3. CAPITAL ADEQUACY

3.1. REGULATORY FRAMEWORK

On 26 June 2013, the European Parliament and the Council approved the Directive 2013/36/EU and the Regulation (EU) no. 575/2013 (Capital Requirements Directive IV / Capital Requirements Regulation – CRD IV/CRR), which established new and stricter capital requirements to credit institutions, with effects from 1 January 2014.

These stricter requirements result from a narrower definition of own funds and risk weighted assets, together with the establishment of minimum ratios, including a capital conservation buffer (2.5%) and additional Pillar 2 requirements (2.4%), of 9.4% for Common Equity Tier 1 (CET1), 10.9% for Tier 1 (T1) and 12.9% for Total Capital, which also includes Tier 2 (T2) own funds.

Additionally, supervisory authorities may impose a capital buffer to systemically important institutions given their dimension, importance to the economy, business complexity or degree of interconnection with other institutions of the financial sector and, in the event of insolvency, the potential contagion of these institutions to the rest of the non-financial and financial sectors. The Group has been considered an O-SII (other systemically important institution), and is obliged to comply with an additional buffer of 0.188% from 1 January 2018, of 0.375% form 1 January 2019, of 0.563% from 1 January 2020 and of 0.75% from 1 January 2021.

It is also predicted a countercyclical buffer, which aims to ensure that the banking sector has enough capital to absorb the losses generated in macroeconomic downturn conjectures, especially after periods of excess credit expansion, and to moderate these movements, given that this buffer depends on a discretionary decision of the competent authorities, based on their assessment regarding the underlying risks of the evolution of credit aggregates. This buffer may vary between zero and 2.5% for each institution and the need to achieve the defined goals may also impose restrictions in terms of distributions that go against an adequate capital conservation level. Pursuant to a decision of the Board of Directors of 29 September 2017, Banco de Portugal, in the exercise of its powers as national macroprudential authority, decided that the countercyclical buffer rate to be in force in the fourth quarter of 2017 would remain unchanged at 0% of the total risk exposure amount.

The CRD IV/CRR also predicts the possibility of institutions to gradually accommodate the new requirements, both in terms of own funds and compliance with minimum capital ratios, over determined maximum transition periods.

The consolidated capital ratios, as of 31 December 2016 and 2017, were calculated applying methodologies based on Internal Rating Based models (IRB) for the calculation of capital requirements for credit and counterparty risks, covering a substantial part of both its retail portfolio in Portugal and Poland, and its corporate portfolio in Portugal. The advanced method (internal model) was used 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 operating risk coverage. The capital requirements of the other portfolios/geographies were calculated using the standardised approach.

3.2. OWN FUNDS AND CAPITAL ADEQUACY ON 31 DECEMBER 2017 AND 2016

Own funds, calculated according to the applicable regulatory norms, include tier 1 and tier 2. Tier 1 comprises common equity tier 1 and additional tier 1.

Common equity tier 1 includes: (i) paid-up capital, share premium, hybrid instruments fully subscribed by the Portuguese State within the scope of the Bank's recapitalisation process and still not reimbursed, reserves and retained earnings and non-controlling interests; ii) and deductions related to own shares and loans given to finance the acquisition of Bank's shares, the shortfall of value adjustments and provisions to expected losses concerning exposures whose capital requirements for credit risk are calculated under 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 capital requirements attributable to the minorities. In addition, the deferred tax assets arising from unused tax losses 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 other hybrid instruments that are compliant with CRR requirements and the 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 CRR requirements and the minority interests related to minimum total capital requirements of institutions that are not totally owned by the Group.

