3. Risk management objectives and policies

The BCP Group develops its activity aiming to maintain a moderate and sustainable risk profile, with a solid reputation in the market and with comfortable levels of capital and liquidity adequate to the managed business portfolio, always with the objective of strengthening the confidence of its clients. customers, markets, and regulators.

To achieve this objective, the Bank has implemented internal control and risk management systems and a prudent risk appetite structure, in line with the pursued business model and the Bank's profile and strategy. Improvements are continuous and permanently introduced to ensure constant alignment with the dynamics of markets, the economy, and regulations.

3.1. Risk culture

The Group has risk management policies and procedures, embodied in a vast set of risk manuals that define the rules to be observed within the scope of the risk management function and which contribute to the strengthening of an established risk culture in line with the risk appetite statement (RAS) defined by the Board of Directors, supported by the involvement of Management and Senior Management and present in the day-to-day activities of the Bank, framing the internal attitudes and behaviors related to the conscience of risk, risk taking and management and implementation of controls appropriate to business processes and activities.

The Bank's internal regulatory framework establishes detailed rules and standards of conduct, defines efficient business, risk and operating processes and the appropriate competencies for their execution. The internal regulatory framework is subject to constant update considering, particularly, the legal and regulatory dynamics issues and internal self-assessment exercises. The rules that make up the internal regulatory framework are reviewed at least every two years, ensuring its permanent updating and constant search for operational excellence, the maintenance of high ethical standards and an adequate governance model.

Still within the scope of strengthening the risk culture, it is worth mentioning the periodic training of risk to employees, including e-learning actions under the coordination of the Millennium Banking Academy.

3.2. Risk strategy

The Bank has in place a Risk Strategy which is formally reviewed and approved annually, ensuring its alignment with the planning and budgeting process. The definition of the Group's Risk Strategy integrates the conclusions of the risk identification process, the results of the assessment of the adequacy of the internal capital and liquidity and influences the Group's strategic business options by defining the main lines of action to be developed to control, mitigate or eliminate the material risks to which the Group's activity is subject in the medium term. The objective of the Risk Strategy is not to eliminate or avoid risks, but to assume acceptable risks and promote proper management fostering the achievement of the strategic and operational objectives of the BCP Group.

The Risk Strategy is reviewed in coordination with the risk appetite statement update, focuses on the material risks identified by the Bank and is formally approved by the Board of Directors by proposal and opinion by the Risk Assessment Committee and the Executive Committee.

3.3. Internal control

The Risk Management Function (RMF) is part of the Internal Control System (ICS) of the BCP Group, together with the Compliance function and the Internal Audit, contributing to the solid risk control and delimitation environment on which the Group develops its business activities and business support.

Within the scope of the ICS, the RMF and the Compliance function constitute the Risk Management System (RMS) of the BCP Group, which materializes in an integrated and comprehensive set of resources, standards and processes that ensure an appropriate framework to address the different nature and materiality of the risks underlying the activities carried out, so that the Group’s objectives are achieved in a sustainable and prudent manner.

In this sense, the ICS and the RMS provide the ability to identify, assess, monitor and control the risks - internal or external - to which the Group is exposed, in order to ensure that they remain at acceptable levels and within limits defined by the Board of Directors.

Thus, the RMS embodies the 2nd Line of Defense in relation to the risks involved in all the Group's activities. In this approach, the 1st Line of Defense is ensured, on a day-to-day basis, by all organizational units of the Group - based on adequate training and awareness of risks and the delimitation of activities through a complete and detailed normative structure - while the 3rd Line of Defense is developed through internal supervision / independent review (Internal Review Function - IRF), ensured by the Internal Audit function.

It should also be noted that the ICS:

- It is supported by an information and communication system that ensures the capture, processing, sharing and internal / external disclosure of relevant, comprehensive and consistent data on the business, the activities carried out and the risks on them, in a timely and reliable manner. This data management and treatment infrastructure (and management information) is in line with the principles of the Basel Committee regarding an efficient aggregation of risk data and risk reporting (BCBS 239 - Principles for effective risk data aggregation and risk reporting).
- It is continuously monitored by the Group, with situations of insufficient internal control being recorded - in the form of recommendations / deficiencies or opportunities for improvement - for correction / eradication and regulatory reporting.

3.4. Principle of the three lines of defense

The organizational structure and the processes created to support risk management and control are defined according to the principle of segregation of functions, in order to guarantee, at all times, a complete segregation of functions between the origin, management and the control of risk functions.

The risk management structure of the BCP Group is based on a model of three lines of defense, a fundamental component of the global risk management function, which ensures clear responsibility for risk taking in the business, effective supervision and risk management, independence in reporting to the Board of Directors and other government bodies on the risk levels to which the Group is subject and the respective framework in view of the approved risk appetite and also on the state of the internal control system.

In this model, the first line, composed of the business areas, risk takers, and their support areas, is responsible for managing the risk that the Bank assumes in the conduct of its daily activities, being responsible for identifying and managing the risks inherent in the products, activities, processes and systems for which it is responsible. The business units, the Credit Division, the Treasury, Markets and International Division and or the Operations Division, among others, are part of the first line of defense.

The second line of defense is responsible for identifying, assessing, monitoring, and reporting risks, as well as challenging the first line in the way it manages risks. The second line of defense includes the Risk Office, the Models Monitoring and Validation Office and the Compliance Office and is functionally and hierarchically independent from the first line. The second line is responsible for reporting risks to the Bank's governing bodies and challenging the risk management under the responsibility of the first line.

The third line of defense consists of the Audit Department and ensures that the risk governance structure is effective, and that risk policies and processes are properly applied, including the BCP Group's controls, processes, and risk management systems.

3.5. Risk management structure and governance

Board of Directors

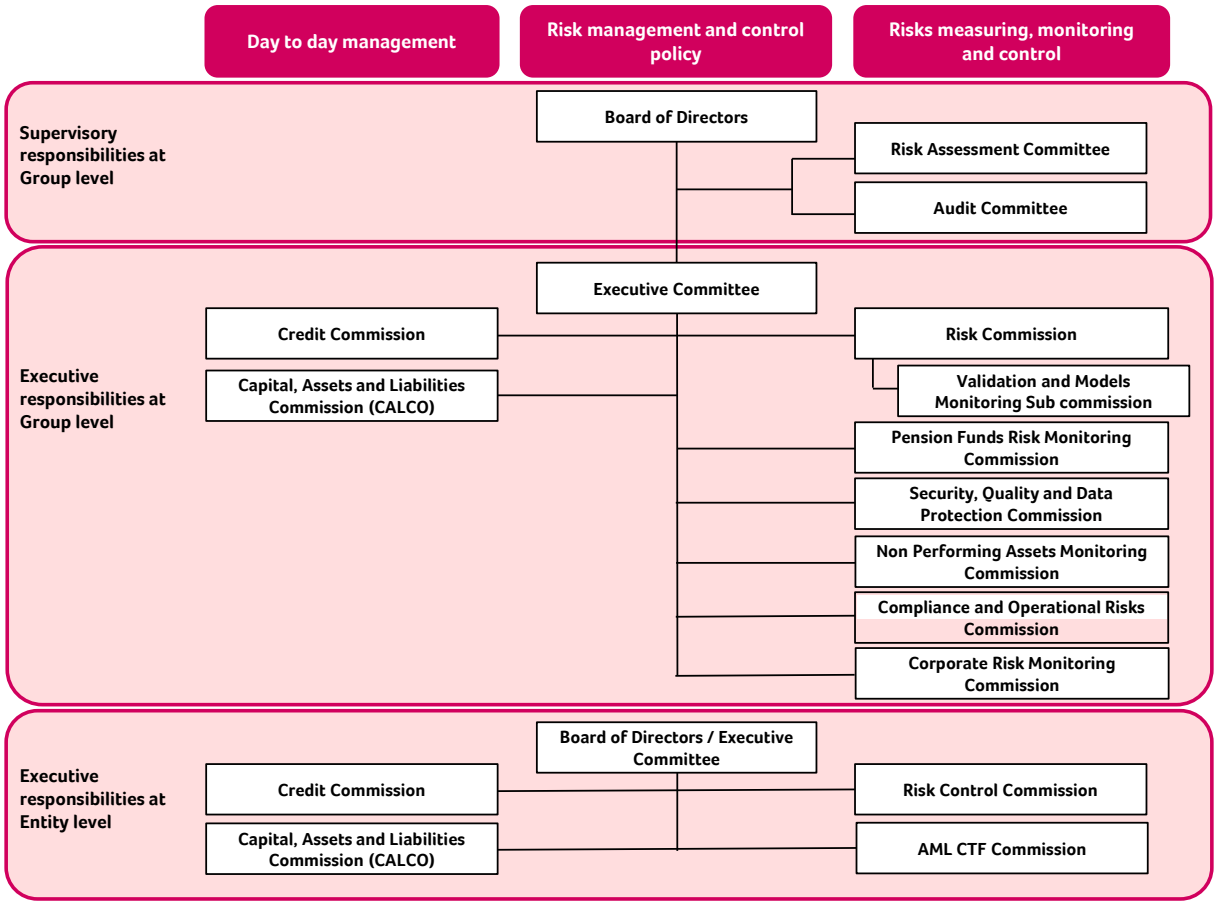
The ultimate body of the BCP Group's risk management structure is the Board of Directors, which, within the scope of the functions assigned to it by the Bank's statutes, has the leading role in the risk management and control structure. The Board of Directors is responsible for defining the profile and risk appetite, issuing the Group's global strategic guidelines and objectives, promoting the risk culture and risk strategy, reserving for itself the approval of group codes that establish policies, principles, rules and risk limits. The Board of Directors monitors the evolution of metrics and risk indicators translated into the RAS, approves the conclusions of the ICAAP and ILAAP processes and the performance of the Internal Control System.

The Board of Directors delegates the following risk management and control powers to the various Committees that emanate from it:

- In the Risk Assessment Committee: advise and support the Board of Directors in relation to the Group's risk appetite and risk strategy, including policies to identify, manage and control the Bank's risk.
- In the Audit Committee: inspect the existence of an adequate risk control organization, effective risk management and internal control systems at the level of the BCP Group.
- In the Executive Committee: define, implement, manage and control the general risk management and control framework, including the organizational structure and the approval of policies and risk limits.

The following figure represents the RMS's Governance, as at 31/12/2020, exerted through various organizational bodies and units with specific responsibilities in the area of risk management or internal supervision.

TABLE 5 – RMS GOVERNANCE MODEL



The composition, capacities and responsibilities of the management and control bodies that intervene in the risk management governance - besides those of the Board of Directors (BoD) and its Executive Committee (EC) – are the following:

Executive Committee

The Executive Committee is responsible for the daily management of the Bank aiming to pursue the corporate objectives within the risk limits approved and defined by the Board of Directors. Particularly regarding the risk management function, the Executive Committee is responsible for:

- Implement the Bank's general business strategy and main policies, considering the Bank's long-term financial interests and solvency.
- Implement the global risk strategy approved by the BoD and ensure that management devotes sufficient time to risk issues.
- Ensuring an adequate and effective internal governance model and an internal control framework, including a clear organizational structure and independent internal risk management functions.
- Promote the risk culture across the BCP Group, addressing risk awareness and appropriate risk-taking behavior.
- Promote a corporate culture and values that foster the ethical and responsible behavior of employees.
- Promote the development, implementation and maintenance of formal processes for obtaining, producing and processing substantive information, appropriate to the size, nature, scope and complexity of the activities carried out, as well as to the institution's risk appetite, which ensure its reliability, integrity, consistency, integrity, validity, timeliness, accessibility and granularity.

Committee for Risk Assessment

The Committee for Risk Assessment, appointed by the BoD, is composed by three to five non-executive Directors and has, among others, the following capacities:

- Advising the BoD on risk appetite and risk strategy, accompanying and intervening in the definition and review of the Group's Risk Appetite Framework and providing an opinion on its adequacy to the BoD.
- Monitoring the evolution of the RAS metrics, verifying their alignment with the defined thresholds and levels and monitoring the action plans designed to ensure compliance with the established risk limits.
- Advising the BoD on the policies regarding the risks' identification, management and control within the Group, monitoring the global risk levels in order to ensure that those are compatible with the goals, the available financial resources and the approved strategies for the development of the Group's activities.
- Monitoring the capital and liquidity planning processes (ICAAP and ILAAP), providing an opinion to the BoD concerning the respective conclusions, as well as analysing and approving the conclusions of the regular follow-up on these processes.
- Monitoring and intervening in the Recovery Plan review, providing an opinion to the BoD on the respective adequacy.

Within the resolution planning, the Committee for Risk Assessment approves its annual work plan and monitors its execution.

