12. LIQUIDITY RISK

12.1. LIQUIDITY RISK MANAGEMENT AND ASSESSMENT

LIQUIDITY MANAGEMENT

The BCP Group liquidity management is globally accompanied and the supervision is coordinated at a consolidated level in accordance with the principles and methodologies defined at a Group level.

The management of liquidity needs is decentralised by geography, given that each subsidiary is self-sufficient and responsible for ensuring the coverage of its liquidity needs, either through its deposits basis, or through the market mechanisms available in each geography.

The Group's subsidiaries present adequate liquidity buffers to the funding needs, with conservative loan-to-deposit ratios.

The BCP Group has been developing a solid business model in retail banking, benefitting from a stable liquidity position, even in financial markets contingency situations, as seen in 2011, after the approval of the rescue program for Portugal.

Since then, strategic priorities were redefined, either through the selling of non-strategic assets in a first stage, or through the management of the deleveraging process, allowing to develop the resiliency of the Bank's funding structure.

The deleveraging process allowed to narrow the commercial gap and to reinforce the stable sources of funding, proving that it could be an alternative to the debt markets, given the difficulties in accessing them.

The BCP Group assures the adoption of the liquidity prudential requirements under the new regulatory framework at both consolidated and individual level.

LIQUIDITY RISK ASSESSMENT

The Group's liquidity risk assessment is based on the calculation and analysis of regulatory indicators defined by the supervisory authorities and on other internal metrics for which exposure limits are also defined.

The evolution of the Group's liquidity situation for short-term time horizons (up to three months) is reviewed daily on the basis of two indicators defined in-house: immediate liquidity and quarterly liquidity. These indicators measure the maximum fund-taking requirements that could arise on a single day, considering the cash flow projections for periods of three days and of three months, respectively.

The calculation of these indicators involves adding to the liquidity position of the day under analysis the estimated future cash flows for each day of the respective time horizon (three days or three months) for the set of transactions brokered by the markets areas, including the transactions with Clients of the Corporate and Private networks that, due to its dimension, have to be quoted by the Trading Room. The amount of assets in the Bank's securities portfolio considered highly liquid is added to the calculated amount, determining the accumulated liquidity gap for each day of the period under review.

In parallel, the evolution of the Group's liquidity position is calculated on a regular basis identifying all the factors that justify the variations occurred. This analysis is submitted to CALCO for appraisal, in order to enable the decision making that leads to the maintenance of adequate financing conditions to business continuity. Complementarily, the Risk Committee is responsible for controlling the liquidity risk.

In order to prevent the occurrence of a liquidity crisis or to trigger an immediate action in the case it materialises, the result of the Early Warning Signals system of the Liquidity Contigency Plan, which synthesises in a single notation the evaluation of a series of indicators that track the evolution of the liquidity risk drivers, is presented to CALCO on a monthly basis.

This control is reinforced with the periodical execution of stress tests, in order to evaluate the Bank's risk profile and to ensure that the Group and each of its subsidiaries fulfil their immediate obligations in a liquidity crisis scenario. These tests are also used to support the liquidity contingency plan and management decisions on this subject.

12.2. MANAGEMENT MODEL

The Group´s liquidity management is coordinated at the BCP Group level, under the responsibility of CALCO, consolidating a broad view of the Group's liquidity position in both short-run and structural management, promoting conditions of efficient access to financial markets. The execution is ensured by the Treasury Department.

The BCP Group consolidates the individual liquidity plans for the main entities of the Group, ensuring that the expected evolution of the inflows and outflows of the assets and liabilities arising from the commercial and corporate goals is aligned with a prudential treasury management and adequate liquidity ratios.

The liquidity of each Group entity is supervised at a global level, with liquidity needs' management autonomy, but assuring that there are internal mechanisms to maximize the efficiency of its management on a consolidated basis, namely in higher tension conjectures.

Liquidity and funding risk management:

Defines the procedures, responsibilities, methodologies and rules employed by the Group to address liquidity and funding risk management as well as its relation to the ILAAP.

Funding strategy:

Aims to evaluate the Group's policies and procedures in regard to its ability to finance its liquidity needs.

Liquidity buffer and collateral management:

Documents the Bank's practices concerning the management of assets and liquid assets that are eligible as collateral in refinancing operations with central banks.

Cost benefit allocation mechanism:

Assesses the Bank's approach on liquidity transfer pricing.

Intraday liquidity risk management:

Presents the Bank's methodology for managing intraday liquidity risk, allowing to obtain support information and to explain registered incidents relating to obligations that were not met in a timely manner.

