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 Liquidity management at the consolidated level is monitored and coordinated in accordance with the principles and methodologies defined at the Group level. The Consolidated Liquidity Plan, which is an integral part of the annual budgeting and planning process, is the main instrument used in pursuit of those purposes.

Liquidity management at the entity level is managed in a stand-alone, each of which must manage and independently guarantee its funding needs, either through its deposit base or, where applicable, through the use of available market mechanisms in each geography.In order to prudently manage liquidity risk, the Group's entities maintain conservative loan to deposits ratios and also have liquidity buffers that are comfortable and appropriate to the size and risk profile of the respective operation.

BCP Group business model is based on retail banking, which has ensured a stable liquidity position, whose resilience has been tested favorably even in situations of financial market distress, as demonstrated in 2011, following the adoption of the Financial Assistance Programme for Portugal.

Since then, in order to reduce the risk profile of the Bank's financing structure and increase its resiliency, strategic priorities have been redefined, both through the alienation of non-strategic assets at first, and through the management of the deleveraging process.

As a result, there was a significant decrease in the commercial gap and a strengthening of stable sources of funding, particularly customer funds, while reducing the bank's dependence on ECB and wholesale funding markets.

The BCP Group ensures compliance with the prudential liquidity requirements required under the current regulatory framework at the consolidated and individual levels.

LIQUIDITY RISK ASSESSMENT

The Group's liquidity risk assessment is based on the calculation and analysis of the regulatory indicators defined by the supervisory authorities as well as other internal, short-term and structural metrics for which consistent exposure limits are defined, monitored and regularly reviewed

In structural terms, the Group's Risk Appetite Statement (RAS) defines, on a consolidated basis, a set of structural liquidity indicators and respective limits, which are then cascaded through limits applicable to each entity.

The wholesale funding evolution, the LCR (Liquidity Coverage Ratio), the *Loans-to-deposits* ratio and the stock of available collateral for discount at the ECB are monitored weekly.

Concurrently, the liquidity position of the Group is regularly analysed, identifying the factors that justify the changes and deviations from the Liquidity Plan, consolidated and per entity. This analysis is submitted to the CALCO, which decides on appropriate measures to maintain adequate financing conditions. Complementarily, the responsibility for controlling the exposutre to liquidity risk lies with the Risk Commission.

In order to prevent the emergence of a liquidity crisis or to prompt immediate action if it materializes, CALCO is also presented on a monthly basis to the results of the Early Warning Signals system of the Liquidity Contingency Plan, with a summarised score of a series of indicators that monitor the evolution of liquidity risk drivers.

Control of liquidity risk is further strengthened by periodically stress tests, carried out to assess the Bank's risk profile and to ensure that the Group and each of its subsidiaries meet their immediate obligations in crisis scenarios. These tests are also used to support the liquidity contingency plan and management decision-making on this matter, including the periodic quantification of the counterbalancing capacity measures defined in the Recovery Plan.

12.2. MANAGEMENT MODEL

The Group's liquidity management is coordinated at the level of the BCP Group, under the responsibility of CALCO, consolidating a comprehensive view of the Group's liquidity position, both short-term management and structural management and promoting conditions for efficient access to financial markets .

BCP Group's Liquidity Plans, prepared on a consolidated basis for the Group and individually for the main entities, are intended to ensure that the expected evolution of inflows and outflows of assets and liabilities resulting from commercial and corporate objectives is in line with prudent treasury management and adequate liquidity ratios, respecting the regulatory risk levels and those internally defined in the RAS.

Liquidity management is carried out by the local units on an autonomous basis, aiming at the self-sufficiency of the various entities in terms of financing, maintaining their funding independence from the parent company.

The liquidity risk management and evaluation methodologies described in 12.1. and the refinement of the governance model succinctly addressed in this section are continuously re-evaluated in the annual Internal Liquidity Adequacy Assessment Process (ILAAP), that annualy materialises in a document drawn according to the EBA guidelines, representing the self-assessment of the Group on liquidity strategy, its management and planning.

Taking as reference the level and the nature of the risks that the Board of Directors intends to limit and control, materialised in the Risk Appetite Statement (RAS), the ILAAP is a key component of the Group's risk management structure and consists of a coherent body of principles, policies, procedures and structures. The improvement opportunities identified in ILAAP lead to detailed action plans, ensuring a permanent adapting of the methodologies and Governance for liquidity risk management (and of liquidity management) to the challenges that the Group faces and the pursuit of best practices. The ILAAP systematically addresses the main components of liquidity management and their respective risk, in accordance with the following structure:

Liquidity and funding risk management:

Definition of the procedures, responsibilities, methodologies and rules employed by the Group to address liquidity and funding risk management.

Funding strategy:

Assessment of the Group's policies and procedures regarding its ability to fund its liquidity needs.

