

## 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 and additional Pillar 2 requirements.

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.

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 28 September 2018, 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 2018 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.

In the scope of the Supervisory Review and Evaluation Process, the minimum Own Funds requirements for 2018 were as follows:

**TABLE 6 – MINIMUM CAPITAL REQUIREMENTS FROM SREP**

	Minimum required Pillar 1	Additional requirements Pillar 2	Capital conservation buffer	O-SII capital buffer	Countercyclical capital buffer	Total
CET1	4,5%	2,25%	1,875%	0,188%	0%	8,813%
T1	6,0%	2,25%	1,875%	0,188%	0%	10,313%
Total	8,0%	2,25%	1,875%	0,188%	0%	12,313%

The consolidated capital ratios, as of 31 December 2017 and 2018, 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 2018 AND 2017

Own funds, calculated according to the applicable regulatory norms, include tier 1 and tier 2. Tier 1 comprises Own funds, calculated according to the applicable regulatory norms, include tier 1 and tier 2. Tier 1 comprises common equity tier 1 (CET1) and additional tier 1 (AT1).

Common equity tier 1 includes: (i) paid-up capital, share premium, reserves and retained earnings (excluding the unaudited 2018 second quarter positive net income) 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. The additional value adjustments necessary for the prudent valuation requirements applied to all assets at fair value as well as the irrevocable payment commitments for the Deposits Guarantee Fund and the Single Resolution Fund, are also deducted.

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. 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 the own funds estimated according to the EU law, to exclude some elements previously considered (phase-out) and to include new elements (phase-in). The transitional period for most of the elements lasted until the end of 2017, except for 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).

By decision of the General Meeting of Shareholders the Bank decided to join the special regime applicable to the deferred tax assets.

The Bank has no restrictions applied to the own funds calculations, on the scope of the CRR article 437 e).

The main aggregates of the consolidated own funds and own funds requirements, as of 31 December 2018 and 2017 as well as the respective capital ratios are shown in Table 7:

**TABLE 7 - CAPITAL RATIO AND SUMMARY OF THE MAIN AGGREGATES**

(Thousand euros)				
	<i>Fully implemented</i>		<i>Phased-in</i>	
	<b>31 Dec 18</b>	<b>31 Dec 17</b>	<b>31 Dec 18</b>	<b>31 Dec 17</b>
<b>OWN FUNDS</b>				
Tier I	5 028 574	4 809 355	5 047 969	5 319 273
of which: Common Equity Tier I	4 949 684	4 737 990	4 974 060	5 319 273
Tier II	563 883	647 694	570 652	612 577
<b>Total capital</b>	<b>5 592 457</b>	<b>5 457 049</b>	<b>5 618 621</b>	<b>5 931 851</b>
<b>RWA</b>				
Credit risk and counterparty credit risk	36 882 826	34 994 647	36 946 914	35 366 357
Market risk	1 125 845	991 992	1 125 845	991 992
Operational risk	3 631 244	3 574 097	3 631 244	3 574 097
Credit Valuation Adjustments (CVA)	151 302	238 668	151 302	238 668
<b>Total</b>	<b>41 791 217</b>	<b>39 799 403</b>	<b>41 855 305</b>	<b>40 171 113</b>
<b>CAPITAL RATIOS</b>				
Common Equity Tier I	11,8%	11,9%	11,9%	13,2%
Tier I	12,0%	12,1%	12,1%	13,2%
<b>Total capital</b>	<b>13,4%</b>	<b>13,7%</b>	<b>13,4%</b>	<b>14,8%</b>

Note: The amounts and values presented at the 2018 Annual Report are different from those presented in this table, since the 2018 net profits were included in the case of the Annual Report.

The phased-in CET1 ratio, calculated according to our interpretation of the CRD IV/CRR and the current applicable prudential regulatory framework, stood at 11.9% as at 31 December 2018 and at 11.6% as at 31 December 2017, both above the respective minimum required thresholds.

