

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 BCP.

53. SOLVENCY

The Group’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 in force stipulates a transitional period between the own funds calculated under national law until 31 December 2013, and own funds estimated according to EU 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 lasted until the end of 2017, with the exception of the deferred tax already recorded on the balance sheet of 1 January 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.

CRD IV/CRR establishes Pillar 1 capital requirements of 4.5%, 6% and 8% for CET1, Tier 1 and Total Capital, respectively. However, under the scope of SREP, European Central Bank notified BCP about the need to comply with phased-in capital ratios, during 2017 of 8.15% (CET1), 9.65% (Tier 1) and 11.65% (Total), that include 2.4% of additional Pillar 2 requirements and 1.25% of capital conservation buffer. The Bank meets all the requirements and other recommendations issued by the supervisor on this matter.

The Group 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 in Portugal and Poland and its corporate portfolio in Portugal. The Group has adopted the advanced approach (internal model) for the coverage of trading portfolio's general market risk and for exchange rate risks generated in exposures in the perimeter centrally managed from Portugal, and the standard method was used for the purposes of operational risk coverage. The capital requirements of the other portfolios/geographies were calculated using the standardised approach.

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

| | (Thousands of euros) | |
|-------------------------------------|----------------------|-------------------|
| | 2017 | 2016 |
| Common equity tier 1 (CET1) | | |
| Share capital | 5,600,738 | 4,268,818 |
| Share Premium | 16,471 | 16,471 |
| Ordinary own shares | (88) | (2,880) |
| Other capital (State aid) | - | 700,000 |
| Reserves and retained earnings | 401,067 | 36,875 |
| Minority interests eligible to CET1 | 564,042 | 654,488 |
| Regulatory adjustments to CET1 | (1,262,956) | (799,737) |
| | 5,319,274 | 4,874,035 |
| Tier 1 | | |
| Capital Instruments | 4,130 | 10,629 |
| Minority interests eligible to AT1 | 47,084 | - |
| Regulatory adjustments | (51,214) | (10,629) |
| | 5,319,274 | 4,874,035 |
| Tier 2 | | |
| Subordinated debt | 596,693 | 403,491 |
| Minority interests eligible to CET1 | 146,229 | 126,963 |
| Others | (130,345) | (147,152) |
| | 612,577 | 383,302 |
| Total own funds | 5,931,851 | 5,257,337 |
| RWA - Risk weighted assets | | |
| Credit risk | 35,366,357 | 35,007,882 |
| Market risk | 991,992 | 675,498 |
| Operational risk | 3,574,097 | 3,260,661 |
| CVA | 238,668 | 215,749 |
| | 40,171,114 | 39,159,790 |
| Capital ratios | | |
| CET1 | 13.2% | 12.4% |
| Tier 1 | 13.2% | 12.4% |
| Tier 2 | 1.5% | 1.0% |
| | 14.8% | 13.4% |