

MAJOR ENHANCEMENTS IN AML/CTF COMPLIANCE
AND OTHER RELEVANT DEVELOPMENTS

BlueOrange



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PROFILE OF THE BANK

Bank was registered in 2001.

The shareholder of Baltikums Bank is joint stock company „BBG”, which owns 100% of the bank’s share capital. Owners (beneficial owners) of the bank are individuals – residents of the Republic of Latvia. During the first decade of its development, the bank, guided by the owners’ previous experience in international business, shipping industry, trade and logistics, mainly focused on corporate financing and servicing. Since 2016, the bank has been actively operating in the domestic market, offering financial services to local businesses, and later on introducing and expanding its retail banking activities.

According to 2016 audited data, the bank is among the top ten Latvian commercial banks with total assets of about EUR 700 mio. and a wide customer base. Mostly these are corporate clients operating in the Baltic region, as well as international trading companies. The core business activity of the bank includes private equity management and investment, payment cards and lending services. The bank has one representative office and a network of partners abroad. The bank leverages remote access systems to ensure product sales and prompt customer service regardless of a client’s location. On the domestic market, the bank provides services and financing to SMEs, and has expanded the scope of its activities by entering the retail banking sector.

Since January 2017, the bank has been using a new brand – BlueOrange. It has entered the retail consumer segment in Latvia, having introduced new products, services, and product distribution channels. The bank actively uses innovative digital solutions and online marketing channels.

Since 2016, the bank has significantly reduced the number and amounts of payments by foreign companies by means of implementing de-risking measures, reshaping its business model, and changing the approach for attracting target customers, as well as through fundamental revision of its approach to ML/TF risk management.

RESHAPING OF THE BUSINESS MODEL IF AML/CTF COMPLIANCE DETERMINED (noteworthy, visible and impactful)

Changes to the bank's income structure
in the past 3 years:

Income structure, 2015



Income structure, 2016



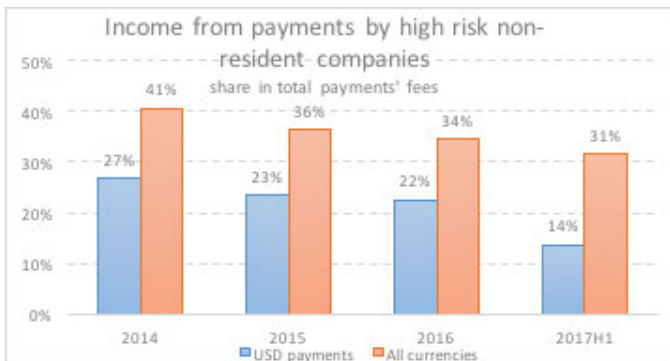
Income structure, 2017H1



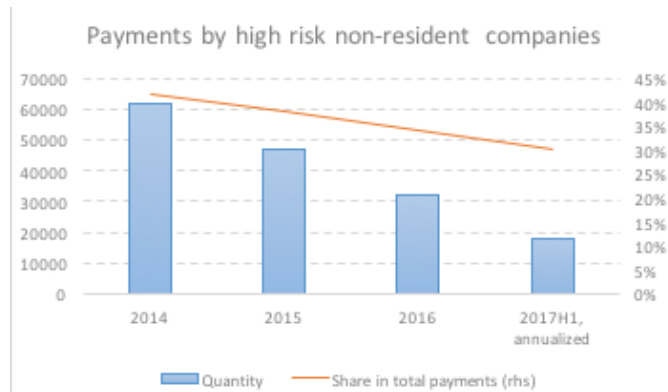
Reduction of turnover in providing services to high risk non-resident companies:

Non-resident companies and turnover (USD '000)	2016H1	2017H1	Changes
Number of payments	17	9	-46.9%
Turnover	1 129 729	805 894	-28.7%

Reduction of income in providing services to high risk non-resident companies:



Reduction of the number of payments in providing services to high risk non-resident companies:



In June 2017, the bank concluded an Administrative Agreement with the FCMC, undertaking to improve its internal control system for client transaction monitoring and international sanctions compliance within a certain period, and to develop an action plan in order to ensure that the bank is able to identify transactions aimed at circumventing or violating international sanctions.

In July 2017, the bank developed a remediation plan in cooperation with an international audit company; the plan was approved by the FCMC and implementation was begun. Full implementation of the plan is expected by the end of the first half of 2018.

CORPORATE GOVERNANCE

The bank continues to improve its internal processes. In 2016/2017, the bank introduced substantial changes to its AML/CFT policies and procedures. In 2017, a new AML/CFT policy was approved, binding procedures were revised and updated, regulating client transaction monitoring, reporting, and enhanced due diligence requirements to account both for the suggestions received from U.S. advisors and for current amendments to Republic of Latvia legislation. In accordance with FCMC regulation requirements, a new client risk scoring system has been implemented.