The Risk Officer functionally reports to this Committee and participates in its meetings, presenting the evolution of the key risk metrics and indicators, as well as all incidences, changes and evolutions relative to the RMSS.

Audit Committee

The BoD's Audit Committee is elected by the Shareholders' General Meeting and is composed by three to five non-executive Directors. Within the risk management governance, this Committee has global corporate supervising capacities - e.g. in what concerns the risk levels follow-up - as well as those that are attributed within the ICS, namely:

- Supervising and controlling of the RMS's and the ICS's effectiveness (and, also, of the Internal Audit System).
- Analysing and regularly following-up of the financial statements and the main prudential indicators, the risk reports prepared by the Risk Office, the Compliance Office's activity, the Internal Audit activity, the handling of claims and complaints and the main correspondence exchanged with the Supervisory Authorities.
- Issuing an opinion in relation to operations of acquisition of goods and services and involving related parties, aiming to avoid conflicts of interests.
- Handling of irregularites and whistleblowing.

The Audit Committee holds regular meetings with the Heads of the Audit Division, the Risk Office and the Compliance Office.

The Risk Officer participates in this Committee's regular meetings, reporting on the evolution of the main indicators and metrics concerning risks and credit impairment, as well as on the implementation status of the recommendations that concern the RMS, issued within the scope of internal control or by the supervisory/regulatory authorities.

The Head of DAU reports functionally to the Audit Committee and regularly reports on interactions and the status of the recommendations of the prudential supervision entities, as well as on the audits carried out on the Bank's processes.

Risk Commission

This Commission is appointed by the EC and has the responsibility for defining, at an executive level, the framework and the risk management policies and instruments within the Group, establishing the respective principles, rules, limits and practices for the Group Entities, considering the defined risk thresholds.

The Risk Commission monitors the overall levels of credit, market, liquidity and operational risk, as well as all other risks considered materially relevant for the Group, ensuring that the risk levels are compatible with the goals, available financial resources and strategies that have been approved for the development of the Group's activity. This Commission also validates the compliance of risk management with all the applicable laws and regulations.

The Chief Executive Officer (CEO), the Chief Financial Officer (CFO) and the Chief Risk Officer (CRO), as well as, optionally, the Chief Operations Officer (COO) and the EC members responsible for the Corporate/Investment Banking and the Retail business (Chief Corporate Officer/CCorpO and Chief Retail Officer/CRetO, respectively) are members of this Commission.

Other members of the Commission are the Risk Officer, the Compliance Officer and the Heads of the following Divisions: Treasury, Markets and International (DTMI), Credit (DCR), Rating (DRAT), Office for the Validation and Monitoring of Models (GAVM) and Regulatory and Supervision Monitoring Office (GARS). The Head of the Audit Division (DAU) is a permanently invited member of the Risk Commission, without voting rights.

Validation and Monitoring of Models Sub-commission

The Models Monitoring and Validation Sub-Commission monitors the performance and confirms the validity of the rating systems and models used by the Bank within the scope of its risk management functions (e.g. PD, LGD, CCF, market risk and ICAAP) and informs the Risk Commission on their adequacy. Moreover, it presents the model's risk management results and suggests improvement measures to increase the model's performance and adequacy.

The CRO is the chairmen of the Sub-commission and other member are the Risk Officer, the head of the GAVM, of DCR and DRAT and also the several Model Owners, responsible for developing and monitoring the risk models of the Bank.

Non-performing Assets (NPA) Monitoring Commission

This Commission is appointed by the EC and has the responsibility of monitoring the evolution of credit risk, under various aspects:

- Monitoring of the NPA/NPE Reduction Plan, including its operational scope and the fulfilment of the quantitative goals assumed; besides the Non Performing Exposures (NPE) reduction, the Commission also monitors the disinvestment process of the real estate portfolio and other assets received in lieu of payment as the result of credit recovery processes (foreclosed assets) and other non-performing assets;
- Analysis of the credit recovery processes' performance.
- Portfolio's quality and main performance and risk indicators.
- Impairment, including the main cases of individual impairment analysis.

The CEO, the CRO, the CRetO and the COO are members of this Commission, as well as, optionally, the CFO. Any other executive Directors may participate in this body's meetings if they deem convenient to do so. The Heads of the following Divisions are also members of this Commission: Risk Office (ROFF), DCR, DRAT, Specialised Monitoring (DAE), Retail Recovery (DRR), Specialised Recovery (DRE), Legal Advisory and Litigation (DAJC), Management Information (DIG) and Specialised and Real-Estate Credit (DCEI). The Head of DAU is a permanently invited member of the Risk Commission, without voting rights.

Pension Funds Risk Monitoring Commission

This Commission is appointed by the EC and has the following competences:

- Assessing the performance and risk of the Group's Pension Funds in Portugal.
- Establishing, for these, the appropriate investment policies and hedging strategies.

The Commission members are the CEO, the CFO, the CRO. Any other members of the EC may participate in the Commission's meetings if they deem convenient to do so. The other Commission's members are the Heads of the following Divisions: ROFF, Research, Planning and ALM (DEPALM), Wealth Management (DWM) and Human Resources (DRH). Representatives of the Pension Funds management entity and of Ocidental Pensões also participate in the Commission's meetings, by invitation and without voting rights.

Compliance and Operational Risks Commission

This Commission is appointed by the EC and has the following capacities and responsibilities, in order to ensure that the Bank's activity contributes to an adequate culture of risk and internal control:

- Monitoring of the Bank's activities, as well of those of the other Group entities, regularly coordinating and managing the policies and the duties of the Bank and its branches/subsidiaries, in order to ensure the compliance with the legal and internal rulings, the alignment of Group strategies and the definition of priorities in Compliance matters;
- Monitoring of the operational risk's management framework, which encompasses the management of IT and the Outsourcing risks.
- Monitoring of the exposures to operational risks, as well as the implementation status and the effectiveness of the risk's mitigation measures and of those that aim at the reinforcement of the internal control environment.
- Follow-up of the management and improvement of the Bank's processes, in order to monitor and reduce the level of exposure to compliance and operational risks.

The Commission members are the CEO, the COO, the CRO and the CRetO. Any other members of the EC may participate in the Commission's meetings if they deem convenient to do so. The Heads of the following Divisions are also members of the Commission: COFF, ROFF, IT (DIT), Operations (DO), Quality and Network Support (DQAR). The Head of DAU, the Anti-Money Laundering Officer and the managers responsible for the COFF areas that deal with the matters under discussion are also permanently invited members of this Commission, without voting rights.

Quality, Security and Data Protection Commission

This Commission is appointed by the EC and has the following capacities and responsibilities:

- Definition of guidelines and approval of the management policies for IT systems, data management and quality, physical security, business continuity and data protection.
- Regular review of the emerging threats and most relevant trends in terms of data security and information technologies, with a particular focus upon cyber-security.
- Analysis of the periodical security incident's reports (regarding systems/data and physical), identifying the appropriate remediation and improvement measures.
- Follow-up of initiatives and projects in the area of systems/data security, physical security and data protection and monitoring of the respective performance metrics.
- Approval of the annual plans for the exercises of security assessment, Disaster Recovery Plan (DRP) and business continuity, and their respective quantitative/qualitative evaluation.

The Commission members are the COO, the CRO and the CRetO. Any other members of the EC may participate in the Commission's meetings, if they deem convenient to do so. The Heads of the following Divisions are also members of this Commission: COFF, ROFF, DIT, DQAR, and Data Security (DSI). The head of the Physical Security and Business Continuity Department (DSFCN), the Data Protection Officer (DPO) and the Chief Data Officer (CDO) are also permanent members of this Commission, along with the Head of DAU (the latter, without voting rights).

Corporate Risk Monitoring Commission

This Commission is appointed by the EC and has the following duties and responsibilities:

- Monitor the evolution recorded by the main performing corporate Clients credit exposures, particularly assessing the implications from the COVID-19 pandemic versus the specific risk factors of each client (sector of activity, prior COVID-19 financial standing, cost structure, etc.), issuing opinions regarding the credit strategy to adopt;
- Monitor the counterparty risk and concentration risk of the largest exposures.

The members of this committee are the CEO, CRO, CCorpO and CRetO. Any other members of the EC may participate in the meetings of this Committee, whenever they consider it convenient to do so. Members of this Committee are also primarily responsible for the following directorates: ROFF, Corporate Network North and South, Large Corporates, Investment Banking Division, Institutional Banking Division, DRE, DCR, DRAT and Corporate and Business Marketing.

Credit Commission

This Commission is appointed by the EC and its functions are to assess and decide on credit granting to Customers of Banco Comercial Português, in accordance with the competences established by internal regulation ('Credit Granting, Monitoring and Recovery'). This commission may also issue advisory opinions on credit proposals from the subsidiary companies of the Group entities.

The members of this Commission are the CEO, the CFO (optional), the CCorpO, the CRetO (optional), the CRO (with veto rights) and the COO (optional), as well as the Heads of the following Divisions: DCR, DAJC, DRAT, DCEI, Companies Network Coordination (North/South), Large Corporates, DAE, DRE and Investment Banking Coordination (DCBI), as well as Level 3 credit managers and, depending on the proposals to be decided upon, the coordination managers of other proposing areas (e.g., Private Banking, Retail, DRR) or members of the subsidiaries' Credit Commissions. The Company's Secretary, the Risk Officer and the Compliance Officer are permanently invited members of this Commission, without voting rights. Other Group Employees may also be invited to participate (without voting rights), if they are relevant for the matters under discussion.

Group CALCO

The Group CALCO - also referred to as the Capital, Assets and Liabilities Management Commission - is responsible for the management of the Group's overall capital, for assets and liabilities management and for the definition of liquidity management strategies at a consolidated level. Specifically, the Group CALCO is responsible for the structural management of interest rate and liquidity risks, including, among others, the following aspects:

- Establishment of management guidelines for assets, liabilities and off-balance sheet items at consolidated level.
- Definition of the capital allocation and risk premium policies.
- Definition of transfer pricing policy, in particular with regard to liquidity premiums.
- Monitoring of the capital and liquidity indicators, of the Recovery Plan indicators and of the execution of the Liquidity Plan.
- Definition of policies and strategies to access wholesale funding markets and definition of the liquidity buffer composition.
- Definition of the investment policy of the Investment Portfolio and monitoring of its performance.

- Definition of the strategy and positioning within the scope of the interest rate risk management, as well as of the respective policies and limits, taking into account the market conditions at any given moment.

The Group CALCO meets every month and is composed of the following executive Directors: CEO (optional), CFO, CCorpO, CRetO, CRO and COO (optional). The other members of the Group CALCO are the Risk Officer, the Chief Economist and the Heads of DEPALM, DIG, DTMI and DWM, the responsible for the ALM Department of DEPALM and 2 representatives nominated by the Retail and the Corporate & Investment Banking Commissions.

Risk Office

The Risk Office (ROFF) is the structure unit responsible for the risk control function at Group level, promoting the overall alignment of concepts and procedures concerning risk monitoring and assessment. The ROFF is responsible for informing the Executive Committee, the Committee for Risks Assessment and the Risk Commission on the general risk level, for proposing measures to improve the control environment and for the implementation of controls which assure compliance with the approved limits. The ROFF has the following functions:

- Supporting the establishment of risk management policies and methodologies for the identification, measurement, limitation, monitoring, mitigation and reporting of the different types of risk.
- Promoting the revision of the Group's Risk Appetite and the risk identification process.
- Issuing opinions related with the compatibility of the risk management decisions considering the approved RAS limits.
- Participate in the definition of the risk strategy and decisions related with risk management.
- Coordinating the NPA (non-performing assets) Reduction Plan and of the ICAAP and ILAAP processes.
- Ensuring the existence of a body of rules and procedures, of an effective IT platform and of a database for the robust and complete management of risk.
- Controlling, on an ongoing basis, the evolution of the different risks and compliance with the applicable policies, regulations and limits.
- Participating in the Internal Control System.
- Preparing information relative to risk management for internal and market disclosure.
- Supporting the works of the following Commissions: Risk, NPA Monitoring, Pension Funds Risk Monitoring, Compliance and Operational Risk.

The Risk Officer is appointed by the BoD, reporting on a line basis to that body and its EC, also reporting functionally to the Committee for Risks Assessment, and participates in the Risk Commissions os the subsidiary companies.

Compliance Office

The Compliance Office (COFF) ensures typical functions of a second line of defence functions, within the scope of the so-called "3 Lines of Defence Model", in relation to compliance risk, i.e., the risk of non-compliance with applicable laws and regulations.

COFF's main missions, in relation to all Group entities, are the following:

- To foster the adoption and compliance with the internal and external regulations that frame the Group's activity, watching over the fulfilment of the relevant contractual commitments assumed.
- To promote the organization's ethical values and to contribute for an internal control culture, in order to mitigate the risk of sanctions being imposed or of the occurrence of property or reputational damages.

