.42	1,672,157.00		1,027,062.78				84,135,143.64	26,523,357.84	25,480,981.10

The following table provides information on past-due and impaired exposure by country of residence. It must be pointed out that only retail exposures are within this category.

Retail Exposures	Past due	Impaired
Austria	591,723	261,304
Belgium	4,863	4,863
Germany	5,051,969	1,344,382
Netherlands	81,016	39,927
<b>Total</b>	<b>5,729,571</b>	<b>1,650,475</b>

## 5. Other Financial Risks

### 5.1. Market Risk

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 minimise 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. For its factoring programme, REB will purchase invoices in Swiss francs, but it will hedge the position as soon as the exposure reaches levels defined by the Market Risk Policy.

REB calculates its capital requirements for FX market risk according to the Standardised Approach. At 31 December 2018 REB had a total market risk exposure amount of €1.3 and own funds requirement of €110,396.

MARKET RISK									
	CURRENCY CODE	ALL POSITIONS		NET POSITIONS		POSITIONS SUBJECT TO CAPITAL CHARGE	RISK CAPITAL CHARGE	OWN FUNDS REQUIREMENTS	TOTAL RISK EXPOSURE AMOUNT
		LONG	SHORT	LONG	SHORT	LONG	LONG		
TOTAL POSITIONS IN NON-REPORTING CURRENCIES		3,859,956.07	2,480,118.54	1,379,949.36	111.83	1,379,949.36		110,395.95	1,379,949.38
All other currencies (including CIUs treated as different currencies)		3,859,956.07	2,480,118.54	1,379,949.36	111.83	1,379,949.36	8.00	0.00	
BREAKDOWN OF TOTAL POSITIONS (REPORTING CURRENCY INCLUDED) BY EXPOSURE TYPES									
	Other assets and liabilities other than off-balance sheet items and derivatives		122,428,472.84	125,376,112.84					
Memorandum Items: CURRENCY POSITIONS									
	EURO	EUR	118,568,516.77	122,895,994.30		4,327,477.53			
	Pound Sterling	GBP	780,782.70	751,187.65					
	Yen	JPY	3,049,349.84	1,699,773.79		0.00			
	Swiss Franc	CHF	25,866.55	25,088.29		0.00			
	US Dollar	USD	3,956.98	4,068.81		111.83			
Decomposition of calculation									
All other currencies			3,859,956.07	2,480,118.54	1,379,949.36	111.83			
	CHF		25,866.55	25,088.29	778.28	0.00			
	GBP		780,782.70	751,187.65	29,595.05	0.00			
	JPY		3,049,349.84	1,699,773.79	1,349,576.05	0.00			
	USD		3,956.98	4,068.81	0.00	111.83			
Not Matched Total			0.00	0.00					

### 5.2. Liquidity Risk

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. All treasury, cash management and liquidity risk management are performed in house, on-site by REB employees in Luxembourg. Rakuten Group does not get involved in day-to-day Euro liquidity management remotely. All bank accounts are operated directly by REB staff.

REB has an Asset & Liability Management Control Committee (“ALMCC”) which is designed to intervene when the liquidity risk profile falls under the liquidity risk appetite.

The following table presents information about REB’s liquidity risk management:

Scope of consolidation (solo/consolidated)	TOTAL ADJUSTED VALUE			
Currency and units (EUR million)				
Quarter ending on	31 March 2018	30 June 2018	30 September 2018	31 December 2018
Number of data points used in the calculation of averages	12	12	12	12
LIQUIDITY BUFFER	6.451	6.563	6.557	6.550
TOTAL NET CASH OUTFLOWS	2.835	2.010	2.754	2.023
LIQUIDITY COVERAGE RATIO (%)	227%	326%	238%	323%

### 5.3. Settlement Risk

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. For payment activity and e-money, settlement takes place with acquiring banks and other payment providers through Rakuten France. They settle with Rakuten France on a daily basis, and it transfers the funds to the bank the next day.

REB has several objectives in managing settlement risk for its customers:

- Ensure that procedures are in place to handle standard settlement activities in an efficient manner;
- Ensure that cases that cannot be resolved through standard exception procedures are escalated in the appropriate manner and resolved in a reasonable time frame.

