



NEXO BANK

MARKET DISCIPLINE REPORT

Date: 21st January 2025

Nexo Bank Inc. (the “Bank” or “Nexo Bank”) is licensed and regulated as a Class I International Bank by the Financial Services Regulatory Commission (FSRC) in Antigua and Barbuda. It was established in 2021 in St. John’s, Antigua, British West Indies, with its main office located at Office Area # 5 (Second Floor), Brysons Building, Friars Hill Road, St John’s, Antigua and Barbuda.

The Bank is 100% owned by Nexo Capital Inc., a company incorporated and existing under the laws of the Cayman Islands with legal address George Town, 71 Fort Street, 3rd Floor, P. O. Box 2775, KY1-1111.

Nexo Bank aims to reinforce resilient and sustainable business operations by taking a holistic, forward-looking, and proactive approach to managing risk and return throughout the organization.

Nexo Bank recognizes that effective risk management is based on a sound risk-aware culture that encourages ethical behavior by employees. We are making strong efforts to ensure a systemic and sustainable approach to managing risk. Regular staff training on risk-related matters is part of Nexo Bank’s risk management practice.

Risk Management

All material risks are identified, measured, and managed through a system of organizational structures, principles, systems, and policies. The objective is to maintain financial soundness and avoid activities threatening Nexo Bank’s reputation.

Credit Risk

Identification

Credit risk is the risk of loss to the Bank from the failure of clients, customers, or counterparties, including sovereigns, to fully honor their obligations to the Bank, including the complete and timely payment of principal, interest, collateral, and other receivables. Nexo Bank’s main credit risk would arise from its lending operations, once such operations commence.



Credit Risk Management

Credit risk is measured by credit rating and regulatory and internal capital demand. Each borrower must be rated, and each rating has to be reviewed at least annually. Ongoing monitoring of counterparties helps keep ratings up to date. Risk-weighted assets are measured to determine the regulatory capital demand for credit risk using a standardized approach pursuant to fixed risk weights.

Nexo Bank shall also apply internal limits and credit exposures under these limits. Credit limits set forth the maximum credit exposures Nexo Banks is willing to assume over specified periods. The credit limit for a counterparty is determined based on the counterparty's credit quality and the limitations in the applicable legislation.

In addition to determining counterparty credit quality and risk appetite, Nexo Bank shall also use various credit risk mitigation techniques to optimize its credit exposure and reduce potential credit losses. Credit risk mitigants shall be applied in the following forms:

- Comprehensive and enforceable credit documentation with adequate terms and conditions.
- Collateral held as security to reduce losses by increasing the recovery of obligations
- Diversification and granularity of the portfolio.
- Powerful credit analytics and scoring technology.
- Efficient collection process.
- Risk-based pricing, ensuring loans are priced to cover the cost of funds, administration costs, the cost of the risk involved in the transaction, and the cost of liquidity and capital employed.

The risk management team shall monitor and manage exposure to credit risk. The findings shall be reported to the Board of Directors, which shall define the overall credit risk limits within the context of Nexo Bank's prudent risk appetite and the statutory limitations.

Market Risk

Identification

Market risk is the risk of loss arising from potential adverse changes in the value of Nexo Bank's assets and liabilities from fluctuation in market variables including, but not limited to, interest rates, foreign exchange, equity prices, commodity prices, credit spreads, force majeure events, implied volatilities and asset correlations.



Market Risk Management

Nexo Bank shall maintain risk-management control systems to measure and monitor market risk using various analytical techniques, including market value, sensitivity analysis, and value-at-risk models.

Interest rate risk exposure will be measured by the Risk Management Department and reported to the Board. The report will be based on calculating both positive and negative instantaneous shocks to interest rates on:

- **Value at Risk (VaR)** measures the maximum potential loss for a specified portfolio, time horizon and confidence level.
- **Capital at Risk (CaR)**, which is considered for assets and liabilities in all interest rate risk re-pricing periods, expressed as the net present value of the negative impact of a sensitivity test on Nexo Bank's capital position;
- **Earnings at Risk (EaR)**, which is considered for assets and liabilities on the forecast balance sheet over a 12-month period, measuring the adverse change to net interest income from a movement in interest rates.

Liquidity Risk

Identification

Liquidity risk relates to the Bank's ability to meet its contractual or contingent obligations or the availability of the appropriate amount, tenor, and composition of funding and liquidity required to support its assets. It results from maturity mismatches between assets (loans) and liabilities (deposits).

Liquidity Risk Management

Nexo Bank shall use a range of customized measurement tools and early warning indicators that provide board members with timely and forward-looking information.