The legislation in force stipulates a transitional period between the own funds calculated under national law until 31 December 2013, and the own funds estimated according to the EU law, in order to exclude some elements previously considered (phase-out) and to 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 assets already recorded on the balance sheet of 1 January 2014, and the subordinated debt and all the hybrid instruments not eligible to the own funds, that have a longer period (until the end of 2023 and 2021, respectively). The applicable percentages during the transitional period in analysis are presented in Table7:

TABLE 7 – PHASE-IN PROGRESSION

	2017	2016
Goodwill and other intangible assets	80%	60%
Shortfall of impairment to expected loss	80%	60%
Investments in financial and insurance entities	80%	60%
Deferred tax assets existing as of 01.01.2014	30%	20%
Deferred tax assets created after 01.01.2014	80%	60%
Fair value reserves on public debt securities	80%	60%
Fair value reserves on other securities	80%	60%
National filters and deductions	80%	60%

The BCP's Extraordinary General Meeting of Shareholders that took place on 15 October 2014 approved the adhesion of the Bank to the special scheme applicable to deferred tax assets, as provided for in Law no. 61/2014 of 26 August 2014, applicable to expenses and negative changes of the net worth of assets accounted for tax periods beginning on or after 1 January 2015 as well as the deferred tax assets recorded in the annual accounts concerning the last tax period prior to that date and part of the expenses and negative changes of the net worth of assets that are associated with them.

This approval had a favourable impact in the capital ratios estimated in accordance with the CRD IV/CRR since 1 January 2015, since it allowed reducing the deductions related to deferred taxes in CET1, associated with loan impairment losses and post-employment or long term benefits of employees, despite an increase of the risk weighted assets.

The main aggregates of the consolidated own funds and own funds requirements, as of 31 December 2017 and 2016 as well as the respective capital ratios are shown in Table 8:

TABLE 8 - CAPITAL RATIO AND SUMMARY OF THE MAIN AGGREGATES

(Thousand euros)

	31 Dec. 17	31 Dec. 16
OWN FUNDS		
Tier I	5,319,273	4,874,199
of which: Common Equity Tier I	5,319,273	4,874,199
Tier II	612,577	383,268
Total capital	5,931,851	5,257,467
RWA		
Credit risk and counterparty credit risk	35,366,357	35,007,882
Market risk	991,992	675,498
Operational risk	3,574,097	3,260,661
Credit Valuation Adjustments (CVA)	238,668	215,749
Total	40,171,113	39,159,791
CAPITAL RATIOS		
Common Equity Tier I	13.2%	12.4%
Tier I	13.2%	12.4%
Total capital	14.8%	13.4%

The phased-in CET1 ratio, calculated according to our interpretation of the CRD IV/CRR and the current applicable prudential regulatory framework, stood at 13.2% as at 31 December 2017 and at 12.4% as at 31 December 2016, both above the respective minimum required thresholds.

TABLE 9 – IMPACTS

(Thousand euros)

	CET1 31 Dec. 16	Phase-in	CET1 1 Jan. 17	Cap. Incr. and CoCo's reimb	LGD/ELBE - Retail Portfolios	Activity 2017	CET1 31 Dec. 17
CET1	4,874,033	-512,196	4,361,838	676,851	-239,048	519,633	5,319,273
RWA	39,159,791	-146,969	39,012,823	228,091	408,574	521,626	40,171,113
Ratio	12.4%	-127 bp	11.2%	166 bp	-72 bp	117 bp	13.2%

The performance of the CET1 phased-in ratio in 2017 mainly reflects the following impacts:

• the capital increase operation performed in February 2017 and the full reimbursement of the remaining CoCos, which determined a CET1 increase of 677 million euros and a 228 million euros increase of RWA (+ 166 basis points in CET1 phased-in ratio);

• the phase-in progression, which determined reductions of CET1 by 512 million euros and RWA by 147 million euros as at 1 January 2017 (- 127 basis points in CET1 phased-in ratio);

• the changes performed in the Retail LGD/ELBE models decreased the CET1 in 239 million euros due to expected losses, despite the 409 million euros risk weighted assets' increase (-72 basis points in CET1 phased-in ratio).

The organic generation of capital, based on the positive net income, as well as on the fair value reserves' favourable evolution, also contributed to the positive performance of capital ratios on this period.