The performance of the CET1 phased-in ratio in 2018 mainly reflects the following impacts:

- The phase-in progression along with the 2018 SREP, determined reductions of CET1 by € 694 million and RWA by € 439 million as at 1 January 2018 (- 160 bps in CET1 phased-in ratio);
- The IFRS9 adoption decreased the CET1 by € 101 million and RWA by € 20 million (- 25 bps in CET1 phased-in ratio);

- The organic generation of capital, based on the positive net income in the first half 2018, as well as on the fair value reserves' favourable evolution, also contributed to the positive performance of capital ratios on this period.

The amounts presented on the 2018 Annual Report differ from the ones obtained on this report due to the positive net income inclusion on the 2018 Annual Report amounts.

The following table presents the full reconciliation of own funds items to audited financial statements as at 31 December 2018 and 31 December 2017, according to the Commission Implementing Regulation (EU) No 1423/2013:

**TABLE 8 - RECONCILIATION BETWEEN ACCOUNTING AND REGULATORY CAPITAL**

(Thousand euros)

	31 Dec. 18	31 Dec. 17
1 Share capital	4 725 000	5 600 738
2 Own shares	-74	-291
3 Share premium	16 471	16 471
4 Preference shares		59 910
5 Other capital instruments	2 922	2 922
6 Reserves and retained earnings	735 089	-27 969
7 Net income for the period attributable to Shareholders	301 065	150 644
<b>TOTAL EQUITY ATTRIBUTABLE TO SHAREHOLDERS OF THE BANK</b>	<b>5 780 472</b>	<b>5 802 424</b>
8 Non-controlling interests (minority interests)	1 131 043	1 048 593
<b>TOTAL EQUITY</b>	<b>6 911 516</b>	<b>6 851 017</b>
9 Own shares of CET1 not eligible instruments	-3 915	-3 989
10 Preference shares not eligible for CET1		-59 910
11 Other capital instruments not eligible for CET1	-2 922	-2 922
12 Subordinated debt fully subscribed by the Portuguese State eligible for CET1	-150 422	
13 Non-controlling interests not eligible for CET1	-579 768	-575 795
14 Other regulatory adjustments	-1 200 428	-1 313 010
<b>COMMON EQUITY TIER 1 (CET1)</b>	<b>4 974 060</b>	<b>4 895 392</b>
15 Subordinated debt	1 169	2 045
16 CET1 transferred adjustments	72 740	70 441
17 T2 transferred adjustments		
18 Other Adjustments		
Of which: Intangible assets		
Of which: Shortfall of impairment to expected loss		
Of which: Residual amounts of CET1 instruments of financial entities in which the institution has a significant investment		
Of which: Other		
<b>TIER 1 (T1)</b>	<b>5 047 969</b>	<b>4 967 878</b>
19 Subordinated debt	477 675	526 549
20 Non-controlling interests eligible for T2	151 777	145 458
21 Preference shares eligible for T2		
22 Adjustments with impact in T2, including national filters	-58 800	-58 800
23 Adjustments that are transferred for T1 for insufficient T2 instruments		
<b>TIER 2 (T2)</b>	<b>570 652</b>	<b>613 206</b>
<b>OWN FUNDS</b>	<b>5 618 621</b>	<b>5 581 084</b>

Table 9 shows BCP Group risk weighted assets as at 31/12/2018, 30/09/2018 and 31/12/2017.