The Compliance Officer is appointed by the BoD, reports hierarchically to the EC and, functionally, to the Audit Committee, exercising his/her functions in an independent, permanent and effective manner, defining the policies, guidelines and tools that are appropriate for a proactive and preventive risks' assessment.

As a second line of defence structure responsible for compliance risk, for the risks associated with money laundering and the financing of terrorism, with conduct and market abuse and for other risks of an operational nature, the COFF issues decisions, with binding force for its recipients, aiming at the legal and regulatory compliance of the various business and business support areas. The COFF' s action is based on an approach to the risks of business, Customers and transactions, thus contributing for the promotion an effective internal control environment.

Within the scope of opinions and the associated analyses produced at request of several Group areas and Divisions, the COFF:

- Identifies and evaluates the various types of risks – either concerning in what refers to products and services approval process, corporate processes and conflicts of interest.
- Issues proposals for the correction of processes and risks mitigation.
- Permanently analyses the general supervisory environment and, in general, provides specialised support in matters of control and regulatory compliance.
- Within the scope of its specific functions, the COFF also ensures an assessment and intervention in what concerns:
- The control and monitoring of compliance risks.
- The Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT).
- The mitigation of reputation risk at all Group entities, aiming at the alignment of concepts, practices and goals in these matters.

It also has the competence for the preparation and submission of reports to the management body, at least once a year, identifying the compliance flaws verified and the recommendations issued for their correction.

The COFF fosters, intervenes and actively participates in the training policy of Employees, namely, through training actions in Compliance, for the entire universe of the Group, maintaining a large knowledge repository for matters of its competence, namely, in what concerns the AML/CFT.

Audit Division

The Audit Department (DAU) provides functions of the third line of defense, under the scope called "Model of the 3 lines of defense" and is responsible for assessing the adequacy and effectiveness of the risk management process, the internal control system and the governance models. DAU performs its function on a permanent and independent basis and in accordance with the internationally accepted principles and best practices of internal auditing, carrying out internal audit inspections to assess the systems and processes of internal control and risk management which can give rise to recommendations aimed at to improve its efficiency and effectiveness.

The main functions of the DAU in the scope of risk management are to ensure that:

- Risks are properly identified and managed and that the controls implemented are correct, adequate and proportional to the Bank's risks.
- The Bank's internal capital assessment system is adequate in terms of the risk exposure level.
- Transactions are recorded correctly in the systems of the Bank, and the operational and financial information is true, appropriate, material, accurate, reliable and timely.
- Employees perform their duties in accordance with internal policies, codes of conduct, rules and procedures and with the legislation and other applicable regulations.
- The goods and services necessary for the Bank's activity are purchased economically, are used efficiently and are properly protected.
- Legal and regulatory provisions with a significant impact on the organization are recognized, properly assimilated and integrated into the operational processes.
- The Bank's governance model is adequate, effective and efficient.

The Head of DAU has a reporting line to the Chairman of the Board of Directors and reports functionally to the Audit Committee, is responsible for the general supervision and coordination of the internal audit activities of the BCP Group subsidiaries and attends the meetings of the Audit Committee of the subsidiaries of the BCP Group.

3.6. Risk management

3.6.1. RISK MANAGEMENT PRINCIPLES

The Group is subject to risks of a different nature related to the development of its activity, the materiality of which is regularly assessed as part of a risk identification process, carried out at least annually, under the coordination of the Bank's Risk Office and with the participation of the several subsidiaries / geographies and results presented in various governing bodies of the Bank until the conclusions are approved by the Board of Directors of BCP.

For the various risks identified, the Group defines principles, methodologies and procedures for monitoring, control and reporting, which are established centrally by the parent company, in coordination with the respective local departments and considering the specific risks of each business. The general risk management principles and rules are approved at the maximum level of the Group: The Bank's Board of Directors in Portugal.

The Group's risk management policy aims to identify, assess, monitor and control all material risks to which the institution is exposed, both internally and externally, in order to ensure that they remain at levels compatible with the risk tolerance predefined by the management body and embodied in the set of indicators of the Risk Appetite Statement (RAS).

The RAS - as the primary set of indicators that render and materialise the risk appetite - is one of the guiding vectors of the Group's "Risk Strategy".

Based on the RAS, several lines of action are established, to be developed by different organizational units of the Group, in order to address the mitigation or control of all material risks identified within the risks' identification and assessment process. These lines of action formally constitute the Group's Risk Strategy. Hence, the RAS and the Risk Strategy are inseparable and central elements of the Group's risk management, both aiming to control and mitigate risks classified within the risks' identification process.

The risk appetite framework - which includes the identification of material risks, the RAS and the Risk Strategy and is reviewed at least once a year or whenever the risks´ monitoring so advises (e.g. conclusion that there are new material risks) - provides a reference framework for the permanent monitoring of risks affecting the business and business support activities developed, for the monitoring of all variables, indicators and respective limits that are derived from RAS. Therefore, the permanent follow-up based on this structure is the result of a strong link between the risk management framework thus defined and the great diversity of methods and indicators applicable to the various activities carried out, this link being essential for the performance of the Group's risk management.

In addition, there is an interaction, in both ways, between the definition of the Group's risk appetite structure and its business objectives, represented in the business planning and budgeting. Thus, the risk appetite structure conditions the definition of the business objectives, since the business plan as to respect the risk limits established by the Board of Directors.

In its turn, the business objectives and risk appetite structures are the foundations for all activities and lines of business carried out, also setting out the global controls on the Group's financial strength, such as the stress tests and the internal processes to assess capital (ICAAP) and liquidity adequacy (ILAAP) as well as the recovery plan and the activities in the scope of the resolution planning.

In 2020, the focus of risk management activities was maintained on the continuous improvement of the Group's risk control environment, in addition to the permanent monitoring of the risk levels incurred in relation to the RAS tolerance limits - both at consolidated level and for each geography in which the Group operates - ensuring, at the same time, full compliance with regulatory and supervisory requirements and updating the internal regulations structure that is appropriate for risk management and control.

3.6.2. MAIN DEVELOPMENTS AND ACCOMPLISHMENTS IN 2020

Below is presented the set of the most relevant activities developed during 2020:

- Participation in the implementation of the Bank's contingency plan regarding the COVID-19 pandemic, particularly in adjusting the risk framework to the challenges arising from the pandemic (e.g. design and implementation of specific reporting to monitor the credit portfolio within the scope of pandemic; adjustment of IFRS9 methodologies; identification of the operating costs related to the coronavirus crisis; monitoring of economic support measures within the scope of the impact of the COVID-19 pandemic and its reporting to the Supervisory Entities).
- Continuous improvement of the internal governance model, risk management, measurement and control at the Group level, including the implementation of a new department in the Risk Office specifically dedicated to the monitoring of credit risk, of a new structure dedicated to the analysis of operations restructured due to financial difficulties and the reinforcement of the Risk Office staff.
- Coordination of the Risk Strategy and the review of the Risk Appetite Statement (RAS) at the Group level, including the risk identification process.
- Inclusion in RAS of indicators for measuring the execution of the Sustainability plan.
- Completion of the annual reports of ICAAP and ILAAP, permanent monitorization of the capital and liquidity adequacy and participation in other Bank planning processes such as the Funding and Capital Plan and the Group's Recovery and Resolution planning.
- Reinforcement of supervision and support for the BCP Group's subsidiaries, continuously promoting a solid and common risk management framework and implementing a daily reporting system of the main risk indicators in all geographies.
- Revision of the liquidity risk management and control framework, including the implementation of new short-term liquidity indicators and the revision of the liquidity stress tests methodology.
- Focus on improving the effectiveness of the internal control system.
- Definition of the procedures to meet the credit granting requirements for increased risk debtors, following Banco de Portugal Circular Letter CC/2020/00000013.
- Implementation of the provision for backstop provisioning as directed by the SSM as well as the respective reporting system.

- Review of the NPA/NPE reduction plan including the sale of credit portfolios to institutional investors.
- Consolidation and monitoring of the implementation process of the new definition of default and its dissemination within the organization.
- Launch of a project for the implementation of the new EBA guidelines on credit origination and monitoring.
- Review of credit risk monitoring processes in the context of the Coronavirus pandemic with a segmented approach to the credit portfolio to early identify customers with higher risk and mark them for closer monitoring and proactive actions towards the prevention of default.
- Submission of several authorization requests in the scope of IRB models, in Portugal and Poland, responses to TRIMIX inspections, broadening the scope of model development and monitoring (Retail PD models) and launching the re-development of several models.
- Continuous improvement of the liquidity and funding risk control and management systems at the Group level, in particular: first annual review of the internal liquidity stress test framework, specifically considering the impact of the collateral easing measures promoted by the ECB as a response to the COVID-19 crisis and the design and implementation of an intraday liquidity stress test completing the original approach; and the implementation of short-term liquidity risk indicators and of the internal liquidity stress test framework by the Banco International de Moçambique.
- Improvement of the interest rate risk control framework of the Banking portfolio, in line with the most recent guidelines of the regulator in force on the subject.
- Participation in the 2020 EBA benchmarking exercise.
- Reinforcement of market risk monitoring and control processes and continuation of the FRTB implementation project - Fundamental Review of the Trading Book.
- Continuous improvement of the quality of the data supporting the Group's risk management decisions, notably participating in BCBS 239 related projects and in the upgrade of the Risk Office's technological platform.
- Execution of the self-assessment annual exercises for operational risks and for information and communication technologies (ICT) risks.
- Outsourcing risk monitoring for the most relevant contracts, in liaison with the respective contract managers and implementation of the EBA/GL/2019/02 (Guidelines on outsourcing arrangements) in internal regulations.
- Continuous review of internal regulations on policies and procedures related to risk management and control.
- Reinforcement of account opening and transaction filtering processes, in order to ensure compliance with the sanctions and embargoes regimes enacted by the competent national and supranational authorities, as well as their monitoring, in order to detect and prevent potentially irregular situations.
- Development of new, more efficient solutions based on automation processes to analyse the risk factors inherent in establishing new business relationships or deepening existing relationships.
- Reinforcement and specialization of the Compliance Office teams within the scope of AML/CFT in its various dimensions.
- Execution of the Communication Plan dedicated to the 1st lines of defence with the most important aspects to be taken into account both in terms of the risk of financial crime and in other risks of compliance and regulatory compliance.
- Development of a systematic set of internal communications to prevent internal fraud risk.
- Reinforcement of the conflict of interest risk monitoring mechanisms, with the development of a new platform for registering operations and entities.
- Integration of the normative document's management function in the Compliance Office, in order to take advantage of the joint management of legal and compliance risks in reinforcing the Bank's regulatory framework.
- Implementation of new management structures the monitor of AML/CFT risk, designated by International AML/CFT Committees, with the participation of management and Compliance bodies of the subsidiary units, in order to assess and monitor specific compliance risk factors in each geography, as well as the existing business segments in each operation.
- Development of joint Compliance Office projects with teams of subsidiaries and branches abroad in order to analyse and improve the effectiveness of existing controls for mitigating the main risks in the area of AML/CFT.
- Strengthening of the subcontracting process with regard to the identification of situations of conflict of interest.
- Development of a new process for monitoring Legislative/Regulatory changes.

- Development of a set of initiatives with the objective of fostering the compliance with the requirements expressed in the Notice 3/2020, which regulates the systems of governance, internal control and organizational culture. These initiatives will continue for 2021.
- Submission to the Supervisory Entities of the Report on Prevention and Money Laundering and Financing of Terrorism for the activity carried out in 2019.
- Submission to the Supervisory Entities of the Internal Control Reports of the various eligible entities that make up the BCP Group, for the period from 1 June 2019 to 31 May 2020.
- Updating the content and training programs related to AML/CFT and the Code of Conduct.
- Monitoring of Supervisory Entities' On-Site Inspections.

3.6.3. CREDIT RISK

The granting of credit is based on the previous classification of risk of Customers, on the respective capacity for the repayment of credit to be made through the cash flows generated in the customer's activity, on the rigorous assessment of the level of protection provided by the underlying collateral and in line with the guidelines that reflect the Bank's credit risk appetite.

For the purposes of rating the customer's risk, a single rating system, the Rating Master Scale, based on the Expected Probability of Default (PD) is used, allowing a greater discriminating capacity in the evaluation of Customers and a better hierarchy of the associated risk.

The Rating Master Scale also enables the Bank to identify Customers that show signs of degradation in their capacity to service their debts and, in particular, those who are classified, within the prudential scope, as being in default. All the rating models and systems used in the Group have been duly calibrated for the Rating Master Scale.

The Group also uses an internal scale of "protection levels" as an instrument aimed at assessing the collateral efficiency in the mitigation of the credit risk, promoting a more active credit collateralisation and a better adequacy of the pricing to the incurred risk.

