

MARKET
DISCIPLINE
2010

A stylized graphic of two hands holding a leaf. The hands are rendered in a light yellow color with darker yellow accents on the fingers. The leaf is a vibrant yellow with a darker yellow vein. The background is a grid of squares in various shades of yellow and orange.

Montepio



Market Discipline

2010

June 30, 2011

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Foreword

This document uses regulatory reporting information in order to comply with the Notice no. 10/2007 of Bank of Portugal regarding the public disclosure of information, which states that the information provided should adequately cover the risks incurred, taking into account strategic goals and the processes and assessment systems in place. All analyses are based on year-end 2010 data.

1. Responsibility Statement

With regards to the information presented in the document "Market Discipline", the board of directors of Caixa Económica Montepio Geral (CEMG) certifies:

- That all procedures deemed necessary were carried out and that, to the best of its knowledge, all information disclosed is true and accurate;
- The accuracy of all information disclosed;
- The prompt disclosure of any significant changes occurred meanwhile..

Between the cut-off date of December 2010 and the publication date the following relevant events occurred:

On March 31, 2011 CEMG acquired 100% of the common equity and voting rights of Finibanco – Holding, SA, from Montepio Geral Mutual Association.

After this deal, on April 4, Finibanco, SA, transferred all its assets and liabilities to CEMG, with the exception of real estate assets owned by Finibanco, SA, which were acquired through foreclosures or leasing contracts (securities and real estate) in which Finibanco, SA is the lessee.

2. Scope and risk management policies

2.1 Scope

This report covers both CEMG and Banco Montepio Geral Cabo Verde - Sociedade Unipessoal, S.A. (IFI), using the consolidated accounts of the group.

2.2 Risk management strategies, processes, structure and organisation

Risk analysis and control at CEMG are the responsibility of the Risk Department (DRI), which advises the board of directors on measures for risk management. Implementation of risk management and control mechanisms is, in general, the responsibility of the areas where the risks in question arise.

As recommended by the Basel Committee, the DRI reports directly to the board of directors and enjoys independence from the departments responsible for commercial decision-making. Additionally, and also independently, the Internal Audit and Inspection Department analyses the adequacy of processes, and their implementation, from the standpoint of internal and external rules.

The DRI encompasses three units:

- (i) **Credit Risk Unit** - responsible for developing internal credit risk analysis models and incorporating them in decision-making processes, and also for regulatory reporting on capital and internal reports on credit risk;
- (ii) **Market Risk Unit** - performs analysis and regulatory and internal reporting on market, interest rate, exchange rate and liquidity risks, as well as being responsible for incorporating that information in the decision-making processes of the dealing-room;
- (iii) **Operational Risk Unit** – responsible for operational risk management.

As identified in the risk assessment model developed by the Bank of Portugal, CEMG is exposed to a diverse set of risks. Most significant among these are credit and liquidity risks.

The main principle of **credit risk** analysis is independence from commercial decision-making, with direct reporting to the board of directors. In this type of analysis, different tools are used, and rules defined, according to the size of the exposure, the degree of familiarity with the type of risk in question (e.g. the capacity to model those risks) and the liquidity of the instruments in question.

The analysis of loans is based on the mandatory use of risk assessment models, developed in-house in accordance with the requirements of the Basel Committee.

Thus, in retail operations (typically smaller amounts), specific scoring models are used for the main credit portfolios (i.e. mortgages, personal loans and credit cards), differentiating between customers based on the length of their relationship with the institution.

In the Small-Business segment, a scoring model is used to evaluate not only the creditworthiness of the business, but also of its promoters.

In the Corporate segment, customers are classified according to an internal rating model that includes four components:

- (i) quantitative (economic and financial information);
- (ii) qualitative (management quality and reputation);
- (iii) sector-oriented;
- (iv) behavioural (banking relationship).

The degree of scrutiny in credit risk analysis is based on the scale of the operations concerned. The reports produced by credit analysts have differing content depending on the size of the client and exposure in question, requiring deeper analysis in the case of larger exposures.

These reports include the internal risk rating and the limits to exposure defined for the loan maturity, taking into account the client capacity to generate cash flows and its financial costs, as well as the absorption of CEMG's own funds by unexpected losses on operations (a restriction that tends to be binding only on larger loans).

The pricing of loans reflects the corresponding expected loss, along with the cost of borrowed capital and of own funds, as well as administrative costs. In quantifying the expected loss, the marginal probability of default for the loan maturity and the internal risk class is taken into consideration, as is the severity of the loss, quantified by market estimates, taking into account the type of credit and collateral. Pricing also reflects the strength of the commercial relationship with customers and associates of the Montepio Geral Mutual Association.

Overriding the response of scoring systems, internal ratings and internal pricing tables is allowed, though only with hierarchical approval, in accordance with principles of delegation

established. Rejection criteria are defined to minimise the risk of adverse selection, assuring that there is always at least one rejection class.

Thus, credit rejections are determined by the existence of credit events in the financial system, breach of credit rules (e.g. borrowing capacity) and whenever the incorporation of risk in pricing significantly increases the risk of adverse selection.

Intervention thresholds are also defined for the different decision-making levels, based on the size of the operation and overall customer exposure, type of operation/collateral and pricing/ROE (Return on Equity). In this context, the guiding principle is that the authority to approve operations with a lower risk-adjusted ROE, or larger exposure, lies with the higher levels of management. These thresholds are approved by the board of directors. At the top of the decision-making hierarchy is the board of directors, which exercises its authority through the Credit Committee. This decision forum has the participation of the heads of the commercial departments, the DRI and the Credit Analysis Department (DAC).