REB's CRO is also in charge of the management of the risks that arise for REB and its customers. He is in regular contact with REB's Heads of Finance and Treasury.

## 6. 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.

### 6.1. Own Funds Requirement

Following CRR Article 446, REB discloses approach to the assessment of own funds requirements of operational risk. Accordingly, REB calculates its capital requirements for operational risk according to the standardised approach. At 31 December 2018, the Bank had a total operational risk exposure amount of €1.4 million and own funds requirement of €113,619.

OPERATIONAL RISK					
BANKING ACTIVITIES	RELEVANT INDICATOR			OWN FUNDS REQUIREMENT	Total operational risk exposure amount
	YEAR-3	YEAR-2	LAST YEAR		
BANKING ACTIVITIES SUBJECT TO BASIC INDICATOR APPROACH (BIA)	941,290.00	677,151.00	653,930.00	113,618.55	1,420,231.88

## 6.2. Types of Operational Risk

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

### 6.2.1. Payment Risk

In regards to Rakuten France seller disbursements, payment monitoring is in place to identify any potential process alerts and provide operational support to drive internal and third-party cross functional incident resolution before customers experience an impact.

### 6.2.2. Fraud Risk

REB and Rakuten globally understand the importance of managing the potential for fraud transaction-related losses carefully at various different levels of the organisation, and they have taken steps to mitigate and control this risk. During the account/transaction lifecycle, fraud mitigation features are applied, including but not limited to:

- Front-end controls to minimise the amount of fraudulent funds entering the system;
- Internally developed models, limit controls, reserve management, proprietary in-house software and highly trained staff to review accounts and transactions within the system for potential loss;
- Sound recovery procedures to minimise net losses;
- Monitoring of fraud trends and impacts of risk programmes;
- Provision of regular and detailed Fraud Risk reports;
- Collaboration with other teams (such as Compliance and Operations);
- Customer protection programmes that help mitigate the impact of potential fraud for buyers and sellers.

### 6.2.3. Information Technology Risk

#### Business Continuity Plan

A Business Continuity Policy and a Business Continuity Plan ("BCP") are to be set up by REB in case its building and/or systems could not be accessed. The BCP covers the REB's critical activities and should allow their recovery. The BCP Team, composed of the CRO and the Information Security Officer ("ISO"), coordinates the operations and is in charge of taking the appropriate actions in case of a disaster. A copy of the BCP is distributed to each department leader, with the procedures applicable to their team.

Among the procedures defined, particular attention has been paid to ensure that in a disaster situation, security (both physical and logical) is at the same level as in normal circumstances.

A representative number of REB employees participate in an annual test to validate the procedures in place as adequate. The test results are documented and analysed by Risk, who will modify the BCP as necessary. REB's business systems are all redundant, with instances on different physical sites.

## Information Security Risk

A dedicated Information Security Policy has been defined and covers the information security risks and mitigating measures in detail. REB holds only customer data that is not available online, and are stored on servers hosted by a PSF in Luxembourg, including state-of-the-art security features. Intrusion Detection Systems ("IDS") are deployed to monitor for and alert on abnormal network or application behaviour. Systems communicate via encrypted communications including Secure Sockets Layer ("SSL"), an industry standard communications security protocol, and they require mutual authentication.

Rakuten encrypts private or sensitive data at rest, such as bank account numbers, credit card numbers and passwords in the core system. Rakuten decrypts data only on an as-needed basis, using a specially designated component of its system that requires authentication before fulfilling a decryption request. Any information exchanged with vendors is encrypted or submitted via an encrypted medium at the application and/or network layer. Care is taken with each file not to send private or sensitive data, unless mandatory.

## 6.2.4.Outsourcing Risk

In line with Luxembourg regulations, outsourcing activities should not result in outsourcing their risk. Outsourcing, including the process to outsource activities and functions, monitoring, risk assessment and mitigating measures are covered in detail in the Outsourcing Policy. All outsourcing of critical functionality is backed by appropriate service level agreements and annual monitoring of such agreements by the Chief Risk Officer.