Aiming at the best possible adequacy of credit risk assessment, the Group has defined a series of client macro-segments and segments which are treated under different rating systems and models and support the links between internal ratings (risk grades) and the Customers' PD, ensuring that the risk assessment takes into account the specific characteristics of the Customers, in terms of their respective risk profiles.

The assessments made by the rating systems and models referred above are translated into the risk grades of the transversal Master Scale, with fifteen levels, of which the last three correspond to situations of relevant deterioration in Customer creditworthiness, called "procedural risk grades". Non-processual risk grades are attributed by rating systems models with automatic decision or by the Rating Department and are revised/updated periodically or whenever justified by events. The worst rating on Master Scale corresponds to customers classified in default (Default).

The development, implementation and calibration of rating models and systems is carried out by the Rating Division (non-individual customers) and the Risk Office (individual customers), with the respective monitoring and validation being guaranteed periodically by the Office for Validation and Monitoring of Models. The models are reviewed / updated periodically or whenever events occur that justify it.

The internal estimates of Loss Given Default (LGD) and Credit Conversion Factors (CCF) are supported by internal approaches validated by the Supervisor within the scope of the approval of the IRB-based approaches. The LGD estimations are produced by resorting to a model that collects and analyses the history of losses due to credit risk and discounts all the cash flows inherent to the respective recovery processes while the CCF own estimations result from the analysis made to data on the use of credit lines and limits or from the execution of the collateral provided for a time horizon of one year before the occurrence of the defaults. The CCF own estimations (or the regulatory values for these factors) apply to almost all off-balance sheet exposures.

The stage of development of the processes and systems allocated by the Group to credit risk management and control enabled the approval, by the Supervision, of the Group's application for the use of the IRB approach for the calculation of the regulatory capital requirements for this type of risk and for the main risk classes, with effect as of 31 December 2010 for the Group's activities in Portugal, which was followed by the joint authorisation given by the Polish and Portuguese supervision authorities for the sequential adoption of that approach for Bank Millennium (Poland), effective as at 31 December 2012. Effective from 31 December 2013, the Supervisor has approved, for the Group activities in Portugal, the use of own LGD estimates for the Corporates risk class (IRB Advanced), as well as internal rating models with own LGD estimates for the real estate promotion Clients.

The consistency of the credit granting framework with the Group's risk appetite is ensured by the alignment of the credit regulations with the credit risk strategy and policy guidelines approved by the Board of Directors and by the Executive Committee, respectively, and by the definition of a credit risk matrix with specific guidelines for the areas involved in the credit granting, monitoring and recovery process.

The Group adopts a policy of continuous monitoring of its credit risk management processes, promoting changes and improvements whenever deemed necessary, aiming at greater consistency and effectiveness of these processes. In this context, the Credit Risk Monitoring Area of the Risk Office is responsible for developing and implementing the appropriate processes for credit life cycle monitoring, in line with the RAS, policies and procedures implemented by the Bank, namely with regard to the evolution of the relevant risk parameters, both for existing credit portfolios and for new businesses and restructured loans, implementing preventive alert systems adjusted to the various credit portfolios.

Still within the Risk Office, the Credit Risk Area is responsible for permanently monitoring the levels of Non Performing Exposures (NPE), ensuring the processes of marking and unmarking Customers in default, and of restructuring due to financial difficulties of Customers, monitoring the quality and effectiveness of the credit recovery process and also for the analysis of the impairment of the Bank's loan portfolio.

Taking into consideration the impact of the COVID-19 pandemic outbreak, the Bank's credit policy principles were revised as soon as the disruptive impact that it could imply was perceived. These principles were periodically reviewed and, where necessary, adjusted according to the evolution of the environment.

Within the scope of the changes to the Bank's credit policy introduced to respond to the impacts of the COVID 19 outbreak we highlight the following:

- Reinforcement of the non-automatic decision-making procedures.
- Reduction of delegated powers attributed to local credit decision levels.
- Early review of lines not used by the customers, namely those related to customers in higher risk sectors or with worse risk grade.
- Suspension of internal limits not contracted with customers, except for those assigned to customers with better risk grade, with definition of limits.
- Exposure reduction to lower risk customers.
- Explore opportunities to increase the exposure to customers with better risk grades.
- Conversion of financial credit into commercial credit.
- Revision of repayment plans, with the introduction of greater flexibility for the first years of repayment.
- Requirement of more conservative LTV levels for new credit lines.
- Reinforcement of collateral required (ongoing and for new credit).
- Lower risk appetite for certain credit purposes, such as real estate development, acquisition finance and operations with a relevant size in relation to the client's scale.
- Focus on the use of credit lines with State, Mutual Guarantee or EIF (EIB) guarantees, regarding new loans to Companies wit the objective of supporting the real economy.
- Loans with repayment automatically linked to the operation's cash-flows, isolating the risks from the client's credit and liquidity profile.

With the aim of supporting the guidelines defined in terms of credit policy, some of the procedures underlying the risk analysis and the attribution of rating to customers were adjusted or strengthened, of which we highlight those detailed below:

- Rating Division performed the monitoring of customers with significant exposures, in a first stage by applying stress scenarios to the existing rating models and subsequently by assessing the rating of customers based on the available interim 2020 Financial Information.
- Credit decision process:
  - Increase of the relevance of forward-looking analysis and sensitivity analyses.
  - Expansion of the scope of information regarding the most impacted economic sectors.
- Granting of new credits and monitoring of the current portfolio:
  - For corporate and private clients, request further qualitative information on the impact of the COVID19 pandemic and on future prospects.
  - This information is carefully analysed, especially the business plans, and updates are requested whenever necessary.

More specifically with regard to the implications on the classification in IFRS9 stages, which translates into the identification and classification of customers in situations of increased risk or even default, as well as the definition of impairments, the main procedures implemented by the Bank are described below.

Updating of macroeconomic scenarios

With respect to the portfolio of customers subject to collective analysis, at the end of June and at the end of December, updates were made in Portugal to the macroeconomic assumptions used in the calculation of impairment, in both cases based on three scenarios (Central, Upside and Downside Scenarios) prepared by the Bank's Planning division, which took into account, at each point in time, the most recent forecasts of leading bodies that publish forecasts of macroeconomic variables, such as the Bank of Portugal and European bodies.

The same procedure was followed in the Bank's main subsidiaries.

Inclusion of impairment overlays

In an effort to follow the Supervisors' guidelines, namely with respect to the identification and measurement of credit risk against the backdrop of the COVID-19 pandemic, the Bank recorded additional impairment in relation to the prevailing models for the calculation of collective impairment (overlays), which amounted to around Euros 27 million in Portugal and € 14 million in Poland.

The exercise carried out considering an analysis of migrations of customers identified as having a higher risk to Stage 2 and Stage 3. It should be noted that the most significant impact was verified in the corporate segment.

Review of the credit portfolio with respect to most significant exposures

With respect to customers with more significant credit exposures, we should highlight the implementation of a series of extraordinary procedures with the aim of evaluating the potential impacts of the outbreak of the COVID-19 pandemic.

- Customers with significant exposures - Performing portfolio:
- With respect to customers who form part of the individual analysis of impairment group, which consists of customers with greater exposures or with a risk profile considered high, significant effort was made to bring forward the implementation of questionnaires regarding signs of impairment.
- The re-evaluation of the portfolio of significant cases sought to identify customers who may have experienced a significant rise in credit risk and/or an increase in the probability of default that could result in a transfer of stage or classification as NPE.
- Customers with significant exposures - NPE Portfolio:
- For this group of customers, in addition to the usual portfolio analysis, special attention was paid to a review of more representative customers.

Transverse approach with a view to identifying situations involving more vulnerable corporate customers and respective close monitoring

As with the objective of identifying, evaluating and monitoring the impact in terms of credit risk arising from the COVID-19 pandemic crisis, from a more global and transverse perspective, and one which may allow consistent support during the period in which the effects of the aforementioned pandemic persist, the Bank has developed an approach to Corporate customers, with heavy involvement of the Rating Division, which is reflected in the following methodology:

- Identification of the business sectors deemed to be at greater risk and with a more adverse potential impact in the context of the COVID-19 crisis;
- Definition of stress scenarios adapted to the severity of the impact expected for each business sector;
- Assessment of resilience (measured in terms of the potential deterioration of the respective rating) of the companies belonging to the sectors identified as being more vulnerable;
- Identification of customers who exhibit greater vulnerability, according to the assessment carried out.

Under this process, the Bank assessed practically all the exposure of the sectors deemed to have been impacted most. This assessment constitutes a highly valuable starting point for selecting the most vulnerable customers, identifying customers who should be subject to closer monitoring and analysis and devising the credit strategy to be followed on a case-by-case basis for each of these customers.

This approach allows the early detection of potential default risk, creating the conditions for informed and prompt action by the Bank, specifically adjustment of the credit strategy to be adopted for each customer prior to the end of the period of the moratoriums. The strategy to be determined for each case may involve measures such as the following: reducing exposure; reducing unused internal limits; restructuring loans with amortisation plans, anticipating potential future defaults; increasing guarantees; maintenance (without changes); maintenance with the option of granting specific credit operations with a good risk profile (e.g.: commercial credit); partial conversion of financial loans into commercial credit; repricing; transfer to the recovery division.

Approach addressed to customers in the Retail segment

In terms of the retail segment, with a view to monitoring and following up the default risk of customers within the context of the COVID-19 pandemic and supporting the determination and implementation of more appropriate solutions to address the potential default of each cluster of customers, the Bank is in the process of developing a series of projects and activities to adapt credit portfolio monitoring and management processes to the new situation on the ground.

These initiatives, which form part of the NPA Reduction Plan, are being developed in an integrated manner under the auspices of a specific Project, with the direct involvement of all relevant internal stakeholders and, despite also involving customers who have benefited from support measures such as recourse to moratoriums, it is not limited to those.

The development of this approach is based on CRM tools, Data Analytics and Decision Models with the goal of boosting efficiency and automatization.

In short, the main initiatives in this domain may be characterised in the following terms:

- Improvement of credit data marts for all customers with credit exposure, with a view to supporting the production of information on customers (financial/non-financial/behavioural); credit decision models and internal and external reporting.
- With this support, the goal of the Bank is to systematise information critical to customer evaluation, in particular in the following domains: historical analysis pre-COVID, and in the entire subsequent period; analysis of financial flows (inflows and outflows) and recurring flow variations; analysis of the variation in financial assets; analysis of credit behaviour in OCI (number of entities, recourse to moratoriums, balance history) and their changes; anlysis of delays in payments and receipts and other risk implications; analysis of the impacts of the pandemic from a sectoral perspective;
- Bolstering of the system of early warning signs for the retail segment (private and small business)
- Segmentation in homogeneous clusters, with a view to prioritising contact and action plans
- Launch of a process of contacting customers, in particular the completion of questionnaires to gauge their economic and financial situation, inter alia to evaluate the impacts of the pandemic.
- Development of standard credit solutions adapted to the different standard situations and review of the predefined solutions in effect.
- Determination of a pre-analysed restructuring option for customers with risk implications.
- Broadening of the range of solutions on the Banking App.
- Increase in the capacity to monitor customers in difficulties, involving an increase in the capacity for processing customers and simplification and automation of support processes that allow the Bank to cope with the increase in the number of transactions.

Classification of operations as restructured due to financial difficulties

Specifically, with respect to the classification of customers as restructured due to financial difficulties, under the provisions of the guidelines issued by regulators and supervisory authorities, operations that fell under the state moratorium (Decree-Law 10-J/2020, of 26 March) or the sectoral moratorium (official memorandum adopted within the context of the APB), did not have to be flagged as restructured due to financial difficulties. Even so, the Bank decided to adopt a conservative approach, classifying as restructured due to financial difficulties operations that benefited from the aforementioned moratoriums which, as of 26 March (the date of entry into force of Decree-Law 10-J/2020), had been in default for more than 60 consecutive days after the due dates, and which remained in a situation of default as of 31 March.

As presented in Table 36 of section point 5.2 ("Credit Quality"), on 31 December 2020 the Bank's support to the economic agents through EBA compliant moratoria in force, under a consolidated scope, corresponded to exposures of € 8.814 million. This figure does not include exposures of € 2.155 million, which had already benefited from a moratorium which had expired.

Within the moratoria in force at the end of 2020, Portugal had almost the full share (98,5 %) and €4.202 were in the households' segment (of which 88,7% related to loans secured by residential property). In the corporate segment, exposures subject to moratorium concerning Non-Financial Corporations amounted to €4.516 million, of which €4.111 million concerning SME.

At the end of 2020, the weight of non-performing clients was 7.3% of the exposures subject to moratorium.

