

# Interest-rate and currency risk

## Interest-rate risk

Interest-rate risk is exposure to losses as a result of adverse and contingent interest rates change as well as significant drop of interest income. The Bank controls the level of net interest margin (the difference between income obtained from interest-earning assets and costs on interest-bearing liabilities) that is sufficient to cover operating costs and ensure profitable operations.

The Bank does not consider interest-rate risk as a source of additional income and does not increase it in response to market expectations. Nonetheless, Bank Vozrozhdenie reacts quickly to any changes in the overall level of interest rates and adjusts current base rates on assets and liabilities to meet its targets for interest income.

The Bank has an internal mechanism for transfer pricing on resources, allowing to effectively control interest-rate risk so that the cost of funds on bank operations does not exceed the income from these operations. Prices for cash resources within the Bank (purchase and sale of cash between internal divisions) are regulated in accordance with the situation on the short-term capital market. This encourages internal divisions to structure their assets and liabilities in a way that ensures liquidity is maintained and an optimum price level to protect the net interest margin of the Bank. Mortgage loans and the possibility of their early repayment are the main sources of interest-rate risk. The Bank constantly monitors early repayments in its long-term loan portfolio.

To reduce interest-rate risk, the Bank balances its assets and liabilities according to dates of interest-rate adjustment and maturity, and reviews current rates at least once a quarter. Rates may be adjusted during a quarter depending on changes in the Bank of Russia refinancing rate and rates on financial markets. The Bank conducts regular stress testing of interest-rate risk for the assessment of potential losses given adverse changes in risk factors.

Interest-rate risks on loan and deposit operations are assessed using gap analysis. Interest-rate risk management is carried out in accordance with the Regulation on the Basic Principles for Managing the Resources of Bank Vozrozhdenie in Roubles and Foreign Currency, updated on a quarterly basis, as well as the Regulation on the Procedure for Calculating Market Risk at Bank Vozrozhdenie.

## Currency risk

Currency risk is the probability of losses related to changes in exchange rates of foreign currency to local currency in relation to credit, foreign exchange, equity and currency markets operations.

The main method for assessing and controlling currency risk is calculating open currency positions. The Bank uses methodology developed by the Bank of Russia to estimate the risks from maintaining open positions in foreign currencies.

The Bank's policy for managing open foreign currency positions includes establishing external and internal limits on currency positions as well as controlling compliance with these limits on a daily basis.

Bank Vozrozhdenie strives to restrict currency risk by minimizing open positions. The quality of assets denominated in foreign currency is monitored carefully, particularly the quality of the loan portfolio.

Internal management of currency risks includes a procedure for daily revaluation of positions and a system of control over volumes and stop-limits for positions that carry currency risk. The Bank sets limits on cash and term transactions by types of transactions and currencies. All currency operations are within the limits that the Bank sets for counterparties. The Bank sets a stop-loss limit for dealer transactions that restricts losses over a particular period: intraday, five-day and one-month.

### Assets and liabilities currency structure



The Bank periodically carries out a reassessment of assets and liabilities and uses a stress test that includes calculation of potential losses from drastic changes in currency exchange rates. The frequency of such tests depends on the speed at which market conditions are changing and the level of currency risk. Bank Vozrozhdenie regularly analyzes the potential consequences of changes on the market. When evaluating potential profits and losses, it is conservative in forecasting future foreign-exchange rates and evaluates various situations, including the worst-case scenario.

The Bank uses currency baskets (combinations of currencies in specific proportions) in order to limit losses from anticipated changes in currency exchange rates. A basket consists of currencies with negatively correlated fluctuations, making the aggregate value of a basket more stable. The most obvious example is a basket consisting of US dollars and euros on the basis of the dual-currency basket of the Bank of Russia.

Open positions in foreign currency on the spot market are regulated in “today”, “tomorrow”, and spot transactions within the limits on counterparties.

The effect of currency risk on capital is evaluated using the methodology stipulated in the Bank of Russia's Regulation no. 313-P "On the Procedure of Calculating Market Risk by Credit Organizations", dated 14 November 2007, and the internal Regulation on the Procedure Calculating Interest Rate Risk at Bank Vozrozhdenie.