A limit framework shall ensure that Nexo Bank can continue to operate in a period of severe stress. Monitoring of limits and reporting limit compliance shall be performed regularly and effectively. Any breach by units will be reported and escalated without delay. In such cases, appropriate steps shall be undertaken in consultation with the relevant unit, or contentious matters are escalated to the next highest responsible body.



The liquidity risk is measured and monitored through:

- Liquidity coverage ratio (LCR) - The liquidity coverage ratio (LCR) assists with maintaining the short-term resilience of banks by ensuring that they have an adequate stock of unencumbered high-quality liquid assets (HQLAs) to meet potential liability run offs that might occur in a crisis, which can be converted into cash to meet liquidity needs for a minimum of 30 calendar days in a liquidity stress scenario. The Bank will maintain a LCR ratio of at least 110%, which is compliant with Basel II regulations.
- Net Stable Funding Ratio (NSFR) - Available stable funding is defined as the portion of equity and debt which is expected to be a reliable source of funds over the time horizon of one year covered by the NSFR. Nexo Bank's required stable funding depends on the liquidity characteristics and residual maturities of the various assets and off-balance sheet positions. The Bank will maintain a NSFR ratio of at least 110%, which is compliant with Basel II regulations.

Liquidity Risk is managed through Limits, Liquidity Buffer, Funding Diversification and Reserves.

- Limits - Limits are defined both under a business as usual as well as under a stress perspective. In accordance with the defined risk appetite, each unit must demonstrate a survival horizon of several months in a severe, combined stress scenario (reputational and market stress). This can be ensured either by a structurally positive liquidity profile or by a sufficiently high liquidity buffer.
- Liquidity buffer - Each unit actively maintains and manages liquidity buffers, including high quality liquid assets (HQLA) which are always sufficient to cover the net outflows expected in crisis scenarios.
- Funding diversification - Diversification of the funding profile in terms of investor types, regions, products and instruments is an important element of our liquidity risk management framework.
- Liquidity reserves - Liquidity reserves comprise available cash and cash equivalents, highly liquid securities (includes government, agency and government guaranteed) as well as other unencumbered central bank eligible assets.

Operational Risk

Identification

The risk of direct or indirect losses or reputational damages due to failure attributable to technology, employees, processes, procedures or physical arrangements, including external events and legal risks. Nexo Bank is exposed to operational risk in all its activities.



Operational Risk Management

In order to monitor operational risks, early warning indicators that allow prompt identification and minimization of losses shall be used. Loss data shall be collected in a central database in a structured manner according to the event type and the business line.

The operational risk management will focus on proactive measures, in order to ensure business continuity, the accuracy of information used internally and reported externally, a competent and well-informed staff and its adherence to established rules and procedures, as well as on security arrangements to protect the physical and Information and Communication Technology (“ICT”) infrastructure of the Nexo Bank.

The process of operational risk management has three major components:

- Data Collection
- Risk Assessment
- Early Warning Indicators

Data Collection

For the purpose of managing operational risk, Nexo Bank’s activities have been divided into a set of core business processes and sub-processes with designated process owners. The process owners will be responsible for identifying, reporting and responding to risks inherent in the processes.

Risk Assessment

Risk assessment aims to identify areas with a heightened level of operational risk and timely implement measures for risk mitigation. Process owners and key personnel involved in the process seek to detect potential risk exposures or threats to the process's efficient functioning and assess the adequacy of risk mitigation techniques.

Early Warning Indicators

Early Warning Indicators that monitor the respective risk level compared to pre-determined quantitative bands/metrics shall be put in place. The main indicators shall be determined by a risk committee and approved by the Board of Directors of the Bank. Subsequently, the process owner, Risk Committee, and Board monitor them.



Compliance Risk

Identification

The risk of legal or regulatory sanctions, material financial loss, or reputational damages due to failure to comply with laws, rules and standards. Nexo Bank faces compliance risk in all its business activities.

Compliance Risk Management

Nexo Bank is committed to following best practices and market standards in accountability, transparency, and business ethics. We have zero tolerance for misconduct and corruption. Accordingly, our procedures and practices will ensure compliance with relevant laws, regulations, rules, and codes and adhere to professional practice and the highest ethical standards, which may go beyond what is stipulated by the minimum regulatory requirements.

Fraud and Financial Crimes Risks

Identification

In managing compliance and integrity risks, Nexo Bank will place particular emphasis on detecting and preventing fraud and corruption, money laundering and the financing of international terrorism, as well as tax fraud and tax evasion.