Regarding the remaining period of the moratoria, 90% would end within 6 to 9 months after 31 December 2020, being almost all this portion related with the legislative moratoria that, at that time, were set to be elapsed by 30 September 2021.

Another crucial support measure to the economy in the context of the covid-19 pandemic concerns the credit lines granted under the new public guarantee systems introduced in response to the covid-19 crisis, which at the end of 2020 amounted to 2.369 million euros, almost all of which was destined for Non-Financial Corporations, especially SMEs, with 92% of the total. Once again, Portugal's weight in the total is significant, with a share of 95.5% of the total support in this regard.

3.6.4. MARKET RISKS

For the purposes of profitability analysis and market risks quantification and control, the following management areas are defined for each entity of the Group:

- Trading - Management of positions whose objective is the achievement of short-term gains, through sale or revaluation. These positions are actively managed, tradable without restriction and may be valued frequently and accurately. The positions in question include securities and derivatives of sales activities
- Funding - Management of institutional funding (wholesale funding) and money market positions.
- Investment - Management of all the positions in securities to be held to maturity (or for a longer period of time) or positions which are not tradable on liquid markets.
- Commercial - Management of positions arising from commercial activity with Customers.
- Structural - Management of balance sheet items or operations which, due to their nature, are not directly related to any of the management areas referred to above.
- ALM - Assets and Liabilities Management.

The definition of these areas allows for an effective management separation of the trading and Banking Books, as well as for the correct allocation of each operation to the most suitable management area, according to its respective context and strategy.

The Trading Book portfolio is composed by positions held with the aim of obtaining short-term gains, through sale or revaluation. These positions are actively managed, traded without restrictions and can be precisely and frequently evaluated. The positions in question include securities and derivatives relative to the Treasury sales' activities. The Banking Book portfolio includes all the other positions, namely: the wholesale funding, the securities held for investment, the commercial activity and the structural activity.

In order to ensure that the risks incurred in the portfolios of the Group are in accordance with the Group's risk tolerance levels, several limits are defined for market risks (reviewed at least once a year) and are applied to all portfolios that, in accordance with the management model, might incur these risks.

The definition of these limits is based on the market risk metrics used by the Group in its control and monitoring, which are followed by the Risk Office on a daily basis (or intra-daily, in the case of the financial markets areas - Trading and Funding).

In addition to these risk limits, stop loss limits are also defined for the financial markets' areas, based on multiples of the previously defined risk limits, aiming at limiting the maximum losses which might occur within each of the areas. When these limits are reached, a review of the management strategy and assumptions for the positions in question must be undertaken.

Also, within the scope of risk appetite, the Group has clearly defined the list of products and currencies in which the dealing rooms of the different entities are authorized to trade. The introduction of any new product or currency is subject to approval by the Bank's Risk Committee, based on a reasoned proposal from the business areas subject to Risk Office's opinion.

The Group has in place procedures that aim to ensure the effective control of positions considering the entities' trading strategy, including the monitoring of transaction volume and compliance with expected holding periods.

The Group uses an integrated market risk measure that allows the monitoring of all the relevant sub-types of risk considered. This measure covers the evaluation of the following types of risk: generic risk, specific risk, non-linear risk and commodities' risk. The measurement used on the assessment of the generic market risk - relative to interest rate risk, exchange rate risk, equity risk and price risk of Credit Default Swaps uses a VaR (Value at Risk) model, where the calculation considers a time horizon of ten business days and a significance level of 99%.

A model is also used to assess the specific risk existing due to the ownership of securities (bonds, shares, certificates, etc.) and of derivatives which performance is directly related with the securities' value. With the necessary adjustments, this model follows the standard methodology defined in the CRD IV/CRR.

Other complementary methods are also applied to the remaining risk types, namely a non-linear risk measure that incorporates the option risk not covered by the VaR model, with a confidence interval of 99%, and a standardised approach for the commodities risk. These measures are integrated in the market risk indicator, with the conservative assumption of perfect correlation between the several risk types (worst-case scenario).

The amounts of capital at risk are thus determined, both on an individual basis, for each of the portfolio positions of the taking and managing risk areas, and in consolidated terms, considering the effects of diversification of the various portfolios.

To ensure that the internal VaR model is adequate to assess the risks involved in the positions held, there is a process of backtesting, carried out daily through which the VaR indicators are confronted with those that really occurred. This backtesting is made in a hypothetical manner (using the static portfolio for the estimation of the VaR and the market variations occurred in the meantime) and in a real manner (using the real result of the portfolio, writing off the intermediation results).

The interest rate risk derived from the operations of the Banking Book is assessed through a process of risk sensitivity analysis, undertaken every month, covering all the operations included in the Group's consolidated Balance Sheet.

This analysis considers the financial characteristics of the contracts available at the Group management information systems. Based on these data, the respective projection of expected cash flows is carried out, according with the repricing dates and any prepayment assumptions considered.

The aggregation, for each of the currencies assessed, of the expected cash flows for each of the periods of time, allows the determination of the interest rate gaps by repricing period.

The sensitivity of each currency to the interest rate risk is determined by the difference between the present value of the interest rate mismatch, discounted at market interest rates, and the present value of the same cash flows arising from the simulation of parallel and non-parallel shifts of the yield curves.

Complementing the previous approach, the Bank monthly calculates the impact on net interest margin projected for the following 12 months, due to changes in market interest rates (NII method). For this purpose, all assets, liabilities and off-balance products that generate interest are considered and the calculation on interest cash flows is performed based on the repricing and amortisation characteristics of the products and on yield curves for 12 months projected in accordance with the "cash and carry trade" and "non-arbitrage principle" methods. This exercise assumes a static balance for 12 months in which, for each amortisation, an exposure with the same maturity and price features is generated.

The Group performs hedging operations with the market on a regular basis, aimed at reducing the interest rate mismatch of risk positions associated to the portfolio of the Commercial and Structural areas.

In the context of market risk management, in 2020, the Group continued its efforts to continually improve the market risk management framework, leading to the reinforcement of the control mechanisms of the assumptions of the internal model used (VaR - Value at risk), to the update of Risk Appetite for market risks, namely, in what concerns the revision of the limits established for the different areas, and to the revision and formalisation of internal manuals that accordingly define the operationalisation of market risks' control.

The Risk Office's Market Risks Area is responsible for the following main activities:

- Proposing and implementing market risks' management policies and methodologies for their identification, measurement, limitation, monitoring, mitigation and reporting.
- Participating in the structural management of market risk, particularly in the planning processes, in ICAAP and Recovery Planning.
- Measuring, monitoring and reporting the risk positions and the results of stress test exercises, as well as compliance with the established internal limits, computing the capital requirements (or RWA) for market risks and ensure the calculation of the Credit Valuation Adjustment (CVA / DVA) for OTC derivatives.
- Modelling the market risk management system and ensure the respective updates as well as verify its operational implementation on the Bank's front-office platform.
- Reporting to the Executive Committee any excess over limits, as well as verifying the compliance with the required ratification and approval processes.
- Analysing the new products prior to their launching and the trading in new currencies.
- Defining and reporting the classification of financial instruments, in the fair value hierarchy under the terms defined in terms of IFRS 13 and ensure the calculation of impairment for capital instruments portfolio.
- Coordinating with the relevant Group entities the definition of the negotiation strategies, validating their compliance with the defined policy and limits.

On the other hand, the Market Risks Area acts independently – both organically and functionally - from all market risks taker, which ensures the autonomy of its management functions, oriented towards a risk profile in accordance with the Group's strategic goals.

3.6.5. OPERATIONAL RISK

Operational risk materialises in the occurrence of losses resulting from failures or inadequacies of internal processes, systems, or people, or resulting from external events.

In the management of this type of risk, the Group adopts duly documented principles and practices, which are expressed in control mechanisms subject to continuous improvement. This framework has a variety of features, such as: functions segregation, definitions for lines of responsibility and respective authorisations, tolerance limits for exposures to risks, appropriate internal regulations' framework (including ethical codes and codes of conduct), risks self-assessment (RSA) exercises, key risk indicators[1] (KRI), access controls (physical and logical), reconciliation activities, exception reports, loss events data capture, a structured process for new products approval, contingency plans, contracting of insurance (for the total or partial transfer of risk), follow-up of the Bank's outsourcing contracts and internal training on processes, products and systems.

The operational risk management system adopts the 3 lines of defence model and is based on a structure of end-to-end processes, considering that a vision which is transversal to the functional units of the organisational structure is the most suitable approach for the perception of risks and to estimate the effects of the corrective measures introduced for their mitigation. Furthermore, this processes' structure also underlies other strategic initiatives related to the management of this risk such as the actions to improve operating efficiency and the management of business continuity.

Hence, the Group's subsidiaries have their own processes structure, which is periodically adjusted according to business evolution, to ensure suitable coverage of the business activities (or business support activities) developed.

The responsibility for the day-to-day management of operational risk lies with the 1st line of defence which is composed of process owners (seconded by process managers), whose mission is to characterise the operational losses captured under their processes, to monitor the respective KRI, to perform the RSA exercises, as well as to identify and implement suitable actions to mitigate operational risk exposures, thus contributing to the strengthening of control mechanisms and the improvement of the internal control environment. The periodic review of the processes' structure in each geography is ensured by their own structure units.

The Risk Management System represents the 2nd Line of Defence, which implements the defined risk policy for the Group, having the responsibility of proposing and developing methodologies for managing this risk, supervising its implementation and challenging the 1st Line of Defence regarding the levels of risks incurred.

The objective of the risks self-assessment (RSA) is to promote the identification and mitigation (or even elimination) of risks, actual or potential, within each process. Each risk is classified according to its positioning on a tolerance matrix, for three different scenarios, which allows for the: determination of the risk of the process without considering the existent controls (Inherent Risk); assessment of the risks exposure of the different processes, considering the influence of existing controls (Residual Risk); and identification of the impact of the improvement opportunities in the reduction of the most significant exposures (Target Risk).

These exercises are based on workshops, attended by the Risk Office and with the participation of the process owners and process managers or questionnaires sent to the process owners to update the results, according to pre-defined updating criteria. Representatives from the Internal Audit (3rd Line of Defense), the IT Department, the Business Continuity Area and the Personal Data Protection Office are invited to participate in the RSA workshops.

The process owners play a relevant role in promoting the data collection on losses occurring within the context of their processes, which are identified through the systematic monitoring of their activities, through notifications of any employee or through communications from organisational units, following costs authorizations concerning operational flaws. The Risk Office ensures the completeness of the database, notifying process owners about events that are not yet registered in the database by using information made available by other areas, such as accounting, complaints management and insurance.

The main objective of data collection on operational loss events is to strengthen awareness of this type of risk and provide relevant information to the process owners, to be incorporated in the management of their processes, besides providing some feedback measure on the assessment made for each risk.

The identified operational losses are related to a process and risk and are registered in the Group's operational risk management IT application, being characterised by their respective process owners and process managers.

The full characterisation of an operational loss includes, in addition to the description of the respective cause-effect, its valuation and, when applicable, a description of the identified mitigation action (based on the analysis of the cause of loss)

[1] The monitoring of the KRI metrics enables the identification of changes in the risk profile or in the efficiency of the controls, providing the detection of opportunities for the launching of corrective actions to prevent effective losses. This management tool is used for all processes of the main Group geographies.

which was or will be implemented.

Each process has a set of identified KRI, the continuous monitoring of which allows to assess changes to the risk profile of the processes, thus trying to anticipate risk situations that have not yet materialised.

The consolidation of the loss data capture process at the different subsidiaries of the Group is evidenced by the evolution of its respective records in the database. Uniformity of criteria in data capture is ensured by the Group Risk Office, which analyses loss events data and promotes the circulation of information on the mitigation of events throughout all the geographical areas in which the Group operates.

The Risk Office integrates an Operational Risk Area that ensures the following activities:

- plan and carry out the annual Self Assessment exercise on operational risks in all Bank processes.
- monitor and control the recording of operational losses in the event database, ensuring their completeness, quality and timeliness.
- monitor the risk indicators (KRI) and plan and carry out the Scenario Analysis exercise.
- promote the assessment of the operational risks in terms of IT, cybersecurity and outsourcing risks.
- propose operational risk mitigation actions and monitor their implementation together with the respective Process Owners.
- support the design of measures to remedy internal control weaknesses and monitor the implementation of the respective mitigation plans.

3.6.6. LIQUIDITY RISK

Liquidity risk is the potential inability of the Group to meet its liabilities concerning funding repayment without incurring in significant losses, whether due to the deterioration of funding conditions (funding risk) or non-existent funding or due to the sale of assets for amounts below market value (market liquidity risk).

The liquidity risk assessment is based on the regulatory framework, as well as on other internal indicators for which exposure limits have also been defined.