Liquidity buffer and collateral management:

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

Cost benefit allocation mechanism:

Assessment of the Bank's approach for liquidity transfer pricing.

Intraday liquidity risk management:

Presentation of the Bank's methodology for managing intraday liquidity risk, as well as of the mechanism that allow to obtain supporting and root-cause information for registered incidents related 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 of its adequacy, through internal limits developed from common and transversal concepts to the Group.

Liquidity stress testing:

Execution of liquidity stress tests on a regular basis.

Contingency funding plan:

Presentation of the lines of responsibility for designing, monitoring and executing the Contingency Funding Plan along with the methodologies for the early detection of tension situations and an assessment of the adjustment measures feasibility.

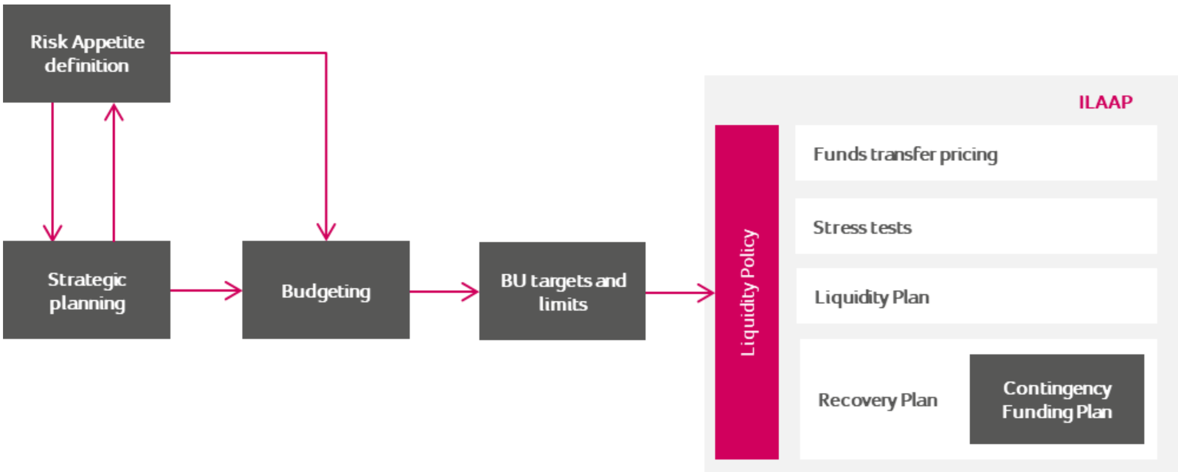
12.3.REGULATORY REQUIREMENTS

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 (via COREP – the Common reporting Framework).

Within liquidity risk management, it should be noted, the application of the Commission Delegated Regulation (EU) 2015/61 of 10 October 2014, from 2016 onwards 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.

Within the scope of the ILAAP, the bank analyses a vast set of qualitative and quantitative information, aiming at defining a liquidity risk management framework for 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 already mentioned (at section 12.2) 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 considers specific features of the Group, such as business model, governance, implemented controls and its monitoring, dimension, complexity, market constraints, and local regulatory duties of each geography.



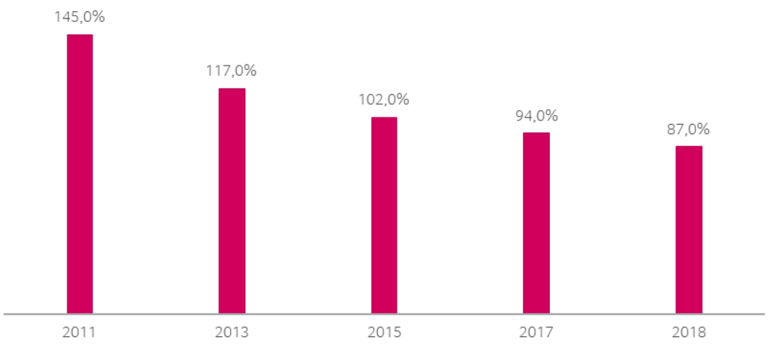
12.4.BALANCE SHEET INDICATORS

The main evolutions regarding the Group's liquidity situation in 2018 were the following:

- Increase of 313 million euros in wholesale funding requirements, mainly attributable to the opposite impacts of the increase in sovereign debt portfolios in Portugal and Poland, on the one hand, and a new reduction of the commercial gap in Portugal and cash flow from operations, on the other hand. The increase in liquidity needs was almost entirely supplied through the money market, with a net increase 357 million euros, to a balance of 1,168 million euros as a result of the increase in the interbank market of 755 million euros (to a balance of 738 million euros) and a reduction of 398 million euros in REPOs , to a balance of 430 million euros at the end of the year.
- The value of collateralised borrowings with the ECB remained at 4,000 million euros, corresponding to the balance of the TLTRO (Targeted Longer Term Refinancing Opererations), which will reach maturity in 2020. Net funding with the ECB - which deducts the liquidity deposited with the Bank of Portugal above minimum cash reserves requirements and other liquidity denominated in euros, as well as the interest associated with the negative financing rate applied to TLTRO - continued its progressive reduction path in 2018, by 396 million euros, to a balance of 2,652 million euros.
- The growth of the ECB's eligible assets portfolios allowed for a significant strengthening of the liquidity buffer with the Eurosystem which, at the end of 2018, reached 14,261 million euros (vs. Eur 9,728 million euros in December 2017).
- The Group structurally improved its liquidity profile, recording a Loans-to-deposit ratio of 87%[*] at the end of 2018 (85% if all balance sheet resources were included) - while at 31 December 2017 it attained 94% and 90%, respectively - keeping a comfortable liquidity reserve of EUR 14.261 million of available elegible assets to guarantee Eurosystem operations.

[*]As per Instruction no. 16/2004 of Banco de Portugal.

GRAPH 8 – LTD RATIO EVOLUTION



At the end of December 2018, customer deposits stood at 55,248 million euros, recording a 7.9% increase *vis-à-vis* 31 December 2017, with the Clients' balance sheet resources amounting to 56,585 million euros, with gross credit reaching 50,724 million euros, which represents a 0.5% decrease from the end of 2017.

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 62 - LIQUID ASSETS INTEGRATED IN COLLATERAL POOLS

(Thousand euros)

	31 Dec 18	31 Dec 17
European Central Bank[(*)]	7 248 348	7 431 756
Other Central Banks	5 608 093	3 216 224
TOTAL	12 856 441	10 647 980

As at 31 December 2018:

- The amount discounted at the European Central Bank amounted to 4,000 million euros (same amount as at 31/12/2017);
- The amount discounted at Banco de Moçambique was of 1,275,000 euros (null amount as at 31/12/2017);
- No amounts were discounted in other central banks.

The ECB's Monetary Policy Pool, the net borrowing at the ECB and the liquidity buffer were the following at 31/1272018 and 2017:

TABLE 63 – LIQUIDITY BUFFER OF THE ECB

(Thousand euros)

	31 Dec. 18	31 Dec. 17
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 (17,954,000 euros), of deposits at the Banco de Portugal and of other liquidity of the Eurosystem (1,227,481,000 euros), plus the minimum cash reserve and the accrued interest (344,053,000 euros).
[(iii)] Collateral eligible for the ECB, after haircuts, less net borrowing at the ECB.

[(*)] Includes securities issued by SPE concerning securitization operations in which the assets were not derecognised at a consolidated level. Therefore, the respective securities are not recognised in the securities portfolio.

Thus, as at 31 December 2018, the liquidity obtainable through available collateral, plus deposits with Banco de Portugal deducted from the minimum cash reserves and accrued interest, amounted to 14,261 million euros, comparing to 9,728 million euros in 31 December 2017.

12.5.REGULATORY INDICATORS

12.5.1. LIQUIDITY COVERAGE RATIO

The regulatory requirement for the minimum Liquidity Coverage Ratio (LCR) is of 100% and the Group's LCR was comfortably above that path by 31 December 2018, supported by portfolios of highlyliquid assets whose amount is compatible with the Group's prudent short-term liquidity management, as illustrated by the following table

TABLE 64 – 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			
1	Total high-quality liquid assets (HQLA)	-	11 256 085
CASH OUTFLOWS			
2	Retail deposits and deposits from small business customers, of which:	25 115 859	2 309 184
3	Stable deposits	9 087 544	454 377
4	Less stable deposits	16 028 315	1 854 807
5	Unsecured wholesale funding	12 388 457	5 217 267
6	Operational deposits (all counterparties) and deposits in networks of cooperative banks	1 693 469	422 685
7	Non-operational deposits (all counterparties)	10 681 003	4 780 596
8	Unsecured debt	0	13 986
9	Secured wholesale funding	-	46 126
10	Additional requirements	8 471 856	1 153 322
11	Outflows related to derivative exposures and other collateral requirements	335 257	335 257
12	Outflows related to loss of funding on debt products	0	0
13	Credit and liquidity facilities	8 136 599	818 065
14	Other contractual funding obligations	754 188	754 188
15	Other contingent funding obligations	5 089 142	261 355
16.	Total cash outflows	-	9 741 442
CASH INFLOWS			
17	Secured lending (eg reverse repos)	40 516	-25 485
18	Inflows from fully performing exposures	2 748 371	1 769 963
19	Other cash inflows	6 910 727	2 073 405
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)	-	-
EU-19b	(Excess inflows from a related specialised credit institution)	-	-
20	TOTAL CASH INFLOWS	9 699 613	3 817 884
EU-20a	Fully exempt inflows	-	-
EU-20b	Inflows subject to 90% cap	-	-
EU-20c	Inflows subject to 75% cap	9 669 185	3 817 884
21	LIQUIDITY BUFFER	-	11 256 085
22	TOTAL NET CASH OUTFLOWS	-	5 923 559
23	LIQUIDITY COVERAGE RATIO (%)	-	190%

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 2018 stood at 218%.

