

LUNAR RISK REPORT 2022

Solvency requirements



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1. Introduction

According to Capital Requirement Regulation (CRR) Lunar is required to publicly disclose our risk exposure. This is done in two reports;

- Risk Report on capital target and solvency requirements (this document)
- Risk Report on other information

The two reports are reviewed and updated once a year in relation to the disclosure of the annual financial statement and created with the purpose of complying with the disclosure obligations in CRR article 431 to 455. The reports are disclosed at Lunar Bank's homepage www.Lunar.app.

The reports are structured based on section eight of the CRR in relation to disclosure of a summary of Lunar Bank (the Bank) approach for assessing the adequacy of internal capital to support current and future activities, and with the objectives of informing stakeholders of Lunar's risk management approach.

This report will include information to comply with CRR article 438 regarding:

- a summary of the institutions approach to assessing the adequacy of its internal capital to support current and future activities;
- the result of the institutions internal capital adequacy assessment process including the composition of the additional own funds requirements based on the supervisory review process

Furthermore, the report includes information to comply with CRR article 444, 445, and 446.

This report is disclosed in connection with the publication of the Annual Report. The content of this report is based on financials as per December 31st 2022 and was last updated and approved in April 2023.

2. Method – CRR 438, litra a

The Bank's method for assessing whether the internal capital is sufficient to support the current and future activities (solvency adequacy) follows the Bank's ICAAP (Internal Capital Adequacy Assessment Process).

The Bank's management (Executive Management and Board of Directors) participates at least once a year in a process with the following purpose:

- The Bank's current and future activities and identified risks are assessed.
- The Banks solvency requirements are determined.
- The Banks current capital foundation is analyzed and concluded in the Board of Directors capital target.

The process involves both the Executive Management and the Board of Directors. Executive Management prepares documentation and recommendations, and the Board of Directors discuss and conclude.

The Bank's process for analyzing, assessing and documenting follows ICAAP, which identifies the risks that the Bank is or can be exposed to where after it is assessed whether the risks can be mitigated through proper procedures and processes or other mitigating activities (e.g. insurance) or whether further capital is required to cover the net risk(s).

Lunar calculates the solvency need according to the 8+ model after the Danish Financial Supervisory Authority's (D-FSA) guidelines on determining the individual solvency need, cf. Vejledning om tilstrækkeligt kapitalgrundlag og solvensbehov for kreditinstitutter.

The 8+ model is based on the 8-pct. minimum capital requirement (Pillar I). The total risk exposure amount (REA) calculated according to Pillar I requirements is not considered to sufficiently reflect all risk areas, and thus the 8 pct. capital requirement is not fully adequate. The 8+ model identifies several risk areas subject to capital add-ons, to cover the areas of risk not fully considered under the Pillar I requirement.

D-FSA's guidelines establish benchmarks for when the authority considers the Pillar I requirements to be insufficient, thus requiring capital add-ons for the respective risk areas. These capital add-ons constitute Lunar's individual solvency need (ISN) under Pillar II.

Furthermore, the D-FSA's guidelines present specific methods to calculate the size of the capital add-ons. Lunar considers the D-FSA's methods to be adequate and sufficient to cover Lunar's risk profile.

Lunar considers the following risk areas:

Risk areas
Earnings
Lending growth
Credit risk
Market risk
Liquidity risk
Operational risk
Leverage risk
ICT risk
Other risks <ul style="list-style-type: none">- E.g. Regulatory requirements such as initial capital requirements according to CRR article 93- E.g. Strategic risk

3. Individual solvency – CRR 438, litra b

The below table presents the Bank's solvency needs and capital requirements as of December 31st 2022, in relation to the annual financial statements.

The solvency requirement is calculated as DKK 346.1 million as of December 31st 2022.

The table also includes disclosure of key metrics, cf. CRR 447(b), (c), (d) and (e).