Four core sources of risk are identified:

- Credit Fraud, which can be defined as an intentional false representation / statement about information which is material and relevant to credit risk within the credit process of Nexo Bank and has the potential to increase the credit risk.
- Money Laundering, which is defined as the process where the origin of money, generated through criminal activity is concealed. In effect, the money is 'cleaned' or 'laundered' by moving it through legitimate financial channels. Moving the monetary proceeds of crime in this way has the effect of concealing its source, 'cleaning' it of its criminal association.
- Terrorist Financing, where funds with legal or illegal origin are utilized to support a terrorist organization; given the limited product portfolio of Nexo Bank, this risk is relatively low; nevertheless, it is considered for the purposes of comprehensive risk overview.



- Tax Fraud and Tax Evasion, which involve an illegal activity for the deliberate falsification of tax returns or financial documents to reduce tax liability, typically by underreporting income, inflating deductions, or concealing revenue.

Fraud and Financial Crimes Risk Management

Given the nature of Nexo Bank's activities, a key element of its compliance risk management framework will be ensuring the adoption of a robust system of policies, practices and systems in relation to prevention of financial crimes. Nexo Bank's risk management framework in relation to financial crimes will be based on the following key elements:

- Governance
- Prevention
- Detection & Remedy Actions
- Ongoing Monitoring

Governance, Culture and Management Information

Nexo Bank dedicates resources embedded in its governance structure to risks related to financial crimes. These will include the Bank's Compliance Officer, Board committee, AML Analysts, and an independent assessment of the effectiveness of the policies undertaken by the internal auditor.

In addition, Nexo Bank promotes a culture of zero tolerance for non-compliance with internal policies and recurring, ongoing training and development of personnel at all levels of the organization.

Nexo Bank ensures that compliance matters comprise a key part of the management information, including detailed reports on new approved and declined accounts, the number of high-risk clients, flagged transactions, the number of transaction monitoring alerts, information on unusual or suspicious account activity, and dormant accounts.

Financial Crimes Prevention

The most widely recognized way to deter or prevent fraud is by having a good system of controls. In its activities Nexo Bank aims at benefiting from a diverse set of controls:

- Segregation of duties – having two people do a task together or splitting the task into parts so that no one person handles the complete assignment
- Having a system of proper authorizations so that only authorized or designated individuals have permissions to complete certain tasks
- Implementing physical safeguards to control and prohibit access to assets and information
- Implementing a system of independent checks such as job rotations, mandatory vacations, audits, etc.



- Having a system of documents and records that provide an audit trail that can be followed to check on suspicious activity and to document transactions

Financial Crimes Detection

Nexo Bank adopts a risk-based approach to detecting and preventing financial crimes. This approach will include utilizing various sources of information to identify high-risk clients based on product, country, and customer risk.

Individual Clients

Nexo Bank will implement strict due diligence procedures when taking on new customers in order to be fully satisfied as to their identity, source of funds and economic rationale for opening an account. Both internal and external information sources will be used to identify risk factors appropriate for retail banking clients, such as sources of income, country of origin and high-risk jurisdictions, politically exposed person (PEP) status, screening against sanctions lists. Each individual will be identified using external databases. Nexo Bank plans to use third party services (such as Comply Advantage) to conduct identification of individuals against various lists covering items such as PEPs, financial crime, EU sanctions, OFAC sanctions and terrorism. Retail clients determined to represent high risk will be escalated for additional review and approval by the MLRO and the CRO.

Business Clients

There are four components to Nexo Bank's KYC process:

- Identify the Business, i.e. verifying that it exists legally by verifying registration with the applicable local body
- Identify the Officers & Verify the identity of the authorized signatory (the applicant) using a third-party electronic identification service provider and by reaching out to the individual for documentary evidence
- Identify Owners holding directly or indirectly 25% or more of the shares or the voting rights (effective control) and we follow the chain all the way to the ultimate beneficial ownership
- Comply Advantage (fraud and AML risk detection tool)
- Performing checks of the provided information by the client by reviewing publicly available financial statements and tax returns, accessing private/public databases, and utilizing other research methods.

Ongoing Monitoring



In addition to initial due diligence checks, Nexo Bank will monitor transaction activity on an ongoing basis. This will be achieved through the use of an AML client transaction monitoring system.

Detection of a “red flag” activity will trigger additional extended due diligence with respect to the client. An electronic system is also used to screen online customer transactions against OFAC, UN, EU sanctions lists and internally blacklisted persons. Details of the customer EDD process and the customer monitoring process are documented and traceable in Nexo Bank’s IT systems.

All system triggers will be reviewed by the BSA/AML Analyst and the CCO, who will decide whether to take additional measures and potentially report suspicious activity or send unusual transaction reports to the relevant authorities.