Table 10 shows the reconciliation between the accounting and regulatory capital as at 31 December 2017 and 2016:

TABLE 10 - RECONCILIATION BETWEEN ACCOUNTING AND REGULATORY CAPITAL

(Thousand euros)

		31 Dec. 17	31 Dec. 16
1	Share capital	5,600,738	4,268,818
2	Own shares	-293	-2,880
3	Share premium	16,471	16,471
4	Preference shares	59,910	59,910
5	Other capital instruments	2,922	2,922
6	Reserves and retained earnings	214,676	12,937
7	Net income for the period attributable to Shareholders	186,391	23,938
	TOTAL EQUITY ATTRIBUTABLE TO SHAREHOLDERS OF THE BANK	6,080,814	4,382,115
8	Non-controlling interests (minority interests)	1,063,786	888,682
	TOTAL EQUITY	7,144,600	5,270,798
9	Own shares of CET1 not elegible instruments	-4,254	
10	Preference shares not elegible for CET1	-59,910	-59,910
11	Other capital instruments not elegible for CET1	-2,922	-2,922
12	Subordinated debt fully subscribed by the Portuguese State eligible for CET1		700,000
13	Non-controlling interests not eligible for CET1	-499,744	-234,195
14	Other regulatory adjustments	-1,258,496	-799,572
	COMMON EQUITY TIER 1 (CET1)	5,319,273	4,874,199
15	Subordinated debt	4,130	10,629
16	CET1 transferred adjustments	104,239	157,263
17	T2 transferred adjustments	-5,880	-11,760
18	Other Adjustments	-102,489	-156,132
	Of which: Intangible assets	-54,479	-107,012
	Of which: Shortfall of impairment to expected loss	-39,246	-24,073
	Of which: Residual amounts of CET1 instruments of financial entities in which the institution has a significant investment	-8,764	-20,788
	Of which: Other		-4,258
	TIER 1 (T1)	5,319,273	4,874,199
19	Subordinated debt	596,693	403,491
20	Non-controlling interests elegible for T2	146,229	126,963
21	Preference shares elegible for T2		
22	Adjustments with impact in T2, including national filters	-130,345	-147,186
23	Adjustments that are transferred for T1 for insufficient T2 instruments		
	TIER 2 (T2)	612,577	383,268
	OWN FUNDS	5,931,851	5,257,467

Notes:
The sum of headings 1, 2, 3 and 9 is equivalent to heading 1 of the transitional model of disclosure of own funds, as set out in the annex.
The sum of headings 6 and 7 is equivalent to the sum of headings 2 and 3 of the transitional model of disclosure of own funds, as set out in the annex.
The heading 12 is equivalent to heading 4 of the transitional model of disclosure of own funds, as set out in the annex.
The sum of headings 8 and 13 is equivalent to heading 5 of the transitional model of disclosure of own funds, as set out in the annex.
The heading 14 is equivalent to heading 28 of the transitional model of disclosure of own funds, as set out in the annex.
The heading 15 is equivalent to heading 33 of the transitional model of disclosure of own funds, as set out in the annex.
The heading 16 is equivalent to headings 34 and 41 of the transitional model of disclosure of own funds, as set out in the annex.
The heading 17 is equivalent to heading 41b of the transitional model of disclosure of own funds, as set out in the annex.
The heading 18 is equivalent to heading 41a and 41c of the transitional model of disclosure of own funds, as set out in the annex.
The heading 19 is equivalent to heading 46 and 47 of the transitional model of disclosure of own funds, as set out in the annex.
The heading 20 is equivalent to heading 48 of the transitional model of disclosure of own funds, as set out in the annex.
The heading 22 is equivalent to heading 57 of the transitional model of disclosure of own funds, as set out in the annex.

Table 11 shows BCP Group risk weighted assets as at 31 December 2017 and 2016.

TABLE 11 – TEMPLATE EU OV1 - OVERVIEW OF THE RISK WEIGHTED ASSETS (RWA)

(Thousand euros)