## 6.2.5.Tax Risk

REB's tax rate could be adversely affected by changes in statutory tax rates or interpretations of tax laws, regulations or accounting principles, or by changes in the valuations of REB's deferred tax assets or liabilities. In addition, REB is subject to the examination of its income tax returns by the Luxembourg Administration des Contributions Directes. Management regularly assesses the likelihood of adverse outcomes resulting from such examinations to determine the adequacy of REB's provision for income taxes. Moreover, there have been, and will continue to be, substantial ongoing costs associated with complying with the various income tax requirements in Luxembourg.

The application of existing, new or future laws could have adverse effects on REB's business. Management continues to work with the relevant tax authorities and legislators to clarify REB's obligations under new and emerging laws and regulations. Passage of new legislation and the imposition of additional tax or tax-related reporting requirements could harm REB's users and its business.

## 6.2.6.Compliance Risk

REB is committed to complying with all rules and regulations governing its services. REB's Compliance Department works to ensure that it complies with all applicable regulations of the jurisdictions in which it does business. REB's Compliance Officer is responsible for ensuring that adequate processes are in place to assist REB to meet its applicable regulatory requirements. The Compliance Officer will also identify market best practices where relevant for REB's practices, policies and processes. The applicable policies and procedures are contained in a separate Compliance Manual.

REB realises that a political risk exists in terms of changes in new legislation and/or regulations. REB's Legal and Compliance Departments work to monitor for new regulations applicable to REB's business activities, or the exercise of jurisdiction by a new regulator. REB will also work with external consultants and counsel to keep apprised of various legislative and regulatory developments.

### Money Laundering/Terrorism Financing Risk

To ensure compliance with all Luxembourg legislation relating to Anti-Money Laundering ("AML"), REB has adopted an AML infrastructure. Processes and procedures are in place to support REB's business, updated and amended as required to meet local Luxembourg legislation obligations and described in the Anti-Money Laundering and Counter Terrorism Financing Policy. As a CSSF-regulated bank, REB complies with all Luxembourg legislation related to AML. Processes and procedures are in place within REB and various related outsourced service providers to ensure compliance with these AML obligations, ensuring:

- Accurate verification of customer identity;
- Effective monitoring of customer operations;
- Checks against government-provided anti-terrorism information;
- Filing of suspicious activity reports with law enforcement agencies as described in the Suspicious Transaction Reporting Procedure.

### Terms and Conditions Violation Risk

The Terms and Conditions ("T&Cs") cover all REB transactions, including purchases and sale of all goods and services on Rakuten marketplaces, other online marketplaces, potentially through the seller's own websites, or any other forum. REB's customers are ultimately responsible for ensuring that all transactions they enter into using the REB product are legal and comply with these T&Cs. In all

transactions, sellers must clearly and accurately describe the goods or services they are selling. The current version of the documents is part of the Merchant Contract.

The T&Cs list various items for which REB payment services may generally not be used. Some items require immediate restriction due to illegality (either jurisdictional or general), conflict with credit card association rules, or by their nature involve higher risk to REB for customer complaints, chargebacks, or financial or fraud risk.

The Compliance team uses a variety of methods to monitor compliance with policy including proactive searches of the Internet, internal inquiries by Rakuten Europe customer service agents, escalations from other service groups, email reports from customers or web users, and monitoring of internal and external reports. Customers found in violation of the policy are notified via email. Violating Rakuten's Acceptable Use Policy or its T&Cs may result in temporary or permanent limitation of a customer's account.

This limitation includes the inability to send and/or receive payments, to remove financial information from an account, and for users to close their accounts as a way of evading the policy. In addition, users whose accounts are permanently limited for violating the Acceptable Use Policy are barred from future use of REB and its services, and such users are not permitted to open new or additional REB accounts. REB may take legal action against the violator to recover losses that are in excess of the amount fined.

### 6.2.7. Legal Risk

REB manages Legal Risk through the maintenance of appropriate corporate governance and codes of conduct, adherence to legal requirements, and control of contractual obligations and litigation risk. REB recognises that these risks are particularly challenging, as the laws governing e-commerce and e-payments are often ambiguous and are evolving.

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 able to call on many international law firms that have developed a strong understanding of REB's business to help identify and address legal risks, and to stay informed of new legislation affecting its business.