Regulatory indicators monitoring:

Alignment of the regulatory requirements defined by the supervision with the Group's current liquidity management requirements and monitoring its adequacy, by defining minimum internal limits developed based on common and transversal concepts to the Group.

Liquidity stress testing:

Presents the liquidity stress tests performed by the Group on a regular basis.

Contingency funding plan:

Presents lines of responsibility for designing, monitoring and executing the Contingency Funding Plan along with the methodologies to detect tension situations early and an assessment of the plan's feasibility.

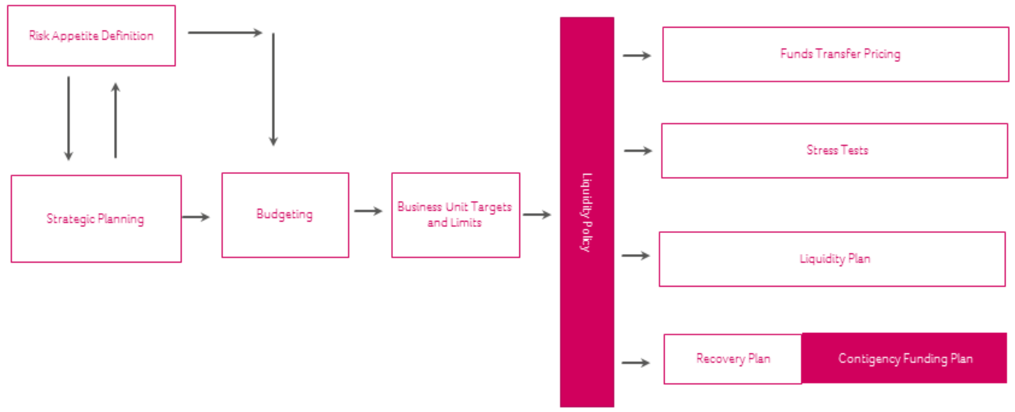
12.3.REGULATORY REQUIREMENTS

In the scope of the new prudential information requirements that is subject, the BCP Group has been monitoring the application and compliance with the new regulatory framework requirements, not only through the participation on study exercises promoted by the Basel Committee (QIS – Quantitative Impact Study) and reporting exercises performed within the European supervision, through the SSM – Single Supervisory Mechanism (STE – short-term exercise), but also through the regular reports on liquidity (COREP).

Within liquidity risk management, it should be noted, in 2016, the application of the Commission Delegated Regulation (EU) 2015/61 of 10 October 2014, in what concerns the liquidity coverage requirement.

The Supervisory Review and Evaluation Process (SREP), regarding the Internal Liquidity Adequacy Assessment Process (ILAAP), together with the Internal Capital Adequacy Assessment Process (ICAAP), are key evaluation instruments for risk management, and for determining internal liquidity and capital needs, respectively.

In the scope of the ILAAP carried out in 2017, a qualitative and quantitative information analysis was performed, with the goal of defining a liquidity risk management framework of the Group in accordance with the respective profile and aligned with the European Banking Authority guidelines and with the Single Supervisory Mechanism expectations. The ILAAP methodology is shared, to a large extent, with the liquidity risk management that the Group has been developing over the last years. In this context, the ILAAP exercise considered own characteristics of the Group, such as business model, governance, implemented controls and its monitoring, dimension, complexity, market constraints, and local regulatory duties for each geography.



12.4.BALANCE SHEET INDICATORS

The main evolutions regarding the Group's liquidity situation in 2017 were the following:

• The commercial gap increased 2.6 billion euros compared to the end of 2016;

• A decrease of 3,264 million euros in wholesale financing requirements on a consolidated basis as compared to 31 December 2016, mainly due to the capital increase, the reduction in the commercial gap and the freed up commercial activity, whose overall effect was mitigated by the growth of the consolidated portfolio of securities;