With regard to the evolution of liquidity, short-term indicators such as the LCR (Liquidity Coverage Ratio, a regulatory indicator) and the ratio between the buffer available for discount with central banks and customer deposits, and structural indicators such as the loan to deposits ratio and the NSFR (Net Stable Funding Ratio, a regulatory indicator) are monitored in the scope of the "Risk Appetite Statement" of the Group and each subsidiary. These high-level indicators are complemented at the operational level by metrics defined within the Group's liquidity risk management framework and adopted at the level of each of the main operations. All these indicators are regularly monitored and reported to the Bank's management bodies.

Liquidity risk management also includes the preparation of an annual Liquidity Plan defining the desired financing structure for the expected evolution of the Group's assets and liabilities, including a set of initiatives and an action plan to achieve the financing structure at both Group level and for the major subsidiaries and currencies. This plan is an integral part of the Group's planning process and is approved simultaneously with final budget approval.

At the same time, the Bank regularly monitors the evolution of the Group's liquidity position, with the identification of all factors that may justify the variations occurred. This analysis is submitted to the appraisal of the CALCO, aiming at making decisions that enable to maintain financing conditions suitable for the development of the activity. The Risk Commission is responsible for the continuous assessment of the liquidity risk management framework and for controlling the approved limits for exposure to that same risk.

The Risk Office has a Liquidity Risk Area that has the following responsibilities:

- permanently monitor liquidity risk levels and promote the implementation of the respective control mechanisms.
- prepare limit proposals in the area of liquidity risks.
- coordinate the Group's ILAAP process.
- proceed with the design and performance of liquidity stress tests.
- support local risk offices in the implementation of the approved methodologies for the entire Group.

3.6.7. DEFINED BENEFIT PENSION FUND RISK

The responsibilities assumed by the BCP Group associated with the Bank's defined benefit Pension Fund are related with the payment of retirement pensions for old age, disability, and survival to its employees.

The defined benefit pension fund risk stems from the potential devaluation of the Bank's Defined Benefit Pension Fund, or from the decrease of its expected returns as well as from changes on the actuarial factors used on the fund projections, implying the necessity of unplanned contributions. The Pension Funds Risk Monitoring Commission is responsible for the regular monitoring and follow-up of this risk. This risk is subject to regular monitoring and follow-up of the respective management by the Pension Fund's Risk Monitoring Committee. This body evaluates and monitors the Fund's performance and risk and is responsible for establishing the appropriate investment policies and coverage strategies and approving changes in actuarial assumptions.

As of December 31, 2020, the Group's liabilities had a coverage level of 102.5% (104.3% according to the requirements of Banco de Portugal), being fully financed at levels above the minimum limits defined by regulator.

3.6.8. COMPLIANCE RISK

The compliance risk is materialized by the occurrence of financial losses (e.g. fines, fines, indemnities) or reputational damages resulting from non-compliance with laws, regulations or contractual commitments to which the Bank is obliged in its activity.

The Compliance Office's main mission is to promote the adoption of internal and external principles and rules that frame the Group's activity, and to ensure that all Group's entities comply with the legal and regulatory standards as well as with the contractual commitments and ethical values of the Group. The Compliance Office promotes the existence of a strong internal control culture, in order to contribute to the mitigation of the risk of imputation to the Group's entities of significant sanctions or damage to property or reputation.

In this context, compliance with the AML / CTF regulatory framework is particularly important, both in correspondence banking and trade finance operations involving jurisdictions classified as high risk, in the monitoring the financial and transactional behavior of the Bank's clients and in the risk analysis of new customers in the onboarding activity.

For AML / CTF risk control, the Bank has implemented in the central system a set of rules, procedures and operational criteria applied to customer processes and transactions that generate alerts to drive acceptance or refusal decisions, including refusal with report to competent authorities. In addition, the Bank monitors, through the exercise of due diligence procedures, the customers that were once participated to the authorities as well as all those that offer a higher AML / CTF risk, in accordance with the AML rating system implemented.

The Compliance Office also carries out the due diligence analysis of entities involved in credit operations, with a special focus on non-client entities or those in the beginning of a commercial relationship and ensures the updating and conformity of the information related to the identification data of Customers, representatives and beneficial owners, promoting their regularization whenever inconsistencies are detected.

Regarding the onboarding activity, simple or reinforce due diligence procedures, is carried out to new customers, deciding whether to continue or cancel account opening processes, through KYC (Know Your Customer) validation, existence of PEP (Politically Exposed Persons), and other AML / CFT risk factors considered relevant, including the verification of the existence of sanctions or embargoes, or belonging to "black" lists published by international entities.

The Compliance Office ensures the regulatory compliance of the new products approval policy, including the verification that the duties of informing customers are fulfilled. It also analyzes the compliance of internal regulations with the current regulatory and legal framework and issues opinions on situations established in internal policies, including those issued by the regulator, such as those concerning related parties and conflicts of interest.

In matters related to regulators, the Compliance Office, with the supervisory entities, monitors inspections in matters of behavioral and prudential supervision, ensuring compliance with various reporting duties. In this context, the role of prevention, control and monitoring of Market Abuse stands out.

It is also the responsibility of the Compliance Office to ensure the consistency of the Document Management Model in the BCP Group, as well as the preparation and review internal documentation.

3.6.9. ENVIRONMENTAL AND SOCIAL RISKS

Within the scope of the approach to environmental and social risks, the Bank created in 2019 the Sustainability Commission, dependent on the Executive Committee, with the objective of assisting this Committee in the integration of the principles of Sustainability (Environmental, Social and Corporate Governance / ESG) in the Bank's processes decision-making and management, to assess and approve the initiatives necessary to implement the actions defined to materialize the strategic axes of the Bank's Sustainability Master Plan, as well as other changes or adaptations necessary to meet the defined objectives, follow and monitor the progress approved initiatives.

In 2021, the Bank created a new department with an enhanced focus on the sustainability themes with direct report to the CEO, named Department of Economic Research, Sustainability and Cryptoassets. (DESC). This new department's mission, in the sustainability context, to propose and execute global and coherent sustainability policies and corporate social responsibility, which promote the business development with the incorporation of ESG principles and forward the growth of the Bank's reputation and its capacity to add social and environmental value eand to respond to needs and expectations of the stakeholders.

Aware of the impact of environmental and social risks on the planet and on the Bank, the Bank defined in its Sustainability Master Plan an approach to the management of environmental and social risks based on three areas of operation: the integration of ESG risk in the management procedures of risks, the identification and classification of customers with greater environmental and social risks and the awareness of customers in sectors of activity with greater exposure to environmental risks.

The Bank has been integrating environmental and social risks considering them as important risk drivers impacting several of the risks assessed in the risk identification process of the Bank and incorporating policies, standards, and procedures for their management. The analysis of environmental risk is integrated in the Customer evaluation processes in the granting of credit and project finance, taking into account not only the risks associated with the activity's sectors of operations, but also the ESG performance of our Customers. The Bank is developing and implementing ESG risk scoring processes for Large Corporate clients and is defining sectoral financing and investment policies for industries with high exposure to environmental risks (positive and negative screening).

In this context, a Sustainable Financing Task Force was created, which is working on the development of a complete and comprehensive offer of ESG financial products and services. As part of the development of its responsible business lines, BCP continues to provide products and services that incorporate social principles and respect for the environment and nature. It is also aware that the implementation of social and environmental criteria and standards in the commercial offer translates into more effective risk management, reputational value and better quality of products and services made available to customers.

BCP also meets the needs of investors who consider it relevant to include, in their investments, social and environmental risk factors, making Responsible Investment Funds available for subscription. Likewise, the Bank assesses the ESG risk of each of the managed portfolios, integrating information on the ESG risk in the construction of portfolios.

The BCP Group monitors legal and regulatory initiatives related to climate change as a systemic risk for the financial system, especially the Task Force on Climate Related Disclosures sponsored by the Financial Stability Board and the Principles of Responsible Banking promoted by the UN.

The Bank is also attentive to the changes that will occur in the prudential and supervisory areas, following the development of criteria and technical standards to be adopted broadly and unequivocally in the market, in order to avoid a dichotomy between the approaches of each company, with disruptive effects for the financing of the economy.

The Bank prepared for 2021 an Action Plan with a view to aligning with the expectations of the ECB Guide on climate and environmental risks.

3.6.10. LITIGATION RISK IN SWISS FRANCS PORTFOLIO IN POLAND

Regarding mortgage loans indexed to Swiss francs (CHF) granted by Bank Millennium, there are risks related to verdicts issued by Polish courts in lawsuits against banks (including Bank Millennium) raised by borrowers of FX-indexed mortgage loans, as well as risks related with the possible application of a sector-wide solution, i.e. a solution applied to all contracts (Swiss Franc-denominated/indexed mortgage loans) in the Polish financial sector. The Polish Financial Supervisory Authority suggested a possible sector-wide solution in December 2020, which has, since then, been under consideration by Polish banks.

On 3 October 2019, the Court of Justice of the European Union (CJEU) issued a judgment on Case C-260/18. This judgement has legal interpretations in connection with the preliminary questions formulated by the District Court of Warsaw in the lawsuit against Raiffeisen Bank International AG, relative to CHF-indexed loans.

Since then, the trend of court rulings, that had been mostly favourable to banks, begun to reverse. The CJEU ruling only concerns situations where the national court has previously determined that contract terms are unfair. It is the exclusive competence of national courts to assess, in the course of judicial proceedings, whether a particular term of a contract can be identified as unfair according to the circumstances of the case.

On 29 January 2021, it was published a set of questions addressed by the First President of the Supreme Court to the Civil Chamber of the Supreme Court, which may have important consequences in terms of clarifications of relevant aspects of the court rulings and their consequences. The Civil Chamber of the Supreme Court was requested to respond to certain requirements related to FX-indexed mortgage agreements: (i) is it permissible to replace - through legal or customary provisions - the abusive provisions of an agreement which refer to FX exchange rate determination; moreover, (ii) in case of impossibility of determining the exchange rate of a foreign currency in the indexed/denominated loan agreement - is it possible to keep the agreement in force in its remaining scope; as well as, (iii) if, in case of invalidity of the CHF loan agreement, there would be applicable the theory of equity (i.e., does it arise a single claim which is equal to the difference between value of claims of bank and the customer), or the theory of two conditions (separate claims for the bank and for the client that should be dealt with separately). The Supreme Court was also requested for commenting on (iv) the determination of the moment from which the limitation period should start counting in case of a claim being filed by a lending bank for repayment of borrowed amounts and, (v) whether banks and consumers may receive remuneration on their pecuniary claims on the other party arising from the contract. The date of the Supreme Court meeting, which was scheduled for 25 March 2021, has since been changed to 13 April 2021. Bank Millennium will assess in due time the implications of the potential decisions of the Supreme Court on the level of provisions constituted for the legal risk. Given the Group's inability to predict the results of that Supreme Court decision, this matter was not considered in the determination of the provision.

On 8 December 2020, Mr. Jacek Jastrzębski, the Chairman of the Polish Financial Supervision Authority (PFSA), proposed a sectoral solution to address the sector risks related to FX-indexed mortgages. The solution would consist in banks offering to their clients a possibility of concluding liability settlement agreements based on which a client would conclude with the bank a settlement as if the loan had been, from the very beginning,

A PLN-indexed loan, bearing interest at an appropriate WIBOR rate, increased by the margin historically employed for such loan.

Following that public announcement, the idea has been subject of consultations between banks under the auspices of the PFSA and Polish Bank Association. Banks are assessing the conditions under which such solution could be implemented and consequent impacts.

In the view of Bank Millennium's Management Board, important aspects to be taken into consideration when deciding on potential implementation of such program are: a) favorable opinion or, at least, non-objection from important public institutions; b) support from the National Bank of Poland (NBP) for the implementation; c) level of legal certainty of the settlement agreements to be signed with the borrowers; d) level of the financial impact on a pre- and after tax basis; e) capital consequences, including regulatory adjustments in the level of capital requirements associated with FX-indexed mortgage loans.

At the time of publishing the Group's Consolidated Report, neither its Management Board nor any other corporate body of Bank Millennium or of the Bank took any decision regarding the implementation of such program. For this reason, the potential effects of this matter were not reflected in the determination of the provision. If, or when, a recommendation regarding the program is ready, Bank Millennium's Management Board will submit it to the Supervisory Board and General Shareholders' meeting, taking into consideration the relevance of such decision and its implications.