In addition to the Legal Department, the Compliance Department is responsible for ensuring that REB complies with applicable regulations, including anti-money laundering and suspicious reporting requirements. The Compliance Department is also responsible for ensuring that all affected employees are trained and receive ongoing education with respect to the firm's regulatory responsibilities.

REB benefits from processes established by Rakuten Inc. that apply to all Rakuten group members and their employees, in particular a Code of Conduct (in addition to REB's) and a Conflict of Interest Policy. Rakuten has in place a number of other policies and procedures that cover REB and help it to reduce legal risk.

## 6.2.8. Privacy / Bank Secrecy Risk

Privacy/Bank Secrecy is a fundamental element of the REB value proposition. It is believed that a significant, public privacy incident would result in an increase in regulatory oversight, in addition to the REB and Rakuten Inc. brand impact from a customer perception perspective. Therefore, potential privacy/bank secrecy issues are being addressed as necessary.

## 6.2.9. Product Risk

REB defines Product Risk as losses arising from failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product, e.g., due to bugs or missed target go-lives. Therefore, REB is focusing on ensuring the required expertise, resources and capabilities to mitigate any Product Risk-related exposures.

## 6.2.10. Human Resources Risk

### Talent Management and Retention Risk

The Head of Human Resources is responsible for defining and implementing a strategy that guarantees people's development and talent retention. The strategy consists of appropriate and adapted remuneration, monetary performance-based rewards, internal promotions (with or without function change), and training courses for employees demonstrating potential.

### Resource Risk

Rakuten has approximately 15,000 employees worldwide. There are appropriate service level agreements ("SLAs") in place to reflect the intra-group services required by REB. There are representatives from each department within REB who are responsible for REB's needs pursuant to SLAs.

### Personnel Risk

With regard to Personnel Risk, REB identifies falsified or misleading personal and employment history and lack of training as Personnel Risk issues. Appropriate guidelines, documentation and training have been established throughout REB to address these risks.

### Internal Fraud

The following internal fraud scenarios have been identified:

- Customer and account information associated with high-value customers could be compromised or used improperly; this risk applies not only to employees, but also to supervisors and Quality Assurance (“QA”) personnel who may have access to sensitive information.
- Transaction-level information could be compromised or used improperly; this risk applies specifically to Fraud Management and Finance personnel who have access to all the outgoing transactions including amounts and bank account numbers.
- Customer and account information could be compromised or used improperly.
- REB employee information/bank data could be misused.

Appropriate monitoring/approval features are in place.

- Employment: REB conducts professional and personal background reference checks in accordance with European and local regulations on all potential hires. Where legitimate according to the respective jurisdiction, background investigations eliminate high-risk individuals, those who have falsified their credentials and experience, and those who have been less than forthright in disclosing their history.
- Training: REB employee development is broken into multiple parts, depending on the area of the business the employee will be supporting. In addition, REB offers several continuing education options to keep employees up to date on product and policy enhancements.

### 6.2.11. Corporate Governance Risk

In order to mitigate Corporate Governance Risk, REB operates strong corporate governance and segregation-of-duty controls to ensure compliance with relevant CSSF Circulars and the Law of April 5, 1993 on the financial sector. The processes are well defined and controlled as defined in the Manual of Internal Governance, including the use of:

- Clearly defined responsibilities for every department and person -- every employee's function is governed by a written job description, containing details of each job designation, purpose and reporting lines and responsibilities of the person concerned.
- Clearly defined and documented policies and procedures, which are kept up to date;
- Provision of an internal procedures handbook, incorporating compliance policies which are available on REB's intranet to every employee;
- Regular training of personnel to keep track of market developments;
- Tasks documented in the contractual arrangements with clients, e.g., SLAs;
- Employment of independent and permanent Compliance staff directly in Luxembourg integrated into and supported by the AML and compliance organisation, which ensures the observance of internal and external regulations to prevent money laundering, funding of terrorism and other criminal activities.

In addition, quarterly Board meetings are being scheduled to discuss any related issues as they may arise.