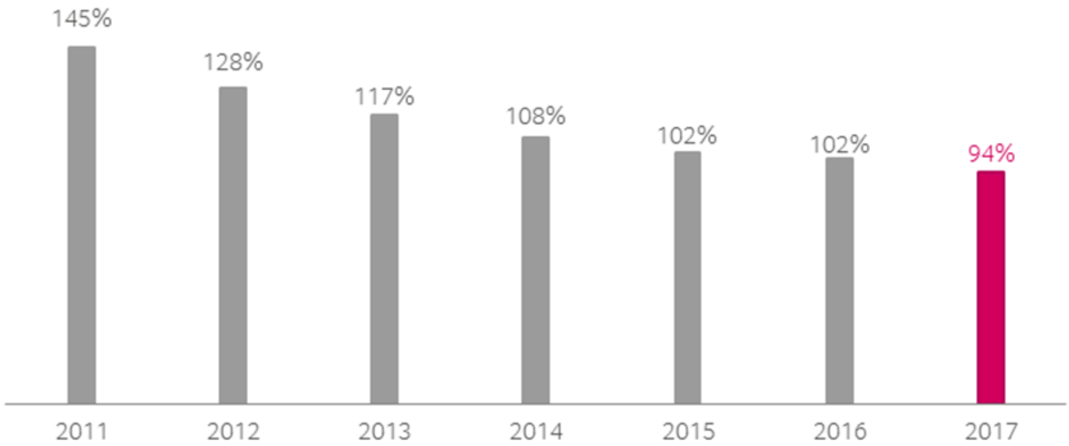
• Repayments of medium and long-term debt amounted to 2,300 million euros, including the amortization of the last tranche of Cocos (700 million euros), with the sum of the amounts to be refinanced in the next 4 years not to exceed 641 million euros;

• Net usage of the ECB by 3,049 million euros, compared to 4,436 million euros at the end of December 2016, showing a further reduction of 1,388 million;

• 12,776 million euros (net of haircut) of eligible assets for financing operations with the ECB, with an available asset buffer of 9,728 million euros in December 2017 (figure that amounted to 7,614 million euros in December 2016);

• The BCP Group structurally improved its liquidity profile, recording a Loans-to-deposit ratio of 94% (*) at the end of 2017 and 90% if all balance sheet resources were included (at 31 December 2016 was set at 99% and 95%, respectively), keeping a comfortable liquidity reserve of EUR 9,728 million of available elegible assets to guarantee Eurosystem operations.

GRAPH 8 – TRANSFORMATION RATIO EVOLUTION*



(*) According to the instruction no. 16/2004 of Banco de Portugal

In the end of December 2017, customer deposits stood at 51,188 million euros, recording a 4.9% increase vis-à-vis 31 December 2016, with the Clients' balance sheet resources amounting to 52,688 million euros, having credit reached 50,955 million euros, which represents a 1.6% decrease comparing to the end of 2016.

The eligible pool of assets for funding operations in the European Central Bank and other Central Banks, net of haircuts, is detailed as follows:

TABLE 65 - LIQUID ASSETS INTEGRATED IN COLLATERAL POOLS

(Thousand euros)

	31 Dec. 17	31 Dec. 16
European Central Bank	7,431,756	8,592,234
Other Central Banks	3,216,224	3,204,850
TOTAL	10,647,980	11,797,084

As at 31 December 2017, the amount discounted in the European Central Bank amounted to 4,000 million euros (31 December 2016: 4,870 million euros). As at 31 December 2017 and 2016, no amounts were discounted in Other Central Banks. The amount of eligible assets for funding operations in the European Central Bank includes securities issued by SPEs concerning securitisation operations in which the assets were not derecognised at a consolidated level. Therefore, the respective securities are not recognised in the consolidated securities portfolio. Until 31 December 2017, the evolution of the ECB's Monetary Policy Pool, the net borrows at the ECB and liquidity buffer is analysed as follows:

TABLE 66 – LIQUIDITY BUFFER OF THE ECB

(Thousand euros)

	31 Dec. 17	31 Dec. 16
Collateral eligible for ECB, afer haircuts:		
The pool of ECB monetary policy (i)	7,431,756	8,592,234
Outside the pool of ECB monetary policy	5,344,503	3,457,859
	12,776,259	12,050,093
Net borrowing at the ECB (ii)	3,048,618	4,436,292
LIQUIDITY BUFFER (iii)	9,727,641	7,613,801

(i) Corresponds to the amount reported in COLMS (Banco de Portugal application).
(ii) Includes, as at December 2017, the value of funding with the ECB net of the interest associated with the negative financing rate applied to the TLTRO (Euro 17,954,000) and of deposits at the Banco de Portugal and other liquidity of the Eurosystem (Euro 1,227,481,000), plus the minimum cash reserve and the accrued interest (Euro 344,053,000).
(iii) Collateral eligible for the ECB, after haircuts, less net borrowing at the ECB.

Thus, as at 31 December 2017, the liquidity obtainable through available collateral, plus deposits with Banco de Portugal deducted from the minimum cash reserves and accrued interest, amounted to 9,728 million euros, comparing to 7.614 million euros in 31 December 2016.

12.5.REGULATORY INDICATORS

12.5.1. LIQUIDITY COVERAGE RATIO

The definition of the Liquidity Coverage Ratio (LCR) was published by the Basel Committee in 2014. In the beginning of October 2015, the European Commission's Delegated Act has been adopted, introducing, in relation to the CRD IV/CRR, new metrics and calculation criteria implemented in the European Union. The adoption of the new framework defines a minimum requirement of 80% for this ratio until the end of 2017 and 100% from 1 January 2018.