According to preliminary calculations, implementation of a solution whereby loans would be voluntarily converted to PLN as if they had been a PLN loan from the very beginning, bearing interest at an appropriate WIBOR rate increased by the margin historically employed for such loans, could imply provisions for the losses resulting from conversion of such loans (if all the current portfolio would be converted) with a pre-tax impact between PLN 4.100 million (Euros 899.06 million) to PLN 5.100 million (Euros 1,118.35 million) (non-audited data). The impacts in Bank Millennium's capital can significantly change in case of variation of the exchange rate and other assumptions of diverse nature. Impacts on capital could be partially absorbed and mitigated by the combination of the existing surplus of capital over the current minimum requirements, the reduction of risk-weighted assets and the decrease or elimination of Pillar 2 buffer. The above mentioned impact would be substantially higher than the estimated impact of PLN 500 million (Euros 109.64 million) to PLN 600 million (Euros 131.57 million) (non-audited data) in the scenario of replacing the exchange rate applied in the contracts by the average NBP exchange rate. Finally, it should be mentioned that Bank Millennium, as at 31 December 2020, maintained additional own funds for the coverage of additional capital requirements related to FX-indexed mortgage portfolio risks (Pillar II buffer), in the amount of 3.41 p.p. (3.36 p.p. at the BCP Group level), part of which is allocated to operational/legal risk.

Due to the complexity and uncertainty regarding the outcome of court cases, as well as due to the potential implementation of PFSA Chairman's solution or potential Supreme Court decisions, it is difficult to reliably estimate potential impacts of such outcomes and their interaction as at the date of publication of the Group's financial statements.

3.7. Concise risk apetite statement

BCP Group carries out its business activities in a sustained, controlled and prudent way, based at all times on the adequacy and compatibility between the objectives set for the business and the levels of risk tolerance that are defined in accordance to the long-term sustainability and profitability of the business.

These risk tolerance levels are embodied in the Group's "Risk Appetite Framework" (RAF) which incorporates the following elements which is an active constraint in what concerns the levels of risk arising from the Bank's plan and budget and is subject to regular reviews considering the various developments in the internal and external environment and of the way in which these have an influence on the perspective evolution of the Bank's risks.

The Group's RAS is articulated and complemented by the RAS of the various subsidiaries, creating a coherent framework that ensures consistency between the risk tolerance levels of the various entities / geographies and the Group on a consolidated basis.

The Group's RAS currently consists of a set of around 27 indicators, defined according on the materiality assessed for the risks they measure and to their importance in relation to the business objectives that are defined in the BCP Group's strategic plan.

The RAS for Portugal includes 46 indicators in question reflect limits associated with different analytical views on the Group's business that are considered imperative for its continuity and sustainability - Solvency / Liquidity and funding / Profitability and business mix / Reputation and brand – and are directly or indirectly linked to the different objectives' types of the strategic plan, namely: Business growth / Value creation / Asset quality.

The indicators of the Group's and Portugal's RAS are approved by the Board of Directors of Banco Comercial Português, S.A., from a proposal of BCP's Risk Office – the structure unit that coordinates the implementation and maintenance of the mechanisms and definitions of the RMS – after an opinion from the BoD's Executive Committee and Committee for Risk Assessment.

The RAS is reviewed at least once a year (or whenever the risk circumstances identified at any given moment so determine), both in terms of the list of indicators considered and their limits thresholds. For each indicator, the limits are fixed using a "RAG" approach (red, amber, green):

- Red = critical level, represented by an excess or insufficiency, that must be corrected in the shortest time possible.
- Amber = alert level, representing a negative evolution towards an excess or insufficiency, which should prompt immediate corrective and/or mitigation measures.
- Green = comfort level, within the defined risk tolerance.

For the main subsidiaries of the group - Bank Millennium (Poland), Banco Internacional de Moçambique (Mozambique) and Millennium Banque Privée (Switzerland) - local RAS are defined, with the same structure of risk areas as in the parent company, adapted to the specificities of the business in these geographies and calibrated in order to ensure consistency with the Group's RAS.

The Group has defined a set of indicators to be included in the RAS of all entities it consolidates - the so-called Corporate RAS - and which allows monitoring and comparing the Group's material risks at the consolidated and individual level of each subsidiary / geography, ensuring the comparability of the information between the various entities of the group. In addition to the set of corporate RAS indicators, the different geographies define other indicators to include in their RAS for monitoring material risks at the local level.

The implementation of a comprehensive and diversified structure of mechanisms necessary for the identification, measurement, monitoring, control, prevention and mitigation of the various risks incident on the Group's activities is based on criteria of economic and financial rationality (based, *inter alia* , on a cost/benefit analysis), in order to allow the sustained (and sustainable) development of all business activities, in a simultaneously profitable and prudent manner, adequate to the defined objectives.

3.8. Risk identification and risk taxonomy

The Bank has implemented a regular risk identification process at BCP Group consolidated level and at each Entity level in order to assure that all potential risks to capital, earnings and liquidity are regularly considered, and that the Group decides on respective high-level risk materiality, resulting on a comprehensive internal risk inventory.

The BCP Group's risk identification process is led by BCP's Risk Office and is based on a risk taxonomy, in which the main risk categories (eg credit, market, liquidity, operational, etc.) are broken down into a wide range of types of risk to be analyzed by the Bank in a self-assessment exercise, in order to predict the respective impact on the risk profile of the BCP Group or any of its Entities. To this end, materiality thresholds are approved by the Committee for Risk Assessment to be used as references for assessing the risks likelihood and impact on solvency or liquidity. Based on this reference framework, the risks considered material for the Group are selected. The results of the risk identification process are approved by the Board of Directors, following a recommendation of the Committee for Risk Assessment.

The BCP Group risk taxonomy, containing the list of risks that are formally assessed in the annual risk identification processis regularly updated in order to reflect all the risk types that may impact in or arise from the activity of the BCP Group.

TABLE 6 – RISK TAXONOMY

Risk name	Credit risk
Credit default risk	The current or prospective risk to earnings, capital and liquidity arising from an obligor's failure to meet the terms of any contract with the institution or its failure to perform as agreed,which includes the potential impact of climate related risks, namely the physical and transition risks.
Issuer credit risk	The current or prospective risk to earnings, capital and liquidity arising from default or downgrade of issuer of security or contractual trading party. This includes e.g. loans, bonds and potential future exposure through OTC derivatives.
Counterparty credit risk	The current or prospective risk to earnings, capital and liquidity arising from the risk of a trading counterparty defaulting before the settlement date of a transaction, which includes the potential impact of climate related risks, namely the physical and transition risks.
Settlement risk	The current or prospective risk to earnings, capital and liquidity arising from the risk that the credit institution will deliver the asset sold or cash to the counterparty and will not receive the purchased asset or cash as expected. As such a settlement risk comprises credit risk and liquidity risk.
Securitization risk	The risk of loss associated with buying or selling asset-backed securities (investor perspective). The current or prospective risk to earnings, capital and liquidity arising from an obligor's failure to meet the terms of any contract with the institution or its failure to perform as agreed, in a securitized exposure that is not de-recognized for risk purposes (originator perspective).
Country risk	The current or prospective risk to earnings, capital and liquidity arising from the risk of exposure to losses caused by events in a specific country (countries where Bank does not have a local presence), which may be under the control of the government but not under the control of a private enterprise or individual.
Residual risk	The current or prospective risk to earnings, capital and liquidity arising from the risk that recognized risk measurement and mitigation techniques used by the firm prove less effective than expected.
Transfer risk	The current or prospective risk to earnings, capital and liquidity arising from the risk that the government will impose restrictions on the transfer of funds by debtors in the country in question to foreign creditors, either for financial or other reasons. This risk is almost exclusively related to foreign currency exposure.
Wrong way risk	The current or prospective risk to earnings, capital and liquidity arising from the risk that occurs when the exposure to a counterparty is adversely correlated with the credit quality of that counterparty.
Sovereign risk	The current or prospective risk to earnings, capital and liquidity arising from the credit risk related with all sovereign exposures, including the risk associated with the impact of changes of rating of Sovereign debt or events of default (Banking Book) and the risk arising from the possibility that changes in credit spreads will affect the value of financial instruments or contracts (fair value Banking Book exposures).
Migration risk	The current or prospective risk to earnings, capital and liquidity arising from the risk that a portfolio's credit quality will materially deteriorate over time without allowing a repricing of the portfolio to compensate the creditor for the now higher default risk being undertaken.
FX Lending	The current or prospective risk to earnings, capital and liquidity arising from an obligor's failure to meet the terms of any lending contract in non-local currency or increased probability of default in such contracts only due to changes in FX rates and not by the deterioration of the credit quality of the debtor.
Risk name	**Credit concentration risk**
Single name	The current or prospective risk to earnings, capital and liquidity arising from the risk associated with large individual exposures.
Sector	The current or prospective risk to earnings, capital and liquidity arising from significant exposures to groups of counterparts whose likelihood of default is driven by common industrial sector underlying factors.
Geography	The current or prospective risk to earnings, capital and liquidity arising from significant exposures to groups of counterparts whose likelihood of default is driven by common geographical underlying factors.
Risk name	**Liquidity risk**
Intra-day liquidity risk	The current or prospective risk to earnings, capital and liquidity arising from a liquidity constrains during the daily operations.
Short term cash flow risk	The current or prospective risk to earnings, capital and liquidity arising from an institution's inability to meet its liabilities when they come due in the short term.
Structural liquidity	The current or prospective risk to earnings, capital and liquidity arising from an institution's inability to meet its liabilities when they come due arising from balance sheet structural imbalances of assets and liabilities terms NSFR, including the potential impact of climate related risks, namely the physical and transition risks.
FX Liquidity Risk	The current or prospective risk to earnings, capital and liquidity arising from an institution's inability to meet its liabilities in foreign currency.
Funding concentration risk	The current or prospective risk to earnings, capital and liquidity arising from the potential cost to obtain additional funding to compensate significant and sudden withdraw from large funding providers.
Funding cost risk	The current or prospective risk to earnings, capital and liquidity arising from an increase in the cost of the wholesale funding of the Bank

Risk name	Market risk
Traded market risk	The current or prospective risk to earnings, capital and liquidity arising from adverse movements in bond prices, security or commodity prices, interest rates or foreign exchange rates in the trading book. It can arise from market making, dealing, and position taking in bonds, securities, currencies, commodities, or derivatives (on bonds, securities, currencies, or commodities).
CVA risk	The current or prospective risk to earnings, capital and liquidity arising from the fair value adjustment, required for OTC derivatives, due to the additional risk implied for positive fair values due to the counterparty inability to pay the required cash flows.
Non-traded market risk - FX rate risk BB	The current or prospective risk to earnings, capital and liquidity arising from the risk of holding or taking positions in foreign currencies in the banking book (e.g. in the form of loans, bonds, deposits or cross-border investments, including financial participations in foreign currencies).
Market concentration risk	The current or prospective risk to earnings, capital and liquidity arising from the risk of loss arising from a large position in a single asset or market exposure. An excessive concentration can give rise to liquidity risk or market risk losses (Trading Book).
Credit spread risk	The current or prospective risk to earnings, capital and liquidity arising from the possibility that changes in credit spreads will affect the value of financial instruments or contracts (including both trading and banking book positions) excluding fair value Banking Book sovereign debt portfolio.
Financial instruments Price Risk (BB)	The current or prospective risk to earnings, capital and liquidity arising from adverse movements in bond prices, security or commodity prices in the banking book (BB), which includes the potential impact of climate related risks, namely the physical and transition risks.
Default and migration risk	The current or prospective risk to earnings, capital and liquidity arising from the materialization of credit default and credit migration risks types.
Market liquidity risk	Also named "asset illiquidity risk". The current or prospective risk to earnings, capital and liquidity arising from positions that cannot easily be unwound or offset at short notice without significantly influencing its market price, because of insufficient market depth or market disruption. Includes risk from holding illiquid equity assets.
Valuation risk	The current or prospective risk to earnings, capital and liquidity arising from mispricing or pricing adjustments, due to complex pay-offs/pricing models or illiquidity / unobservability of pricing model's input parameters as well as adjustments made to the mid-price of fair valued positions (e.g. valuation adjustments on derivatives due to collateral, liquidity, funding costs, model risk, close out costs, etc.).