	RWA		Minimum capital requirements
	31 Dec. 17	**31 Dec. 16**	**31 Dec. 17**
CREDIT RISK (EXCLUDING CCR)	**31,921,172**	**31,568,860**	**2,553,694**
of which:			
Standardised Approach	9,020,139	10,690,134	721,611
Advanced IRB (AIRB) approach	22,901,033	20,878,725	1,832,083
CCR	**519,686**	**584,546**	**41,575**
of which:			
Mark to Market	519,686	584,546	41,575
Standardised Approach			
SETTLEMENT RISK			
SECURITISATION EXPOSURES IN THE BANKING BOOK (AFTER THE CAP)	**350,669**	**406,177**	**28,054**
of which:			
IRB Approach	3,781	17,261	302
IRB Supervisory Formula Approach (SFA)	346,888	388,916	27,751
MARKET RISKS	**991,992**	**675,498**	**79,359**
of which:			
Standardised Approach	358,218	36,374	28,657
IMA	633,773	639,124	50,702
LARGE EXPOSURES			
OPERATIONAL RISK	**3,574,097**	**3,260,661**	**285,928**
of which:			
Standardised Approach	3,574,097	3,260,661	285,928
AMOUNTS BELOW THE THRESHOLDS FOR DEDUCTION (subject to 250% risk weight)	**2,178,123**	**2,016,516**	**174,250**
Floor Adjustment			
TOTAL	**39,535,739**	**38,512,259**	**3,162,859**

By the end of 2017 and 2016, the Group had an own funds surplus, comparing with the respective own funds requirements, of 2,718 million euros and 2,125 million euros, respectively, as referred to in Table 12.

TABLE 12 – CAPITAL ADEQUACY

(Euro thousand)

	31 Dec. 17	**31 Dec. 16**
CET1 Ratio (%)	13.2%	12.4%
Surplus (+) / Deficit (-) of CET1	3,511,573	3,111,843
T1 ratio (%)	13.2%	12.4%
Surplus (+) / Deficit (-) of T1	2,909,007	2,524,446
Total ratio (%)	14.8%	13.4%
Surplus (+) / Deficit (-) of Own Funds	2,718,162	2,124,553

3.3. LEVERAGE RATIO ON 31 DECEMBER 2017 AND 2016

The calculation of the regulatory leverage ratio is specified in article 429 of the CRR, modified by the Delegated Act no. 62/2015 of 10 October 2014.

The leverage ratio is defined as the proportion of tier 1 capital (either in a phased-in or fully implemented mode) divided by the exposure measure, i.e. balance sheet and off-balance-sheet assets after certain value adjustments, related namely to intra-group exposures, to securities financing transactions (SFT's), to items deducted from the total capital ratio's numerator and off-balance-sheet items, to account for different risk profiles of each type of exposure (in SFT's and derivatives add-ons for future risks are considered while in off-balance sheet items different CCFs are considered according to the risk of the exposure).

The following table shows the Group's leverage ratio, on a phased-in basis, as of 31 December 2017:

TABLE 13 – LEVERAGE RATIO ON 31 DECEMBER 2017

(Thousand euros)

	Summary reconciliation of accounting assets and leverage ratio exposures	Applicable amount
1	Total assets as per published financial statements	71,939,450
2	Adjustment for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	108,734
3	Adjustment for fiduciary assets recognised on the balance sheet pursuant to the applicable accounting framework but excluded from the leverage ratio total exposure measure in accordance with Article 429 (13) of Regulation (EU) No 575/2013	
4	Adjustments for derivative financial instruments	452
5	Adjustment for securities financing transactions (SFTs)	
6	Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off-balance sheet exposures)	3,571,601
EU-6a	Adjustment for intragroup exposures excluded from the leverage ratio total exposure measure in accordance with Article 429(7) of Regulation (EU) No 575/2013	
EU-6b	Adjustment for exposures excluded from the leverage ratio total exposure measure in accordance with Article 429(14) of Regulation (EU) No 575/2013	
7	Other adjustments	-1,169,298
8	**LEVERAGE RATIO TOTAL EXPOSURE MEASURE**	74,450,939

(Thousand euros)