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: TLTRO with the European Central Bank, repurchase agreements, mortgage bond issues and securitizations. Senior debt securities and subordinated debt securities that concur, in part, for regulatory capital, increase the funding sources' level of diversification and a significant risk of financing concentration is not recognised.

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 zlotys (PLN), mostly obtained by the subsidiary in Poland and representing about 21% of the total funding. The liquidity coverage ratio in PLN is significantly above the required 100%.

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 for the Group's liquidity 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 generatring 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. The 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 NFSR to stand at 133% as at 31 December 2018 (which compares to 124% by 31 December 20217).

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 65 – ENCUMBERED ASSETS

31/12/2018 (Thousand euros)

	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, of which:	10 981 675		62 475 453	
Equity instruments	-	-	71 853	71 853
Debt securities	1 739 649	1 740 137	15 520 632	15 522 488
Other assets	-		7 697 410	

31/12/2017 (Thousand euros)

	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, of which:	12 542 681		60 204 359	
Equity instruments	-	-	1 946 587	1 946 587
Debt securities	2 222 056	2 222 056	11 029 696	11 019 693
Other assets	-		8 744 647	

(Thousand euros)

RECEIVED COLLATERAL	Fair value of encumbered collateral received or own debt securities issued		Fair value of collateral received or own debt securities issued available for encumbrance	
	31 Dec 18	31 Dec 17	31 Dec 18	31 Dec 17
Equity instruments	-	-	-	-
Debt securities	-	-	164 835	50 471
Other assets	-	-	-	-
Own debt securities issued other than own Covered Bonds or ABS encumbered	-	-	-	-

(Thousand euros)

ENCUMBERED ASSETS, RECEIVED COLLATERAL AND ASSOCIATED LIABILITIES	Carrying amount of selected financial liabilities	
	31 Dec 18	31 Dec 17
Matching liabilities, contingent liabilities and securities lent	6 845 902	8 957 873
Assets, collateral received and own debt securities issued other than Covered Bonds and ABS encumbered	10 088 945	11 885 777

At the end of 2018, total encumbered assets in funding operations represented 14% of the Group's balance sheet total assets, comparing with the value of 17% registerd at the end of 2017. This evolution was due to the improvement of the commercial gap, resulting in a decrease of the funding needs and a corresponding collateral unencumberance.

The encumbered assets are mostly related with the Group's funding operations (namely, at the ECB and via REPO) through the issuance of mortgage bonds and securitisation programs. The type of assets used as collateral for these financing transactions are different loans to Clients' portfolios, supporting mortgage bonds issues and securitisation programs – either placed outside of the Group or aimed at reinforcing the collateral pool at the ECB and to collateralise REPO operations from the money markets. Another part of the REPO financing collateralisation, as well as of the funding from the European Investment Bank, is obtained though public sovereign debt eligible for central banks, together with bonds issued by public sector companies.

On 31/12/2018, other assets in the amount of 7.697.410.000 euros (8,744,647,000 euros at 31 December 2017), although not encumbered, were mostly related to the Group's activity, namely, to: investments in associated companies and subsidiaries, tangible assets and investment properties, intangible assets, assets associated with derivatives and current and deferred taxes.

On 31/12/2018 the Group had in place two covered bond programmes: the "€12.500.000.000 BCP Covered Bond Programme" (BCP Programme) and the "€ 2.000.000.000 BII Covered Bond Programme" (BII Programme), with 8.2 thousand million euros and 895 million euros of covered bonds outstanding, respectively. The BCP Programme is backed by a11.4 thousand million euros portfolio of residential mortgages, providing an overcollateralisation ("OC") of 38.5% which is above the minimum of 14% currently required by rating agencies. The BII Programme is backed by its own 1,020 million euros cover pool of essentially residential mortgages, corresponding to an OC of 14% which is above the minimum of 12.5% currently required by rating agencies.

The Portuguese covered bond legislation ensures covered bond holders the benefit of dual-recourse over the issuer, together with a special preferential claim over the respectively assigned residential mortgage portfolios, with precedence over any other creditors, covered bond law superseding the general bankruptcy regulation. Residential mortgages in a cover pool are subject to certain eligibility criteria inscribed in the Portuguese covered bond legislation, which include a maximum LTV of 80%, delinquency of no more than 90 days and first lien mortgages (or, if otherwise, all preceding liens being included in the cover pool) over properties located in the EU. Both the BCP Programme and the BII Programme documentation limit property location to Portugal.