Risk name	Operational risk
Process risk	
Damage to physical assets	The current or prospective risk to earnings, capital and liquidity arising from damages to the Bank's physical assets, caused by accidental or deliberate events such as climate risks, natural disasters, terrorism or vandalism acts, etc.
Execution, delivery & process management	The current or prospective risk to earnings, capital and liquidity arising from errors in execution of operative processes (e.g., "fat finger errors"; lack of or loosing documentation), including failed process management and relations with counterparties and vendors (e.g. outsourcing), excluding ICT related risks.
External fraud risk	The current or prospective risk to earnings, capital and liquidity arising from external fraud.
Employment practices and workplace safety	The current or prospective risk to earnings, capital and liquidity arising from losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity/discrimination events.
Model risk	The current or prospective risk to earnings, capital and liquidity arising from the development or the use of any flawed of inappropriately applied models/algorithms, within the scope of pricing or transactions' decision making, internal capital quantification models or business decisions.
ICT risk	
ICT - Security risks	The current or prospective risk to earnings, capital and liquidity arising from a financial loss, disruption or damage to the reputation connected with activity online, internet trading, electronic systems and technological networks, as well as storage of personal data, (e.g., disruptive cyber-attacks and other external based attacks; inadequate IT physical or logical security).
ICT - Availability and continuity risk	Or "Business disruption and system failures". The current or prospective risk to earnings, capital and liquidity arising from disruption of business or system failures (e.g., inadequate capacity management; inadequate continuity and disaster recovery planning; dysfunctional data processing or handling; ill designed data validation controls in systems; ill designed and/or managed data architecture, data flows, data models or data dictionaries).
ICT - Data integrity risk	The current or prospective risk to earnings, capital and liquidity arising from data stored and processed by ICT systems incomplete, inaccurate or inconsistent across different ICT systems, for example as a result of weak or absent ICT controls during the different phases of the ICT data life cycle, impairing the ability of an institution to provide services and produce (risk) management and financial information in a correct and timely manner.
ICT change risk	The current or prospective risk to earnings, capital and liquidity arising from the inability of the institution to manage ICT system changes in a timely and controlled manner, in particular for large and complex change programmes (e.g., inadequate controls over systems changes and development; inadequate architecture; inadequate lifecycle and patch management).
ICT Outsourcing risk	The current or prospective risk to earnings, capital and liquidity arising from engaging a third party, or another Group entity (intra-group outsourcing), to provide ICT systems or related services adversely impacts the institution's performance and risk management (e.g. inadequate SLA, breaches in the SLA, fail of the providers).

Legal and compliance risk	
Compliance and conduct risk	Or "Clients, products & business practices". The current or prospective risk to earnings, capital and liquidity arising from violations or non-compliance with laws and regulations due to internal fraud or unintentional or negligent failure to meet a professional obligation to specific clients, including fiduciary and suitability requirements, from the nature or design of a product, or from market manipulation, antitrust or improper trade and customer conduct risk.
Financial crime risk	The current or prospective risk to earnings, capital and liquidity arising from violations or non-compliance with financial regulations (includes AML-Anti money laundering and CTF - Counter terrorism financing, sanctions and bribery)
Data protection risk	The current or prospective risk to earnings capital and liquidity arising from failing to ensure the data protection legal requirements.
Litigation risk	The current or prospective risk to earnings, capital and liquidity arising from court processes started by clients due to contractual disagreements.
Governance risk	The current or prospective risk to earnings capital and liquidity arising from violations or non-compliance with principles of good governance within the firm.
Risk name	**IRRBB – Interest Rate Risk in the Banking Book**
Behavioral and optional risk	The current or prospective risk to earnings, capital and liquidity arising from early unscheduled return of principal on interest rate sensitive asset and liabilities (e.g. changes in the behavioral profile of classes of customers and products, including embedded options.
Gap risk	The current or prospective risk to earnings, capital and liquidity arising from direct or indirect financial losses in the banking book due to movements in interest rates and mismatch between assets and liabilities, making the bank vulnerable to changes in the yield curve, under the current behavioral and prepayment customer and product profiles
Basis risk	The current or prospective risk to earnings, capital and liquidity arising from imperfect hedges.
Risk name	**Business risk**
Economic risk	The current or prospective risk to earnings, capital and liquidity arising from the uncertainty in revenues in the short run (< 1 year) due to unforeseen changes in the economic and competitive environment as well as risk of regulatory changes and requirements.
Strategic risk	The current or prospective risk to earnings, capital and liquidity arising from changes in strategy and from adverse business decisions.
Participations	The current or prospective risk to earnings, capital and liquidity arising from the risk of depreciation of strategic financial participations outside the consolidation perimeter.
IT Strategy risk	The current or prospective risk to earnings, capital and liquidity arising from misalignment between the IT framework and the strategy of the Bank
Risk name	**Reputational risk**
Reputational risk	The current or prospective risk to earnings, capital and liquidity arising from adverse perception of the image of the financial institution on the part of customers, counterparties, shareholders, investors or regulators due to actions of any BCP Group entity or its employees, which may also result from potential impact of climate related risks, namely the physical and transition risks.
Industry-wide reputational risk	The current or prospective risk to earnings, capital and liquidity arising from adverse perception of the image of the financial institution on the part of customers, counterparties, shareholders, investors or regulators due to actions of the wider industry.
Insurance reputation	The current or prospective risk to earnings, capital and liquidity arising from reputational risk associated with the selling process of financial insurance.
Risk name	**Other risks**
Real estate risk	The current or prospective risk to earnings, capital and liquidity arising from changes in value of firm-owned real estate
Step-in risk	The current and prospective risk to earnings, capital and liquidity due to the need of the Bank, by reputational reasons, to provide financial support to an entity beyond or in the absence of contractual obligations, should the entity experience financial stress (unconsolidated entities, only)
Pension fund risk	The current or prospective risk to earnings, capital and liquidity arising from the risk associated with the uncertainty surrounding required contributions to defined benefit pension schemes or with market rates movements that could lead to direct or indirect financial losses in the pension fund assets.
Underwriting risk	The current or prospective risk to earnings, capital and liquidity arising from the risk associated with underwriting issuance of equity or debt securities.
Equity risk	The current or prospective risk to earnings, capital and liquidity arising from the risk associated with the issuance stock at incorrect risk premiums.
Insurance risk	The current or prospective risk to earnings, capital and liquidity arising from the risk associated with future income/expenses due to life insurance business arm.
Re-hypothecation risk	The current or prospective risk to earnings, capital and liquidity arising from the risk associated with the use of assets that have been posted as collateral by bank´s clients.
Geo-political risks	The current or prospective risk to earnings, capital and liquidity arising from the risk associated with political and/or economic and/or military developments in particular geographies where the Group operates or which may indirectly impact Group operations.
Resolution fund risk	The current or prospective risk to earnings, capital and liquidity arising from the value of the increase in the future contributions to the Resolution Fund.
Circumstantial risks	Other risks that should be evaluated in specific moments on time which due to its temporary nature do not require to be systematically evaluated every year.

The set of risks identified as material risks in the Risk Identification Processo of 2020 are disclosed in the Table 19 of this report.

3.9. Reporting and risk measurement systems

The BCP Group has implemented an IT infrastructure – SAS Solution for Risk Management - that includes the Risk Office Data Mart (RODM) and SAS Risk Dimensions that capture the majority of the risk exposure at a Group level.

SAS Solution for Risk Management is a complete end-to-end application for measuring, exploring, managing, regulatory reporting (COREP/FINREP) and ALM (Assets & Liabilities Management), among other objectives. This solution integrates data access, mapping, enrichment, and aggregation with advanced analytics and flexible calculation and reporting, all in an open, extensible, client server framework.

The Risk Office DataMart (RODM) is an information repository that was designed to support the risk analysis and capital calculation. This application allows the collection of specific and relevant information in terms of risk, from all relevant systems of the Group (domestic and international operations).

RODM aggregates and manages several types of information, namely financial, transactions, customer details, ratings, customer limits, collaterals / guarantees.

The data is obtained directly from the Group's IT systems through automated procedures, which regularly stores data into the RODM, corresponding to the Group's position by the end of each month. The procedures for the loading of updated data were designed by the Group's IT Division at the Risk Office's request and involve the feeding of data from the Group's operational systems, concerning transactions, positions or entities (clients and counterparties) registered into those systems.

The information stored in RODM is used to feed the SAS Risk Dimensions, a simulation software that implements advanced methods for credit risk management, performs risk assessment and mitigation of credit risks through an optimized allocation process, calculates the capital requirements for Pillar I and produces sensitivity analysis and feeds into stress tests exercises. This solution also covers liquidity risk and interest rate risk management.

The main outcomes from this system are:

- Assets & Liabilities Management (ALM), including interest rate risk identification and calculation for all balance sheet (and off-balance) interest-sensitive items, and Gap Analysis for liquidity risk control.
- Capital requirements calculation.
- Regulatory reporting, namely COREP and FINREP.

It also enables Credit risk analysis, monitoring and reporting, such as exposures, risk weighted assets, Non-Performing Loans, concentration risk, impairment and other credit risk indicators that can be aggregated by geography, business line, product, etc.

Data quality is an essential tool for risk information and therefore to a sound and effective risk management. The Bank is implementing the BCBS 239 Project - Governance and Data Quality, which develops permanently processes and enhancements to comply with the principles for effective risk data aggregation and risk reporting, as presented in BCBS 239, the Basel Committee on Banking Supervision (BCBS) Principles for effective risk data aggregation and risk reporting.

The Bank has established an operating model for Data Quality and Governance, based on segregated responsibilities:

- In the first line of defense, roles deal with the Bank's daily operations and, as a result, ensure a proper usage of data and fulfilment of its requirements.
- In the second line of defense, functions aid the first line by monitoring and providing recommendations, such as setting standards, policies, and procedures.
- In the third line of defense, functions are independent from the Governance and Data Quality framework, allowing them to ensure compliance with the BCBS 239 principles and guarantee that the Bank's objectives and strategy are also aligned.

The process is supported by a complete set of internal regulations and procedures detailing the Bank's Data Governance and Quality model, in accordance with the guidelines of the Group Data Officer (CDO), responsible for defining the global principles and rules applicable throughout the Group and published in the form of Group Codes. In addition, the Group CDO is also responsible for monitoring compliance across the group, in coordination with the CDOs of the subsidiaries.

The Governance and Data Quality supervisory functions were incorporated in the Security and Data Quality and Protection Commission.

Data quality metrics were added to the BCP Group RAS.

The risk management and control information need of the governing bodies are fulfilled by the production of several periodic risk reports, presented to the Committees and Commissions of the Bank. The highest level reports are the RAS Monitoring Report, presented monthly to the Board of Directors, the Executive Committee and the Committee for Risk Assessment and the Key Risk Indicators, covering in detail all material risks of the Bank, presented monthly to the Executive Committee and Committee for Risk Assessment.

3.10. Regulatory calculation methodologies

Following the request submitted by Millennium bcp in the first six months of 2009, the Bank received authorisation from Banco de Portugal to use the advanced approach (internal model) for the generic market risk and to use the standard approach for operational risk.

Banco de Portugal authorised, with effects as of 31 December 2010, the adoption of methodologies based on the Internal Ratings Based models (IRB) for the calculation of capital requirements for credit and counterparty risk, covering a substantial part of the risks of the activity in Portugal.

Subsequently, within the scope of the gradual adoption of the IRB approach in the calculation of capital requirements for credit and counterparty risks, Banco de Portugal authorised the extension of this methodology to the subclasses "Renewable Retail Positions" and "Other Retail Positions" in Portugal, effective as of 31 December 2011.

With reference to 31 December 2012, Banco de Portugal authorised the use of own estimates of Credit Conversion Factors (CCF) for the "Corporate" risk class in Portugal and the adoption of IRB models for "Loans secured by residential real estate" and for "Renewable Positions" in the retail portfolio of Bank Millennium, the Group's subsidiary in Poland.

On 31 December 2013, Banco de Portugal authorised the extension of the IRB method to the real estate promotion segment, as well as the adoption of own estimations of LGD (Loss Given Default) for the "Corporate" exposures in Portugal.

Without prejudice to the provision of more detailed information in the next chapters, it is shown in the following table as a summary of the calculation methodologies of the capital requirements used in the regulatory reporting as well as of the respective geographic application scope.

TABLE 7 – CALCULATION METHODS AND SCOPE OF APPLICATION

	31 Dec. 20	31 Dec. 19
CREDIT RISK AND COUNTERPARTY CREDIT RISK		
PORTUGAL		
Retail	IRB Advanced	IRB Advanced
Corporates	IRB Advanced [1]	IRB Advanced [1]
POLAND		
Retail		
- Loans secured by residential real estate	IRB Advanced	IRB Advanced
- Renewable positions	IRB Advanced	IRB Advanced
OTHER EXPOSURES (ALL ENTITIES OF THE GROUP)	Standardised	Standardised
MARKET RISKS [2]		
Generic market risk in debt and equity instruments	Internal Models	Internal Models
Foreign exchange risk	Internal Models	Internal Models
Commodities risk and market risk in debt and equity instruments	Standardised	Standardised
OPERATIONAL RISK [3]	Standard	Standard

[1] Excluding exposures derived from the SOE rating systems and the simplified rating system, which were weighted by the standardised approach.
[2] For exposures in the perimeter centrally managed from Portugal; for all other exposures the only approach applied is the standardised method.
[3] The adoption of the standard method of operational risk was authorised in 2009 for application on a consolidated basis.