The bank has introduced an internal control system that ensures compliance with the international sanctions requirements.

The Head of the Client Activity Compliance Department is responsible for AML/CFT and compliance with international sanctions. The bank has also appointed an employee who provides for daily handling of issues related to international sanctions.

The number of employees at the AML/CFT division continued to grow in 2016/2017 and currently is around 10% of the bank's total staff.

INTERNAL CONTROLS

The bank's structure is organized in accordance with regulatory requirements of the Republic of Latvia and international best practice. AML/CFT and other risk control functions of the bank are independent from its business functions.

Upon switching to a different business model, the bank has reviewed the internal processes and has accordingly defined internal procedures for establishing business relations with residents.

In order to improve identification of transactions aimed at circumventing or violating international sanctions, and to ensure processing thereof in compliance with procedures as defined in regulatory enactments, the bank explores a variety of new IT solutions to ensure compliance with the sanctions, for example, to monitor marine traffic or client transactions in real time, in order to decide on the need for an additional IT solution.

To obtain additional information required for monitoring of the bank's clients and transactions and improving performance, the bank cooperates with the information service providers WorldCheck and Accuity, as well as makes extensive use of the publicly available sources.

STAFF TRAINING

Bank employees regularly participate in both internal and external AML/CFT training; this includes AML compliance specialists, client service support specialists, sellers of products and services in various areas (front office employees). Every employee upon commencing their employment with the bank undergoes the initial training on AML/CFT. Further training sessions in AML compliance are provided depending on the employee's position, job responsibilities and professional qualifications. Currently, a 4-level AML internal training programme is available at the bank.

During 2016, 282 employees received internal training (AML/CFT training programmes) and 31 employees attended external training.

In H1 2017, internal training (AML/CFT training programmes) was provided to 220 employees, and 42 employees attended external training. There is one Certified Anti-Money Laundering Specialist (CAMS) at the bank.

Independent AML/CFT compliance reviews of the internal control system

In 2016, results of the review conducted by U.S. advisors exposed differences between legislations in the USA and the Republic of Latvia. U.S. advisors gave a number of recommendations regarding the improvement of the bank's internal AML processes, which apply to both

ML/TF risk management and the internal control system for monitoring client transactions, as well as the need to implement a new transaction monitoring system and review the bank's approach to training programmes for its staff.

In 2016/2017, during implementation of the recommendations by U.S. advisors, the bank has reviewed and updated internal documents, developed a new ML/TF risk management strategy and introduced changes to processes relating to attraction, monitoring and research of clients.

The number of AML employees has considerably increased at the bank. AML/CFT training sessions have been organised both for employees involved in the process of attracting clients, and employees who provide services and support for profit-driving units. The bank has by now implemented ~78% of recommendations expressed by U.S. advisors, planning to complete the remaining part by 31.12.2017, which is mainly related to implementation of the new FISERV client transaction monitoring system.

During the annual audit of financial statements in February 2017, the auditors examined the procedures relating to client due diligence and transaction monitoring, as well as conducted the analysis of individual client cases to review the bank's activities in AML/CFT.

The bank continues to improve its internal AML/CFT processes and the skills of the employees by providing training sessions on various AML-related issues. Together with partners, the bank continues to introduce new IT solutions and improve the existing ones to increase the efficiency of the internal control system as regards AML/CFT.

Independent inspections are also performed by the bank's Internal Audit (consisting of the head and 2 auditors) at least once a year, in accordance with the plan approved by the Council. All internal auditors regularly participate in internal and external AML/CFT training sessions, as well as constantly improve their knowledge of AML/CFT.

AUTOMATED (IT) SYSTEMS AND TOOLS

For AML/CFT purposes, the bank uses the automated client transaction monitoring and data management system, which is part of the bank's transaction accounting system The Wall (designed in Latvia and provided by DSW Latvia Ltd). The Wall provides online and off-line monitoring of client transactions in a separate AML module, as well as provides the required transaction monitoring to ensure compliance with the international sanctions.

To ensure the KYC principle and electronic storage of client documents/information, the bank uses the Microsoft Dynamics CRM system.

To ensure additional monitoring of clients and transactions, the bank has obtained a database of politically exposed persons from Accuity (provider: Reed Business Information Limited) and a database from World-check (provider: Thomson Reuters). The bank performs ML/TF risk assessment by using the Risk Scoring System (developed and implemented in cooperation with Deloitte Latvia SIA).

In 2016, the bank implemented new alert scenarios to The Wall AML module.

In 2017, the bank decided to obtain a new transaction monitoring system from FISERV to ensure uniform case management, including documentation of suspicious and unusual transaction alerts, monitoring compliance with the international financial sanctions, documentation and evaluation of reviews of client transactions, as well as introducing a variety of additional scenarios.

DE-RISKING OF CUSTOMERS AND BUSINESS LINES

The bank has significantly reduced its cooperation with partners as regards the attraction of international clients, and has suspended cooperation agreements with more than 2/3 of its partners since 2016.