The BCP Group's LCR ratio was comfortably above the minimum requirement 100% in 31 December 2017, supported by portfolios of highly liquid assets compatible with the Group's short-term liquidity prudential management, as evidenced in table 67.

TABLE 67 – LCR DISCLOSURE

(Thousand euros)

		Total unweighted value	Total weighted value
Period ending on 31-12-2017			
	Number of data points used in the calculation of averages	12	12
HIGH-QUALITY LIQUID ASSETS		0	0
1	Total high-quality liquid assets (HQLA)	-	9,259,829
CASH OUTFLOWS		0	0
2	Retail deposits and deposits from small business customers, of which:	22,246,172	2,062,282
3	Stable deposits	7,811,579	390,579
4	Less stable deposits	14,434,593	1,671,703
5	Unsecured wholesale funding	12,646,344	5,509,820
6	Operational deposits (all counterparties) and deposits in networks of cooperative banks	1,955,820	488,297
7	Non-operational deposits (all counterparties)	10,561,525	4,892,523
8	Unsecured debt	129,000	129,000
9	Secured wholesale funding	0	429,544
10	Additional requirements	8,100,483	1,226,983
11	Outflows related to derivative exposures and other collateral requirements	452,519	452,519
12	Outflows related to loss of funding on debt products	0	0
13	Credit and liquidity facilities	7,647,964	774,464
14	Other contractual funding obligations	717,446	717,446
15	Other contingent funding obligations	4,910,718	116,898
16.	**Total cash outflows**	-	10,062,973
CASH INFLOWS		0	0
17	Secured lending (eg reverse repos)	33,636	1,075
18	Inflows from fully performing exposures	3,310,874	1,869,604
19	Other cash inflows	6,494,100	1,854,624
EU-19a	(Difference between total weighted inflows and total weighted outflows arising from transactions in third countries where there are transfer restrictions or which are denominated in non-convertible currencies)	0	-
EU-19b	(Excess inflows from a related specialised credit institution)	0	-
20	**TOTAL CASH INFLOWS**	0	3,725,303
EU-20a	Fully exempt inflows	-	-
EU-20b	Inflows subject to 90% cap	-	-
EU-20c	Inflows subject to 75% cap	9,838,610	3,725,303
21	**LIQUIDITY BUFFER**	-	9,259,829
22	**TOTAL NET CASH OUTFLOWS**	-	6,337,670
23	**LIQUIDITY COVERAGE RATIO (%)**	-	147%

Note: Information calculated as the consolidated LCR simple month-end observations over the twelve months of 2017 (EBA/GL/2017/01).
The LCR value as at 31 December 2017 stood at 158%.

Concentration of funding and liquidity sources:

Considering that the core business of the BCP Group is based on commercial banking, deposits of retail clients contribute significantly to the funding structure and to the increase of stability. Other deposits made by financial entities and large corporations further contribute to the diversification of the funding structure, increasing the relationship with some counterparties at the operational level. Collateralized resources contribute to the stable funding base, both for longer maturities and collateral quality, namely Targeted longer-term refinancing operations (TLTRO) with the European Central Bank, repurchase agreements, mortgage bond issues and securitization. Senior debt securities and subordinated debt securities that compete in part for regulatory capital increase the funding sources' level of diversification, without recognizing that there is a significant risk of financing concentration.

Derivative exposures and potential collateral calls:

Derivative transactions carried out by the BCP Group are mainly defined under guarantee agreements that ensure the market risk hedging of these transactions. Group entities include liquidity risk, considering the impacts of an adverse market scenario that leads to changes in the market values of the derivatives, creating additional liquidity needs due to collateral coverage / replacement needs. In the LCR approach, this additional liquidity requirement is determined by the historical observation of the most significant net change in the last 24 months.

Currency mismatch in the LCR

The BCP Group has a significant amount of funding obtained in PLN, mostly obtained by the subsidiary in Poland, representing about 20% of the total funding. The liquidity coverage ratio in PLN is significantly above the required liquidity ratio for the transition period (80% in 2017) and comfortably above 100% (required from 2018 onwards).