	Leverage ratio common disclosure	CRR leverage ratio exposures
	ON-BALANCE SHEET EXPOSURES (EXCLUDING DERIVATIVES AND STF)	
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	71,058,193
2	Asset amounts deducted in determining Tier 1 capital	-1,067,728
3	**TOTAL**	69,990,464
	DERIVATIVES EXPOSURE	
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	646,575
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	446,058
EU-5a	Exposure determined under the Original Exposure Method	
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework	
7	Deductions of receivables assets for cash variation margin provided in derivatives transactions	-211,530
8	Exempted CCP leg of client-cleared trade exposures	-253,508
9	Adjusted effective notional amount of written credit derivatives	261,278
10	Adjusted effective notional offsets and add-on deductions for written credit derivatives	
11	**TOTAL**	888,874
	SFT EXPOSURES	
12	Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	
13	Netted amounts of cash payables and cash receivables of gross SFT assets	
14	Counterparty credit risk exposure for SFT assets	
EU-14a	Derogation for SFTs: Counterparty credit risk exposure in accordance with Articles 429b(4) and 222 of Regulation (EU) No 575/2013	
15	Agent transaction exposures	
EU-15a	Exempted CCP leg of client-cleared SFT exposure	
16	**TOTAL**	
	OTHER OFF-BALANCE SHEET EXPOSURES	
17	Off-balance sheet exposures at gross notional amount	12,126,739
18	Adjustments for conversion to credit equivalent amounts	-8,555,138
19	**TOTAL**	3,571,601
	EXEMPTED EXPOSURES IN ACCORDANCE WITH ARTICLE 429 (7) AND (14) OF REGULATION (EU) No 575/2013 (ON AND OFF BALANCE SHEET)	
EU-19a	Intragroup exposures (solo basis) exempted in accordance with Article 429(7) of Regulation (EU) No 575/2013 (on and off balance sheet)	
EU-19b	Exposures exempted in accordance with Article 429 (14) of Regulation (EU) No 575/2013 (on and off balance sheet)	
20	**TIER 1 CAPITAL**	5,319,273
21	**LEVERAGE RATIO TOTAL EXPOSURE MEASURE**	74,450,939
	LEVERAGE RATIO	
22	Leverage ratio	7.1%
	CHOICE ON TRANSITIONAL ARRANGEMENTS AND AMOUNT OF DERECOGNISED FIDUCIARY ITEMS	
EU-23	Choice on transitional arrangements for the definition of the capital measure	Transitional
EU-24	Amount of derecognised fiduciary items in accordance with Article 429(11) of Regulation (EU) No 575/2013	

(Thousand euros)

	Breakdown of on-balance sheet exposures (excluding derivatives and STF and exempted exposures)	CRR leverage ratio exposures
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	71,058,193
EU-2	Trading book exposures	-234,028
EU-3	Banking book exposures, of which:	70,824,165
EU-4	Covered bonds	
EU-5	Exposures treated as sovereigns	12,007,548
EU-6	Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns	798,628
EU-7	Institutions	303,957
EU-8	Secured by mortgages of immovable properties	24,041,423
EU-9	Retail exposures	6,599,982
EU-10	Corporate	10,369,891
EU-11	Exposures in default	6,928,377
EU-12	Other exposures (eg equity, securitisations, and other non-credit obligation assets)	9,774,357

3.4. EVENTS WITH A MATERIAL IMPACT ON OWN FUNDS AND CAPITAL REQUIREMENTS IN 2018

The main events with recognised or possible material impact on own funds and capital requirements in 2018 are related with:

I) ENTRY INTO FORCE OF THE IFRS 9:

In the beginning of 2018 came into force the IFRS 9, which establishes new requirements regarding the classification and measurement of financial assets and liabilities, the impairment calculation methodology and the application of hedge accounting rules. The Group's regulator issued a transitional guidance within the scope of the IFRS 9 implementation, which allows choosing between two approaches for the recognition of the impacts on regulatory capital. The Group chose to defer the impact, as defined in Article 473a of the CRR.

The estimated impact, of the IFRS 9 application, on the CET1 pro-forma ratio as at 31 December 2017 is -34 basis points fully implemented and -25 basis points phased-in.

II) SREP MINIMUM REQUIREMENTS:

The Bank informed the market of the European Central Bank's (ECB) decision regarding the minimum prudential requirements to be fulfilled from January 1st, 2018, based on the results of the Supervisory Review and Evaluation Process (SREP). In addition, BCP was informed by the Banco de Portugal on its capital buffer requirement as "other systemically important institution" (O-SII). These decisions define, concerning minimum own funds requirements, as from January 1st, 2018, the following ratios, determined as a percentage of total risk weighted assets (RWA): 8.8125% CET1, 10.3125% T1 and 12.3125% Total. In addition to the minimum requirements set by CRR article 92 these minimum own funds requirements include 2.25% of Pillar 2, 1.875% of additional conservation buffer and 0.1875% of other systemically important institutions (O-SII) buffer.