**TABLE 9 – TEMPLATE 4 / EU OV1 - OVERVIEW OF THE RISK WEIGHTED ASSETS (RWA)**

(Thousand euros)						
	RWA			Minimum capital requirements		
	31 Dec 18	30 Sep 18	31 Dec 17	31 Dec 18	30 Sep 18	31 Dec 17
<b>CREDIT RISK (EXCLUDING CCR)</b>	<b>34 400 279</b>	<b>34 207 539</b>	<b>32 317 879</b>	<b>2 752 022</b>	<b>2 736 603</b>	<b>2 585 430</b>
of which:						
Standardised Approach	10 299 053	9 884 086	9 020 139	823 924	790 727	721 611
Foundation IRB (FIRB) Approach						
Advanced IRB (AIRB) Approach	24 101 226	24 323 453	23 297 740	1 928 098	1 945 876	1 863 819
Equity under the Simple Risk-weighted Approach						
<b>CCR</b>	<b>588 938</b>	<b>620 368</b>	<b>758 354</b>	<b>47 115</b>	<b>49 629</b>	<b>60 668</b>
of which:						
Mark to Market	437 636	447 320	519 686	35 011	35 786	41 575
Original exposure						
Standardised Approach						
Internal Model Method (IMM)						
Risk exposure amount for contributions to the default fund of a CCP						
CVA	151 302	173 048	238 668	12 104	13 844	19 093
<b>SETTLEMENT RISK</b>						
<b>SECURITISATION EXPOSURES IN THE BANKING BOOK (AFTER THE CAP)</b>	<b>284 073</b>	<b>299 037</b>	<b>350 669</b>	<b>22 726</b>	<b>23 923</b>	<b>28 054</b>
of which:						
IRB Approach	1 946	3 551	3 781	156	284	303
IRB Supervisory Formula Approach (SFA)	282 127	295 487	346 888	22 570	23 639	27 751
Internal Assessment Approach (IAA)						
Standardised Approach						
<b>MARKET RISK</b>	<b>1 125 845</b>	<b>1 675 978</b>	<b>991 992</b>	<b>90 068</b>	<b>134 078</b>	<b>79 359</b>
of which:						
Standardised Approach	485 130	970 193	358 219	38 810	77 615	28 658
IMA	640 715	705 785	633 773	51 257	56 463	50 702
<b>LARGE EXPOSURES</b>						
<b>OPERATIONAL RISK</b>	<b>3 631 244</b>	<b>3 574 097</b>	<b>3 574 097</b>	<b>290 500</b>	<b>285 928</b>	<b>285 928</b>
of which:						
Basic Indicator Approach						
Standardised Approach	3 631 244	3 574 097	3 574 097	1 929 735	285 928	285 928
Advanced Measurement Approach						
<b>AMOUNTS BELOW THE THRESHOLDS FOR DEDUCTION (subject to 250% risk weight)</b>	<b>1 824 927</b>	<b>1 764 874</b>	<b>2 178 123</b>	<b>145 994</b>	<b>141 190</b>	<b>174 250</b>
<b>Floor Adjustment</b>						
<b>TOTAL</b>	<b>41 855 305</b>	<b>42 141 892</b>	<b>40 171 113</b>	<b>3 348 424</b>	<b>3 371 351</b>	<b>3 213 689</b>

The Group is no longer qualified as a financial conglomerate; therefore the capital requirements were not assessed.

### 3.3. LEVERAGE RATIO ON 31 DECEMBER 2018

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 2018 and 2017:

**TABLE 10 – LEVERAGE RATIO ON 31 DECEMBER 2018**

		(Thousand euros)	
		Applicable amount	
Summary reconciliation of accounting assets and leverage ratio exposures		31/12/2018	31/12/2017
1	Total assets as per published financial statements	75 933 421	71 939 450
2	Adjustment for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	-921	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	0	0
4	Adjustments for derivative financial instruments	889 684	452
5	Adjustment for securities financing transactions (SFTs)	68 274	0
6	Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off-balance sheet exposures)	5 151 577	3 571 601
UE-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	0	0
UE-6b	Adjustment for exposures excluded from the leverage ratio total exposure measure in accordance with Article 429(14) of Regulation (EU) No 575/2013	0	0
7	Other adjustments	-1 487 078	-1 169 298
8	<b>Leverage ratio total exposure measure</b>	<b>80 554 958</b>	<b>74 450 939</b>