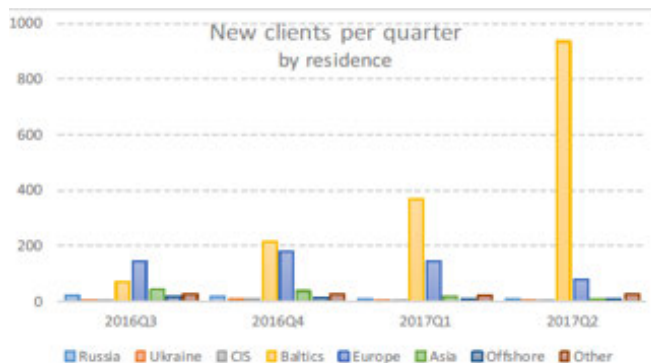
In 2016, the bank terminated business relations with most clients from countries such as Azerbaijan, Uzbekistan, and paid increased attention to client transactions from other CIS countries.

During the review of the client base in 2016, the bank closed more than 1'600 accounts, thus shedding deposits by international clients worth more than EUR 100 mio. in total. The volume of international payments decreased by more than 30%.

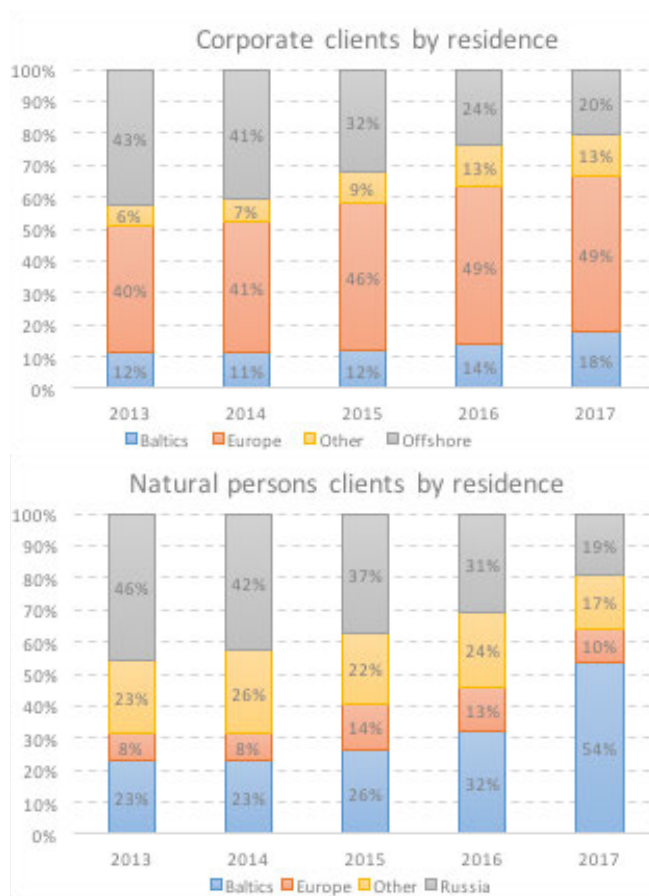
Due to the new provisions regarding establishment of business relations with international clients, the number of new international clients has dropped from 250 to 50 per month.

This year, the bank has discontinued cooperation with partners in the area of client identification (bank employees now perform client identification by meeting with clients face-to-face).

The bank has been actively reducing attraction of foreign companies, offshore companies specifically, and increasing the number of domestic clients (including EEA residents), see the diagrams below:



Changes in the client base:



The bank has implemented a number of risk mitigation measures allowing to limit the number of foreign PEPs. The overall number of PEPs has not decreased because the number of clients (residents of the Republic of Latvia) with PEP status – as the bank changed its business model and started to actively offer its services to residents of the Republic of Latvia – has increased for the bank.

With the change of the business model, Latvia, the Baltic states and EU countries are the main target markets of the bank both in retail and corporate sectors. The bank plans to receive interest income from loan products and investment banking.

In 2017, making its entry to the Latvian market and actively offering its products and services to individuals, the bank developed attractive offers for clients, also facilitating brand recognition of the bank in the domestic market.

Other products offered to clients by the bank include asset management, payment cards, e-commerce services to e-merchants, various international trade financing products, investment in securities and financial instruments.

With internet and electronic environment development, the bank is planning to use opportunities to develop new channels of financial product delivery and customer service.

The bank is currently considering possibilities for cooperation with non-financial institutions and FinTech companies.

The Bank's target audience among international clients includes trade establishments and owners of vessels (and other assets) originating from the EU. Key products include asset management, investment services, trade finance, and financing for the purchase of new assets (e.g. vessels or real estate).

In order to provide a higher level of service to these clients, in June 2017 the bank opened a new Client Support Centre at Jēkaba iela 2 in Riga.