Also on the scope of SREP, the CET1 deduction of irrevocable payment commitments for the Resolution Fund and the Deposits Guarantee Fund is required from January 1st, 2018.

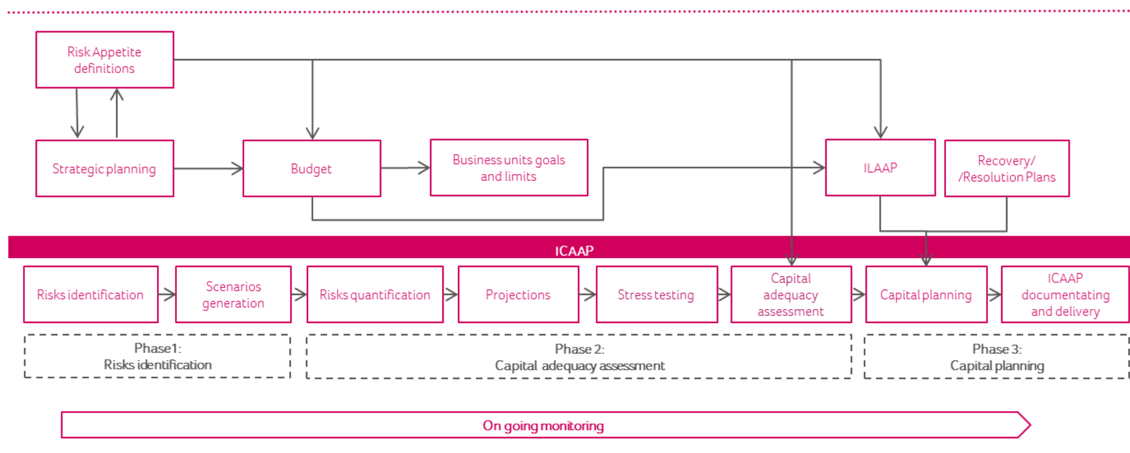
III) PHASE-IN PROGRESSION:

It is also worth noting that the year 2018 will have the last phase-in progression with substantial impact on capital ratios.

The estimated impact on CET1 pro-forma ratio, considering the application of the SREP result and the phase-in progression as for January 1st, 2018, stood at -31 basis points in fully implemented ratio and -157 basis points in phased-in ratio.

3.5. INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP)

The Bank continuously monitors the adequacy of capital to cover the risks level to which the Group's activity is subject in the development of its business strategy, current and projected for the medium-term. This continuous process, designated by ICAAP (Internal Capital Adequacy Assessment Process), is a key process within the risk management function's scope at Group BCP. The chart below summarizes the process at stake:



The ICAAP develops under an internal governance model that ensures the involvement of the BoD (the body responsible for approving the results) and its Risk Assessment Committee, of the EC, of the Risk Commission and of the top management, along the various stages of the process.

The results of the ICAAP allow the Bank's management bodies – namely, the Board of Directors and the Executive Committee - to test if the Group's capitalisation is appropriate for the risks stemming from its activities and if the strategic plan and budget are sustainable in the medium term and comply with the risk limits defined in the Risk Appetite Statement (RAS) approved for the Group.

For this purpose, the ICAAP is rolled-out from a prospective vision of the impact estimates concerning the occurrence of risks over the Bank's capital (capital requirements), considering their scale or dimension, complexity, frequency, probability and materiality, against a background consisting of the medium term (3 years) projection for the developments of the Group's activities. In this process, impacts are estimated for a base scenario and a stress scenario; the latter, with a severely negative evolution of macroeconomic indicators in order to test the Group's resilience and the adequacy of the capital levels to cover the risks to which its activity may become subject.

The ICAAP's first stage is the identification of the material risks to which the Group's activity is subject, which involves the Bank's management and the management from the main subsidiaries abroad. For this purpose, the Group uses a methodological approach based on an internal list of risks, covering more than 60 different risks, considering the relevancy of each one by taking into consideration its probability of occurrence and the magnitude of the impacts of its occurrence – either before or after the implementation of risk mitigation measures.

Beyond all risks considered to be material, the Group integrates in the ICAAP all of Basel's Pillar I risks, even if these do not attain levels that are considered to be material, at Group level.