		(Thousand euros)	
		CRR Leverage Ratio exposures	
Leverage ratio common disclosure		31/12/2018	31/12/2017
<b>On-Balance Sheet Exposures (Excluding Derivatives, SFT and Fiduciary Assets)</b>			
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	76 019 568	71 058 193
2	Asset amounts deducted in determining Tier 1 capital	-974 059	-1 067 728
3	<b>Total of on-balance exposures (excluding derivatives, SFT and fiduciary assets) = sum of lines 1 and 2</b>	<b>75 045 509</b>	<b>69 990 464</b>
<b>Derivatives' exposures</b>			
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	455 102	646 575
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	158 161	446 058
UE-5a	Exposure determined under the Original Exposure Method	0	0
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework	0	0
7	Deductions of receivables assets for cash variation margin provided in derivatives transactions	-152 810	-211 530
8	Exempted CCP leg of client-cleared trade exposures	-225 515	-253 508
9	Adjusted effective notional amount of written credit derivatives	64 681	261 278
10	Adjusted effective notional offsets and add-on deductions for written credit derivatives	0	0
11	<b>Total of derivatives exposures = sum of lines 4 to 10</b>	<b>299 620</b>	<b>888 874</b>
<b>SFT exposures</b>			
12	Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	58 252	0
13	Netted amounts of cash payables and cash receivables of gross SFT assets	0	
14	Counterparty credit risk exposure for SFT assets	0	0
UE-14a	Derogation for SFTs: Counterparty credit risk exposure in accordance with Articles 429b(4) and 222 of Regulation (EU) No 575/2013	0	0
15	Agent transaction exposures	0	0
UE-15a	Exempted CCP leg of client-cleared SFT exposure	0	0
16	<b>Total of SFT exposures = sum of lines 12 to 15a</b>	<b>58 252</b>	<b>0</b>
<b>Other off-balance sheet exposures</b>			
17	Off-balance sheet exposures at gross notional amount	19 745 165	12 126 739
18	Adjustments for conversion to credit equivalent amounts	-14 593 588	-8 555 138

19	Total of other off-balance sheet exposures = sum of lines 17 and 18	5 151 577	3 571 601
Exempted exposures in accordance with article 429 (7) and (14) of regulation (EU) no 575/2013 (on and off balance sheet)			
UE-19a	Intragroup exposures (solo basis) exempted in accordance with Article 429(7) of Regulation (EU) No 575/2013 (on and off balance sheet)	0	0
UE-19b	Exposures exempted in accordance with Article 429 (14) of Regulation (EU) No 575/2013 (on and off balance sheet)	0	0
Own funds and total exposure measure			
20	Tier 1 capital	5 047 969	5 319 273
21	Leverage ratio total exposure measure	80 554 958	74 450 939
Leverage ratio			
22	Leverage ratio	6,3%	7,1%
Choice on transitional arrangements and amount of derecognised fiduciary items			
UE-23	Choice on transitional arrangements for the definition of the capital measure	Transitional	Transitional
UE-24	Amount of derecognised fiduciary items in accordance with Article 429(11) of Regulation (EU) No 575/2013	0	0

(Thousand euros)

Breakdown of on-balance sheet exposures (excluding derivatives, SFT and exempted exposures)		CRR Leverage Ratio exposures	
		31/12/2018	31/12/2017
UE-1	Total on-balance sheet exposures (excluding derivatives, SFT, and exempted exposures), of which:	76 019 568	62 693 676
UE-2	Trading Book exposures	1 011 920	2 041 213
UE-3	Banking Book exposures, of which:	77 031 487	64 734 889
UE-4	Covered bonds	0	0
UE-5	Exposures treated as sovereigns	14 871 866	12 007 548
UE-6	Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns	862 573	798 628
UE-7	Institutions	1 154 359	303 957
UE-8	Secured by mortgages of immovable properties	24 775 718	24 041 423
UE-9	Retail exposures	7 839 203	6 599 982
UE-10	Corporate	12 734 056	10 369 891
UE-11	Exposures in default	4 988 319	6 928 377
UE-12	Other exposures (eg equity, securitisations, and other non-credit obligation assets)	9 805 395	9 774 357

On 31 December 2018, the Group's leverage ratio was 6.3% (6.2% on a fully implemented basis), well above the reference minimum. In this way, and according to the figures presented, the Group's position is considered comfortable.