## 6.2.12. Insurance Risk

There is a risk of insufficient insurance policies. For certain risks that can be appropriately insured, REB is covered through Rakuten Inc. insurances. These include:

- Property (including Fire and Earthquake (for California operations));
- Liability and excess liability;
- Worker's compensation;
- Directors and Officers;
- Business interruption; and,
- Crime.

## 7. Other Non-Financial Risks

### 7.1. Reputation Risk

Reputation Risk is the risk of losing customers, employees and important business opportunities should REB receive bad publicity or develop a poor reputation. All contingencies are covered by the Public Relations Department of Rakuten Inc. All employees are informed that any press enquiries are handled solely by Rakuten's Public Relations Department, and only those employees given explicit permission by the Public Relations Department are permitted to talk directly with members of the press regarding REB activities.

### 7.2. Country Risk

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.

### 7.3. Regulatory Risk

Regulatory risk refers to potential negative impact, either financial or reputational, due to:

- Different interpretations of the scope of Directives and their implementation within the EU;
- Termination of REB's banking licence;
- Breaching terms of authorisation.

CSSF - Solvency Ratio:

As defined in the Own Funds Policy, the CET1 capital ratio is 4.5%, the minimum Tier 1 capital ratio is 6%, and the lowest total capital ratio is 8%. REB/Treasury monitors the money float daily to ensure the appropriate ratios. REB has committed to keep a minimum internal capital ratio of 16%. In case of need, additional capital is funded accordingly.

#### Banque Centrale de Luxembourg ("BCL"):

Per BCL requirement, REB must deposit a minimum of 1% of its total customer liabilities plus intra-group deposits.

#### Basel III:

Please refer to the Basel III/ICAAP Policy documentation.

## 7.4. Business Risk

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. Business risk could be:

#### Revenue Risk

There is a risk of not meeting business targets. If targets are severely missed, this could have an impact on REB's capital adequacy.

#### Competition Risk

Competition and other developments/innovations in target markets could adversely impact REB's financials. Therefore, it is constantly monitoring any respective developments.

#### Business Model Risk

REB is in a growing phase and expanding its products and services. Break-even is expected to be achieved in 2019. The current business plan provides detailed growth projections for every business line and is monitored regularly. As REB launches additional services (e.g., cards, wallet), it is planned for REB to be profitable in the future.

## 8. Risk Control and Monitoring

Monitoring and control ensures that the risks identified are arrayed against the limits set; that the information and/or data pertaining to the risks have been thoroughly analysed; and any breaches in the limits are appropriately reported and finally, that management actions as spelled out in the risk approval process are followed through.

REB's management assesses the implementation of corrective and/or continuing actions to ensure the completeness of the risk management process. Specifically, where the risk is material, the following approaches are considered by the management to ensure the Bank's overall business strategy and appetite for risk is properly controlled:

- Accept risk - Management decides to continue operations as is with a consensus to accept the inherent risks;
- Monitor risk - Management performs timely review of risk positions & exceptions and ensure that its decisions are implemented for all geographies, products and legal entities;
- Transfer risk - Management decides to transfer the risk from, for example, one business unit to another or from one business area to a third party (e.g. Insurer);
- Control Risk - Management controls the occurrence of risk. It entails establishment and communication of risk limits through policies, standards and procedures that define responsibility and authority;
- Eliminate risk - Management decides to eliminate risk through dissolution of a key business unit or operating area;
- Reduce risk - Management decides to reduce current risks through improvement in controls and process;
- Mitigate risk - Management accepts current level of risk but undertakes key actions to mitigate risks through changing the way it conducts business.

In order to monitor conformance with the specified risk profile of the Bank, a series of key risk indicators have been developed. For the reporting year, the following figures are disclosed:

Key Risk Indicators	Values	Assessment
Capital Ratio (CTE1)	114%	Strong solvency ratio as CTE1 is well above regulatory minimum of 8% and internal limit of 16%
Leverage Ratio	38%	Current leverage is significantly above the reference level of 3%
Liquidity Coverage Ratio (LCR)	323%	Comfortable liquidity position with an LCR above 100% reference value
Impaired Loans (% Total exposure)	2%	Overall impaired loans remain contained; portfolio closely monitored and regular reports presented to senior management particularly for retail exposures
Large Banking Exposures (% CTE1)	54%	All exposures to banking counterparts are below internal limit of 90% of CTE1
Net Income (Year-on-Year growth)	23%	Net income increased versus previous year and continues trend toward profitability

The analysis of key risk indicators shows that the overall risk profile of REB remains moderate, consistently with the strategy of the company. The bank enjoys a solid capital and liquidity position. The loan portfolio is closely monitored so that impairments remain well contained. REB continues on its trend towards profitability.