Description of the centralization degree of both liquidity management and interaction between Group's units:

The management of the Group's liquidity needs is decentralized by geography, since each subsidiary is self-sufficient and responsible for ensuring the coverage of its liquidity needs, either through its deposit base or through the market mechanisms available in each geography. The BCP Group consolidates the individual liquidity plans for the Group's main entities, ensuring that the expected evolution of inflows and outflows of assets and liabilities resulting from commercial and corporate objectives is aligned with prudent liquidity risk management and adequate liquidity ratios. The liquidity of each of the Group's entities is supervised at a global level, with autonomy to manage liquidity needs, but ensuring internal mechanisms that maximize the efficiency of its management on a consolidated basis, particularly in times of higher stress.

Other items in the LCR calculation that are not captured in the LCR disclosure template but are considered relevant by the institution for its liquidiy profile:

The BCP Group's financing structure is based on retail deposits considered to be stable in nature, generating a low level of outflows. On the other hand, although wholesale funding presents a lower stability, potentially giving rise to higher outflows, an adequate management of maturity mismatches is carried out. The liquidity buffer is essentially composed of Level 1 assets based on sovereign public debt.

12.5.2. NET STABLE FUNDING RATIO

The definition of the Net Stable Funding Ratio (NSFR) was approved by the Basel Committee in October 2014. In what concerns this ratio, BCP Group has a stable financing base, obtained by the high weight of customer deposits in the funding structure, by collateralised financing and by medium and long-term instruments, which allowed the financing relation levels in 2017 to stood the NSFR at 124%.

12.5.3. ENCUMBERED AND UNENCUMBERED ASSETS

According to the notice no. 28/2014 of Banco de Portugal, which focuses on the guidance of the EBA on disclosure of encumbered and unencumbered assets (EBA/GL/2014/3), and taking into account the recommendation made by the European Systemic Risk Board, the following information regarding the assets and collaterals is presented:

TABLE 68 – ENCUMBERED ASSETS

(Thousand euros)

	31 Dec. 17				31 Dec. 16			
Assets	**Carrying amount of encumbered assets**	**Fair value of encumbered assets**	**Carrying amount of unencumbered assets**	**Fair value of unencumbered assets**	**Carrying amount of encumbered assets**	**Fair value of encumbered assets**	**Carrying amount of unencumbered assets**	**Fair value of unencumbered assets**
Assets of the reporting institution	12,542,681	n/a	60,204,359	n/a	-	15,302,927	n/a	57,835,396
Equity instruments	-	-	1,946,587	1,946,587	-	-	-	2,092,596
Debt securities	2,222,056	2,222,056	11,029,696	11,019,693	-	3,372,166	3,372,166	9,425,437
Other assets	-	-	8,744,647	n/a	-	-	n/a	8,138,305

(Thousand euros)

	31 Dec. 17		31 Dec. 16	
Collateral received	**Fair value of encumbered collateral received or own debt securities issued**	**Fair value of collateral received or own debt securities issued available for encumbrance**	**Fair value of encumbered collateral received or own debt securities issued**	**Fair value of collateral received or own debt securities issued available for encumbrance**
Collateral received by the reporting institution	-	-	-	-
Equity instruments	-	-	-	-
Debt securities	-	50,471	-	151,932
Other collateral received	-	-	-	-
Own debt securities issued other than own covered bonds or ABS	-	-	-	-

(Thousand euros)

Encumbered assets, encumbered collateral received and matching liabilities	31 Dec. 17	31 Dec. 16
	Carrying amount of selected financial liabilities	**Carrying amount of selected financial liabilities**
Matching liabilities, contingent liabilities and securities lent	8,957,873	11,356,280
Assets, collateral received and own debt securities issued other than covered bonds and encumbered ABS	11,885,777	14,915,249

In the end of 2017, total encumbered assets in funding operations represented 17% of the Group's balance sheet total assets, comparing with the value of 21% recorded in the end of 2016. This evolution was due to the improvement of the commercial gap, translating on a decrease of the funding needs, namely of the obtained with the ECB, and respective collateral exoneration.

The encumbered assets are mostly related with the Group's funding operations, in particular the ECB, in repo transactions, through the issuance of mortgage bonds and securitisation programs. The type of assets used as collateral for these financing transactions are divided into portfolios of loans to Clients, supporting securitisation programs and mortgage bonds issues, whether placed outside the Group, whether to improve the pool of collateral with the ECB, and Portuguese debt, which collateralise repo transactions in the money market. The funding raised from the IEB is collateralised by Portuguese public debt and bonds issues of the public sector entities.

The other assets in the amount of 8,744,647,000 euros (31 December 2016: 8,138,305,000 euros), although unencumbered, are mostly related to the Group's activity, namely: investments in associated companies and subsidiaries, tangible assets and investment properties, intangible assets, assets associated with derivatives and current and deferred taxes.

The amounts presented in table 68reflect the high level of collateralisation of the wholesale funding of the Group.