Although the Bank does not face a situation of excessive leverage risk, taking into account the level of the leverage ratio as of 31/12/2018 and the defined prudential minimum, the regular monitoring of this ratio allows the management bodies to detect and take the measures considered appropriate to avoid the risk of a situation of excessive leverage.

Thus, the leverage ratio is monitored monthly in the scope of the Group's Risk Appetite Statement (RAS), which enables regular monitoring by management bodies and, if necessary, to undertake corrective actions.

### 3.4. EVENTS WITH A MATERIAL IMPACT ON OWN FUNDS AND CAPITAL REQUIREMENTS IN 2019

The main events with recognised or possible material impact on own funds and capital requirements in 2019 are related with:

#### I) SECOND QUARTER POSITIVE NET INCOME INCLUSION:

The second quarter positive net income inclusion, after the 2018 account approval, will generate an estimated increase of +17 bps in both fully implemented and phased-in ratios.

#### II) SREP MINIMUM REQUIREMENTS:

The Bank was informed of the European Central Bank's (ECB) decision regarding the minimum prudential requirements to be fulfilled from March 1st, 2019, 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 the following ratios, concerning minimum own funds requirements, determined as a percentage of total risk weighted assets (RWA): 9.625% CET1, 11.125% T1 and 13.125% Total. In addition to the minimum requirements set by CRR article 92 these minimum own funds requirements include 2.25% of Pillar 2, 2.5% of additional conservation buffer and 0.375% of other systemically important institutions (O-SII) buffer.

### III) PHASE-IN PROGRESSION:

The estimated impact on CET1 ratio, considering the application of the SREP result and the 2019 phase-in progression, stands at +3 bps in the fully implemented ratio and +10 bps in the phased-in ratio.

### IV) PERPETUAL SUBORDINATED NOTES ISSUE (AT1):

The Bank concluded, in January, the issue of perpetual subordinated notes qualified as Additional Tier 1, in the amount of €400 million.

The estimated impact on T1 ratio stands at +96 bps in both fully implemented and phased-in ratios.

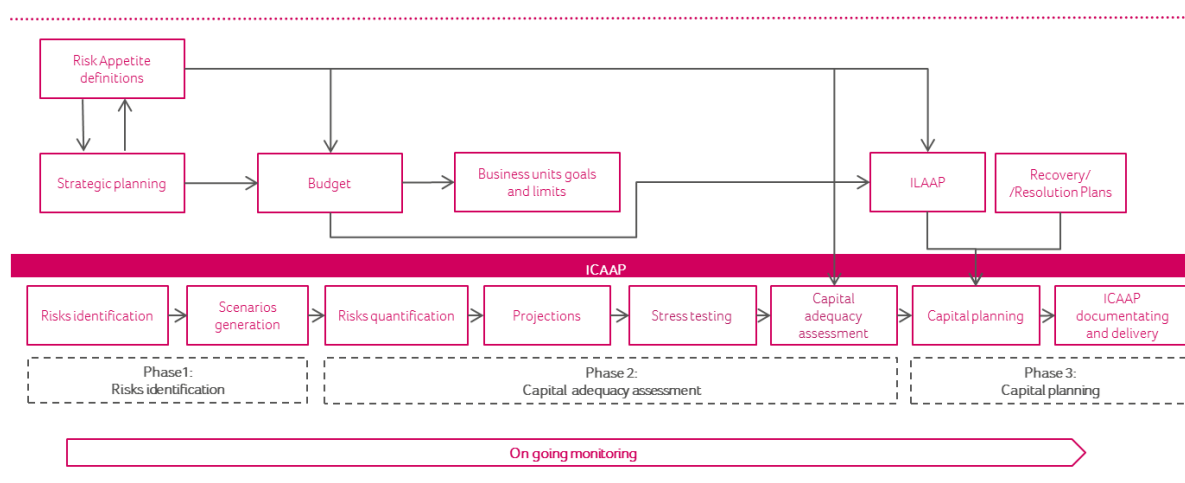
### V) PERPETUAL SUBORDINATED NOTES ISSUE (T2):

The Bank Millennium, S.A., in Poland concluded, also in January, the issue of perpetual subordinated notes qualified as Tier 2, in the amount of 830 million zlotys.