## **9. Asset Encumbrance**

An asset is considered as encumbered if it is pledged or subject to any form of arrangement to secure, collateralise or credit-enhance any on-balance or off-balance sheet transaction from which it cannot be freely withdrawn (for instance, to be pledged for funding purposes). Assets pledged that are subject to any restrictions in withdrawal – e.g. requiring prior approval before withdrawal or replacement by other assets -, are considered encumbered.

Following CRR Article 443, details of asset encumbrance are provided in the following table.

Sources of encumbrance	Assets/Liabilities	Loans on Demand
Central bank funding (of all types, including e.g. repos)	Encumbered assets	
	Matching liabilities	
Exchange traded derivatives	Encumbered assets	
	Matching liabilities	
Over-the-counter derivatives	Encumbered assets	
	Matching liabilities	
Repurchase agreements	Encumbered assets	
	Matching liabilities	
Collateralised deposits other than repurchase agreements	Encumbered assets	1,000,000.00
	Matching liabilities	
Covered bonds securities issued	Encumbered assets	
	Matching liabilities	
Asset-backed securities issued	Encumbered assets	
	Matching liabilities	
Debt securities issued other than covered bonds and ABSs	Encumbered assets	
	Matching liabilities	
Other sources of encumbrance	Encumbered assets	
	Contingent liabilities or securities lent	
Total encumbered assets		1,000,000.00
of which central bank eligible		
Total non-encumbered Assets		68,385,899.84
of which central bank eligible		6,550,387.32
Encumbered + Non-encumbered Assets		69,385,899.84

## 10. Remuneration Policy and Practices

Following CRR Article 450, REB discloses its remuneration policy and practices. In this regard, REB's current Remuneration Policy was approved by the Board of Directors on 2 March 2017 and use effective

as of that date. The policy has been established in line with the law of 23 July 2015 and CSSF Circular 10/496, as repealed by CSSF circulars 17/658.

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 seven 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 the Bank is structured in a way to avoid conflicts of interest.

The Bank 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 realisation of the Bank'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, such as those 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 performance (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: Own Funds Additional Disclosures

This section provides details of the own funds structure of REB. Specifically, it details the transitional own funds disclosure in accordance with the Annex VI of the Regulation (EU) No1423/2013:

Annex IV of Commission Implementing Regulation (EU) No 1423/2013 of 20 December 2013		Amount
1	Capital instruments and the related share premium accounts	60,346,087
	of which : Ordinary shares - EBA List 26(3)	8,700,000
2	Retained earnings	-17,668,980
3	Accumulated other comprehensive income (and other reserves)	
3a	Funds for general banking risk	
4	Amount of qualifying items referred to in Article 484 (3) and the related share premium accounts subject to phase out from CET1	
	Public sector capital injections grandfathered until 1 January 2018	
5	Minority interests (amount allowed in consolidated CET1)	
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	
6	<b>Common Equity Tier 1 (CET1) capital before regulatory adjustments</b>	<b>51,377,107</b>
<b>Common Equity Tier 1 (CET1) capital: Regulatory adjustments</b>		
7	Additional value adjustments (negative amount)	
8	Intangible assets (net of related tax liability) (negative amount)	-10,331,062
9	Empty set in the EU	
10	Deferred tax assets that rely on future probability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met) (negative amount)	
11	Fair value reserves related to gains or losses on cash flow hedges	
12	Negative amounts resulting from the calculation of expected loss amounts	
13	Any increase in equity that results from securitised assets (negative amount)	
14	Gains or losses on liabilities valued at fair value resulting from charges in own credit standing	
15	Defined-benefit pension fund assets (negative amount)	
16	Direct and indirect holdings by an institution of own CET1 instruments (negative amount)	
17	Holdings of the CET1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	
18	Direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above the 10% threshold and net of eligible short positions) (negative amount)	
19	Direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above the 10% threshold and net of eligible short positions) (negative amount)	
20	Empty set in the EU	
20a	Exposure amount of the following items which qualify for a RW of 1250%, where the institution opts for the deduction alternative	
20b	of which : qualifying holdings outside the financial sector (negative amount)	
20c	of which : securitisation positions (negative amount)	
20d	of which : free deliveries (negative amount)	
21	Deferred tax assets arising from temporary differences (amount above the 10% threshold, net of related tax liability where the conditions in 38 (3) are met) (negative amount)	
22	Amount exceeding the 15% threshold (negative amount)	
23	of which : direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities	
24	Empty set in the EU	
25	of which : deferred tax assets arising from temporary differences	
25a	Losses for the current financial year (negative amount)	
25b	Foreseeable tax charges relating to CET1 items (negative amount)	
26	Regulatory adjustments applied to Common Equity Tier 1 in respect of amounts subject to pre-CRR treatment	
26a	Regulatory adjustments relating to unrealised gains and losses pursuant to Articles 467 and 468	
	of which : unrealised loss (AFS)	
26b	Amount to be deducted from or added to Common Equity Tier 1 capital with regard to additional filters and deductions required pre-CRR	
27	Qualifying AT1 deductions that exceed the AT1 capital of the institution (negative amount)	
28	<b>Total regulatory adjustments to Common Equity Tier 1 (CET1)</b>	<b>-10,331,062</b>
29	<b>Common Equity Tier 1 (CET1) capital</b>	<b>41,046,045</b>

<b>Additional Tier 1 (AT1) capital: Instruments</b>		
36	Additional Tier 1 (AT1) capital before regulatory adjustments	0
<b>Additional Tier 1 (AT1) capital: Regulatory adjustments</b>		
43	Total regulatory adjustments to Additional Tier 1 (AT1) capital	0
44	Additional Tier 1 (AT1) capital	0
45	Tier 1 capital (T1 = CET1 + AT1)	41,046,045
<b>Tier 2 (T2) capital: Instruments and provisions</b>		
51	Tier 2 (T2) capital before regulatory adjustments	0
<b>Tier 2 (T2) capital: Regulatory adjustments</b>		
57	Total regulatory adjustments to Tier 2 (T2) capital	0
58	Tier 2 (T2) capital	0
59	Total capital (TC = T1 + T2)	41,046,045
60	Total risk weighted assets	28,281,162
<b>Capital ratios and buffers</b>		
61	Common Equity Tier 1 (as a percentage of risk exposure amount)	145.14%
62	Tier 1 (as a percentage of risk exposure amount)	145.14%
63	Total capital (as a percentage of risk exposure amount)	145.14%
64	Institution specific buffer requirements (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer (G-SII or O-SII buffer), expressed as a percentage of risk exposure amount)	8%
65	of which : capital conservation buffer requirement	0
66	of which : countercyclical buffer requirement	0
67	of which : systemic risk buffer requirement	0
67a	of which : Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer	0
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	137.14%

## Appendix 2: Countercyclical Capital Buffer

Following CRR Article 440, REB discloses capital buffers, including geographic distribution of exposures. 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 materialise. 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.

BREAKDOWN OF CREDIT EXPOSURES RELEVANT FOR THE CALCULATION OF THE COUNTERCYCLICAL BUFFER BY COUNTRY							
	FR	LU	BR	DE	JP	TW	Total
<b>Relevant credit exposures - Credit Risk</b>							
Exposure value under the Standardised Approach	3,374,983.19	2,544,745.11	9,625.41	6,880,308.98	1,110,079.88	36,512.48	13,956,255.05
<b>Own funds requirements and weights</b>							
Total own funds requirements for CCB	269,998.66	203,579.61	770.03	550,424.72	88,806.39	2,921.00	1,116,500.41
Own funds requirements for relevant credit exposures – Credit risk	269,998.66	203,579.61	770.03	550,424.72	88,806.39	2,921.00	1,116,500.41
Own funds requirements weights	0.6642	1.0092	0.0019	1.3554	0.2185	0.0072	3.2564