The result of this stage is the list of risks to be incorporated in the ICAAP, which will also be helpful in defining the variables to be considered for the establishment of the base and the stressed scenarios, mentioned below. The approval of the results of the risks identification process is a capacity attributed to the Risks Assessment Committee.

Within the ICAAP for 2017, the Group has considered the following risks (as materially relevant ones, after mitigation effects, or considered within the scope of Pillar I):

TABLE 14 – RISKS INCORPORATED IN THE SCENARIO MODELS

Risks incorporated in the scenario models	
Credit risk	Counterparty risk
	Default risk
	Issuer risk
	Securitisation risk
	Sovereign risk
	Transfer risk
Concentration risk	Sectorial concentration
	Single name concentration
Market risks	CVA risk
	FX risk of the banking book
	Interest rate risk of the banking book (IRRBB)
	Market risks of the trading book
Business risks	Economic risk
	Strategy risk
	Financial holdings risk
Operational risk	Clients, products and commercial practices
	Damages to physical assets
	Commercial activities disrupture and systems failures
	Execution, delivery and processes management
	Internal/External fraud risk
	Employment practices and safety at the workplace risk
	Model risk
Reputation risk	Reputation risk of the banking sector
Real Estate risk	Real Estate market risk
Other risks	FX risk in Poland
	Reputation risk from insurance selling
	Exposure to the insurance sector risk
	Litigation risk
	Pension Fund risk
	Real estate market risk

In a second stage, the base and stressed scenarios that make the ICAAP's framework were defined. While the base scenario represents the Group's vision of the most probable evolution of the business constraints in the medium term (baseline scenario), the stressed scenario incorporates extreme conditions, with low probability of occurrence but with severe impact over the Group's activity (adverse scenario). The approval of the scenarios to be considered in the ICAAP is also a responsibility of the Risks Assessment Committee.

In the third stage of the ICAAP, the impact of the risks identified is modelled for the reference date and the capital requirements are calculated for that date. All risks identified by the Bank are considered in the ICAAP. The material risks are quantified in term of their impact over the Risk Weighted Assets (RWA) level or over the P&L, in accordance

with a set of methodologies and internal models, formally approved and audited, considering a significance level in line with the regulatory requirements (CRR or Solvency 2) and a time horizon of 1 year (which is lower for the trading portfolio, due to its business nature). The non-material risks are considered through an additional buffer to the capital calculated by the Bank through the ICAAP.

The approval of the estimation methodologies for the risks impacts in the Group's activity is a competence of the Risk Commission.

In the prospective component, the baseline and adverse scenarios referred to above are considered for a medium-term (3 years) projection, either in the current vision of the Group's management (baseline scenario) or within a macroeconomic context that is severely penalizing, in order to test the Group's resilience under extreme scenarios, i.e., if the Group has adequate capital levels to cover the risks to which its activity may be subject to. For this, the different risks are modelled or incorporated within the Group's stress testing methodology.

After the estimation of impacts of the risks over P&L and the Group's balance sheet – especially, in what concerns the Own Funds – the adequacy of the Group's Risk Taking Capacity (RTC) can be assessed, *vis-à-vis* the expected profile of its activity.

The Group adopts a RTC that is aligned with the definitions of the regulatory capital ratios, pursuant to Directive 2013/36/EU and Regulation (EU) No 575/2013 (the CRR – Capital Requirements Regulation), including some adjustments in order to encompass other elements or capital instruments that the Group considers appropriate to cover the existing risks, prudently projected along the timeframe under analysis.

The ICAAP results show that the current capitalisation levels are appropriate for a 3-year horizon, either under the base scenario or the stressed/adverse scenario.

Quarterly, the Bank reviews the ICAAP's assumptions, namely, in what concerns the assessment of the materiality of the risks that are considered as "non-material", the up-to-dating of the projections considered under the macroeconomic scenarios, the analysis of gaps in the business plans, the update of the assessment on the main ICAAP's material risks and the RTC calculation. The results are reported to the Bank's management bodies and are one of the major sources for the revision of the Group RAS. Whenever there are significant changes in the Group's risk profile, the capital adequacy model is recalculated.