

Operational Risk

The approach to operational risk management is based on the business process structure and an end-to-end processes structure, both for business and business support processes. Process management is the responsibility of the Process Owners, who are the first parties responsible for the risks assessment and for strengthening the performance within the scope of their processes. Process Owners are responsible for the updating of all of the relevant documentation concerning the processes, for ensuring the effective adequacy of all of the existing controls through direct supervision or by delegation on the departments responsible for the controls in question, for coordinating and taking part in the risks self-assessment exercises and for detecting improvement opportunities and implementing improvements, including mitigating measures for the most significant exposures.

Within the operational risk model implemented in the Bank, there is a systematic process of capturing data on operational losses that systematically characterizes the loss events in terms of their causes and effects. From the analysis of the historical information and its relationships, processes involving greater risk are identified and mitigation measures are launched to reduce the critical exposures.

COVENANTS

The contractual terms of instruments of wholesale funding encompass obligations assumed by entities belonging to the Group as debtors or issuers, concerning general duties of societary conduct, maintenance of banking activity and the inexistence of special guarantees constituted for the benefit of other creditors ("negative pledge"). These terms reflect essentially the standards internationally adopted for each type of instrument.

The terms of the Group's participation in securitization operations involving its own assets are subject to mandatory changes in case the Group stops respecting certain rating criteria. The criteria established in each transaction results mainly from the existing risk analysis at the moment that the transaction was set, being these methodologies usually applied by each rating agency in a standardised way to all the securitization transactions involving the same type of assets.

Regarding the Covered Bond Programs of Banco Comercial Português and Banco de Investimento Imobiliário that are currently underway, there are no relevant covenants related to a possible downgrade of the Bank.

47. SOLVENCY

The Millenniumbcp's own funds are determined according to the established regulation, in particular, according to Directive 2013/36/EU and Regulation (EU) 575/2013, approved by the European Parliament and the Council (CRD IV / CRR), and Banco de Portugal Notice No.6/2013.

Total capital includes tier 1 and tier 2. Tier 1 comprises common equity tier 1 (CET1) and additional tier 1.

Common equity tier 1 includes: (i) paid-up capital, share premium, hybrid instruments subscribed by the Portuguese State within the scope of the Bank's recapitalization process and not reimbursed, reserves and retained earnings and non-controlling interests; ii) and deductions related to own shares and loans to finance the acquisition of shares of the Bank, the shortfall of value adjustments and provisions to expected losses concerning risk-weighted exposure amounts calculated according to the IRB approach and goodwill and other intangible assets. Reserves and retained earnings are adjusted by the reversal of unrealised gains and losses on cash-flow hedge transactions and on financial liabilities valued at fair value through profits and losses, to the extent related to own credit risk. The minority interests are only eligible up to the amount of the Group's capital requirements attributable to the minorities. In addition, the deferred tax assets arising from unused tax losses carried forward are deducted, as well as the deferred tax assets arising from temporary differences relying on the future profitability and the interests held in financial institutions and insurers of at least 10%, in this case only in the amount that exceeds the thresholds of 10% and 15% of the common equity tier 1, when analysed on an individual and aggregated basis, respectively.

Additional tier 1 comprises preference shares and hybrid instruments that are compliant with the issue conditions established in the Regulation and minority interests related to minimum additional capital requirements of institutions that are not totally owned by the Group.

Tier 2 includes the subordinated debt that is compliant with the Regulation and the minority interests related to minimum total capital requirements of institutions that are not totally owned by the Group. Additionally, Tier 2 instruments held in financial institutions and insurers of at least 10% are deducted.

The legislation stipulates a transitional period between the own funds calculated under national law until 31 December 2013, and own funds estimated according to communitarian law, in order to exclude some elements previously considered (phase-out) and include new elements (phase-in). The transitional period for the majority of the elements will last until the end of 2017, with the exception of the deferred tax already recorded on the balance sheet of January 1, 2014, and the subordinated debt and all the hybrid instruments not eligible to own funds, according to the new regulation, that have a longer period ending in 2023 and 2021, respectively.

According to the regulatory framework, financial institutions should report common equity tier 1, tier 1 and total capital ratios of at least 7%, 8.5% and 10.5%, respectively, including a 2.5% conservation buffer, but benefiting from a transitional period that will last until the end of 2018.

The Millenniumbcp has adopted the methodologies based on internal rating models (IRB) for the calculation of capital requirements for credit and counterparty risk, covering a substantial part of both its retail portfolio and its corporate portfolio. The Millenniumbcp has adopted the advanced approach (internal model) for the coverage of trading portfolio's general market risk and the standard method was used for the purposes of operating risk coverage.

The own funds and the capital requirements determined according to the methodologies CRD IV / CRR (phased-in) previously referred, are the following:

	(Thousands of euros)	
	2017	2016
Common equity tier 1 (CET1)		
Ordinary share capital	5,600,738	4,268,818
Share Premium	16,471	16,471
Other capital (State aid)	-	700,000
Reserves and retained earnings	309,136	163,334
Regulatory adjustments to CET1	(959,028)	(486,436)
	4,967,317	4,662,187
Tier 1		
Capital Instruments	1,461	1,753
Regulatory adjustments	(1,461)	(1,753)
	4,967,317	4,662,187
Tier 2		
Subordinated debt	584,186	397,833
Others	(115,769)	(80,640)
	468,417	317,193
Total own funds	5,435,734	4,979,380
RWA - Risk weighted assets		
Credit risk	29,533,569	29,761,348
Market risk	981,291	702,411
Operational risk	2,248,553	1,939,075
CVA	177,715	283,520
	32,941,128	32,686,354
Capital ratios		
<i>CET1</i>	15.1%	14.3%
<i>Tier 1</i>	15.1%	14.3%
<i>Tier 2</i>	1.4%	1.0%
Total	16.5%	15.2%