	Year 2022 (1,000 DKK)	Year 2022 (%)
Credit risk	1,796,875	
Market risk	38,818	
Operational risk	33,974	
Total risk exposure	1,869,667	
Pillar I	149,573	8.0%
Pillar II	192,454	10.3%
1) Earnings	23,000	1.2%
2) Lending growth	0	0.0%
3) Credit risk	85,799	4.6%
4) Market risk	27,565	1.5%
5) Liquidity risks	0	0.0%
6) Operational risk	56,090	3.0%
7) ICT	0	0.0%
8) Other	0	0.0%
Solvency need	342,027	18.3%
Capital conservation buffer	46,742	2.5%
Countercyclical buffer	22,997	1.23%
Capital requirements	411,766	22.0%
MREL requirement (REA), 22.2 pct. + combined buffers	484,805	25.9%
MREL requirement (TEM), 4.4 pct.	483,610	25.9%
Own funds	676,014	36.2%
Own funds and eligible liabilities	691,369	37.0%
Coverage for Solvency need	333,987	
Coverage for capital requirements	264,248	
Coverage for binding MREL requirement	206,564	
Total exposure measure (TEM)	10,991,140	
Leverage ratio		6.0%

4. Risk Exposure – CRR 438, litra d

The table below shows the Bank's total risk-weighted exposure amount broken down by the different risk categories set out in Part III of CRR.

Risk categories 31.12.2022	Risk exposure (1,000 DKK)	Own funds requirements (1,000 DKK)
Credit risk	1,796,464	143,717
Market risk	38,818	3,105
Operational risk	33,974	2,718
Settlement risk	0	0
Credit Valuation adjustment risk	410	32
<u>Total</u>	<u>1,869,667</u>	<u>149,573</u>

5. Credit Risk Exposure – CRR 444

The Bank calculates the risk-weighted exposure amounts for credit risk and dilution risk in accordance with Chapter 2 of Title II of Part Three, i.e., the 'Standardised approach'.

The table below shows the exposure values broken down by the different exposure classes, as well as the minimum own funds requirement.

Credit risk 31.12.2022	Risk exposure (1,000 DKK)	8% thereof (1,000 DKK)
Exposure towards institutions	35,245	2,819
Exposure towards retail	1,227,613	98,209
Exposures in default	4,644	371
Covered bonds	240,826	19,266
Equity	37,146	2,971
Other items	250,987	20,078
<u>Total</u>	<u>1,796,464</u>	<u>143,717</u>

6. Market Risk Exposure – CRR 445

The Bank holds no trading book, and is thus only subject to own funds requirements according to points (c) of Article 92(3). The bank is subject to foreign exchange risk and determines its own funds requirements according to Article 352.

The below table shows the Bank's minimum own funds requirement related to Market Risk, cf. CRR article 92(3)(b) and (c). The risk exposure amount is calculated by multiplying the own funds requirement by 12.5.

Market risk 31.12.2022	Risk exposure (1,000 DKK)	8% thereof (1,000 DKK)
Foreign exchange risk*	38,818	3,105
<u>Total</u>	<u>38,818</u>	<u>3,105</u>

*The Bank received on 21st of December 2022 permission from the competent authority to exclude a structural hedge position in SEK from the calculation of the net open currency positions, cf. CRR article 352 (2).

As of 31st December 2022 a position SEK 632.2m was excluded from the calculation of the net open currency positions.

7. Operational Risk Exposure – CRR 446

The Bank calculates the own funds requirements for operational risk in accordance with Title III for operational risk. The bank uses the Basis Indicator Approach, cf. article 315 to determine the own funds requirement to operational risk. The below table shows the Bank's minimum own funds requirement related to operational risk. The risk exposure amount is calculated by multiplying the own funds requirement by 12.5.

Operational risk 31.12.2022	Risk exposure (1,000 DKK)	8% thereof (1,000 DKK)
Operational risk	33,974	2,718
<u>Total</u>	<u>33,974</u>	<u>2,718</u>