The estimated impact on Total ratio stands at +11 bps for the fully implemented and +10 bps for the phased-in ratio.

## 3.5. INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP)

The ICAAP (Internal Capital Adequacy Assessment Process), is a fundamental element of the BCP group risk management, consisting in the permanent assessment of the capital needs to adequately cover the risks in which the Group incurs by developing its business strategy, current and projected for the medium-term. The chart below summarizes the process at stake:



The ICAAP develops under an internal governance model that ensures the involvement of the BoD, of the Risk Assessment Committee (RAC), of the EC and of the Group's 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 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.

Besides 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, in which the main Group subsidiaries are involved, is the list of material risks to be considered by the ICAAP, as well as supporting data for the definition of the variables to be considered for the establishment of the base and the stressed scenarios, mentioned ahead. The approval of the results of the risks identification process is a capacity attributed to the RAC.

In a second phase, the base and stressed scenarios that are the ICAAP's framework are defined taking into consideration the main geographies in which the Group develops its business. While the baseline scenario corresponds to the Group's view on the most probable evolution of the medium-term business constraints, the stress scenarios incorporate extreme conditions, with a low probability of occurrence and with a severe expected impact over the Group's activity. The approval of the scenarios to be considered in ICAAP is also a responsibility assigned to the RAC.

In the third stage, the impact of the risks identified is modelled for the reference date and the capital requirements are calculated for that date, under a regulatory and an economic perspective. A set of methodologies and internal models, formally approved and audited, is used for this purpose, considering a significance level in line with 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).

In the prospective component, scenarios for the projections of the Group's activities are considered with a medium-term time horizon (3 years): a baseline scenario – corresponding to the current vision of the Group's management – and adverse scenarios that severely penalise the macroeconomic indicators, in order to test the Group's resilience under extreme scenarios and if it has adequate capital levels to cover the risks to which its activity may be subject.

Some risks whose nature does not allow for the modeling of the impact on capital are incorporated by way of a capital add-on (in particular, risks considered as non-material), other through their impact on profits.

Within the ICAAP for 2019, the Group has considered the following risks (as materially relevant ones, after mitigation effects, or considered within the scope of Pillar I):

**TABLE 11 – MATERIAL RISKS**

Credit risk	Counterparty credit risk
	Default risk
	Issuer risk
	Securitisation risk
	Sovereign risk
Concentration risk	Geographic concentration
	Sectoral concentration
	Single-name concentration
Market risks	CVA risk
	FX risk of the Banking Book
	Market risks of the Trading Book
Business risks	Economic risk
	Strategy risk
	IT strategy risk
	Financial holdings risk
Operational risk	[Complete set of risks]
Legal and compliance risk	Financial crime risk
Interest rate risk (IRR)	Interest rate risk of the Banking Book (Gap risk)
Real Estate risk	Real Estate market risk
Other risks	FX risk in Poland
	Cybernetic risk
	Resolution Fund risk
	Exposure to the insurance sector risk
	Litigancy risk
	Pension Fund risk



These risks are modeled or incorporated into the Group's stress testing methodology framework, producing estimated impacts on capital levels both through the impact on operating results or through changes in the risk-weighted assets (RWA) levels.

Once the impacts of the various risks on the Group's operating account and balance sheet - in particular, over own funds - have been estimated, the Group is able to assess the adequacy of its risk-absorbing capacity against the expected profile for its activity.

The Group assumes a Risk Taking Capacity aligned with the definition of regulatory capital ratios under Directive 2013/36/EU and Regulation (EU) 575/2013 ("CRD IV" and "CRR" , respectively), based on the regulatory definition of CET1 Own Funds (Common Equity Tier 1).

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

On a quarterly basis, the Bank updates the quantification of ICAAP's main material risks, reporting the results to the Bank's management bodies. In case of significant changes in the Group's risk profile, the internal capital adequacy assessment model is fully processed.