In the field of **market risk**, Value-at-Risk (VaR) is a fundamental instrument in analysing and imposing limits on exposure. Financial activity is frequently monitored through reports on asset portfolios and also counterparty risk reports. There are limits for products which require more complex analysis.

Quantitative limits on exposure to asset classes and financial and sovereign issuers are also in place.

Weekly reports are prepared for several of CEMG's portfolios, as well as a report on the overall exposure to counterparties, accompanied by the evolution of the established limits. These reports analyse the concentration, credit, interest rate and price-variation risk, among others. This analysis takes into account different scenarios, for example, changes in interest rates, spreads, market prices and credit quality of counterparties.

In terms of **liquidity and interest rate risks**:

- Static and dynamic 12-month gaps are regularly calculated, in accordance with monthly reports submitted to the Bank of Portugal. In this context, CEMG also performs simulations of potential adverse events.
- The liquidity position and its evolution are monitored daily, by the Financial Department, and on a monthly basis by the ALCO Committee, where the medium and long term risks are also addressed. In addition to mismatches, the concentration of funding, principal repayments of liabilities expected, and existing and prospect funding sources are also analysed.
- An analysis of Balance Sheet interest rate risk is also presented to the ALCO Committee. The balance sheet characterisation and the sensitivity analysis of the net interest income and earnings of various risk factors play a key role in this committee.
- At the same time, CEMG has been calculating the metrics defined by Basel III and monitoring all developments regarding this issue. The ratios established are already calculated on a regular basis in order to adapt to the new requirements.

In an important development, in terms of **operational risk**, Montepio obtained authorisation from the Bank of Portugal, effective 30 June 2010, to adopt the Standard Method (TSA) for the purposes of calculating the minimum capital requirements to cover operational risk.

The operational risk management system implemented is based on identifying, assessing, monitoring, measuring, mitigating and reporting risks of this type. In terms of organisational

structure, there is a department exclusively dedicated to operational risk management, complemented by operational risk partners in the units.

The main management tools are periodic self-assessments of risk and control, capture of loss events from operational risk, monitoring and development actions to mitigate operational risk—specifically for business continuity—and production of periodic (quarterly and annual) reports on CEMG's operational risk profile.

Starting in the last quarter of 2010, in order to align with best practices and recommendations, an approval process was put in place for the operational risk of new products, processes or activities, or of existing ones which have changed significantly. This involves the identification and analysis of key operational risks and recommendations for their mitigation.

In terms of **business continuity** a process is being implemented which aims to mitigate risk by ensuring the continuity of operations in case of a disruptive event.

Internal committees focusing on risk management issues have also been instituted, namely the monthly Risk and Internal Control Committee, where the DRI is responsible for the coordination and presentation of the relevant risk indicators and information. In addition, the DRI is part of the ALCO Committee, the Investment and Management Committees of Futuro (in charge of Montepio's Pension Fund management) and the Monitoring Committee of Montepio's Pension Fund.

2.3 Scope and nature of risk measurement and information systems

The risk analysis procedures at CEMG involve regular reports on the main types of risk to the board of directors and the business areas related. Regarding credit risk, monthly internal reports are produced, with information broken down by commercial department, the main credit portfolio risk indicators and metrics on the use of risk models. In addition, a half-yearly report is produced, with more aggregated risk information. A watchlist summarising exposures that deserve closer supervision and action is regularly drawn up for the Credit Committee to examine and discuss. A weekly report on exposures to counterparty risk is also produced.

In the area of market risk, given the relatively small size of the trading book, a weekly risk report is prepared for this portfolio. Weekly risk reports are also done for the proprietary portfolio of available for sale assets and a monthly report on the pension fund portfolio. These reports contain information on market risk (e.g. Value-at-Risk), credit risk (external ratings and credit VaR), compliance with VaR and portfolio composition limits by rating, type of security and issuer. A weekly report on overall exposure is produced, reporting total counterparty exposure.

At the operational risk level, a set of monitoring reports is released internally, on a quarterly or yearly basis, depending on the users. Additionally, the software tool GIRO (Integrated Operational Risk Management) includes a module dedicated to reporting—based on data provided by the Identification and Monitoring stages of the Operational Risk Management Cycle implemented at CEMG—organised and made available to different users according to their profile.

Risk control techniques and models for credit risk are based on econometric modelling using CEMG's own experience in granting different types of credit and also, wherever possible, in terms of recovery.

Thus, internal rating models are used for the corporate segment and reactive scoring models are used for lending to retail and small businesses. The models used for corporate and small business clients distinguishes between the construction sector and other economic sectors, while in retail lending specific models are used for each of the main credit portfolios—mortgage loans, personal loans and credit cards—and a distinction is made between individuals who have been customers of CEMG for more than a year and others.

Internal rating models classify companies into seven “performing” risk classes and a final class corresponding to default¹. Taking into account relative 1-year frequencies of default, these classifications can be mapped to Moody’s rating classes as shown in the table below:

Table 1 - Mapping between internal ratings and Moody’s ratings

| Rating Model for the Construction Sector | | Rating Model for Other Sectors | |
|--|------------------------------|--------------------------------|------------------------------|
| Internal Rating | Corresponding Moody's Rating | Internal Rating | Corresponding Moody's Rating |
| 1 | Aaa-Baa3 | 1 | Aaa-Baa3 |
| 2 | Baa3 | 2 | Ba1 |
| 3 | Ba1 | 3 | Ba1 |
| 4 | Ba3 | 4 | Ba2 |
| 5 | B1 | 5 | Ba3 |
| 6 | B2 | 6 | Ba3 |
| 7 | B3 | 7 | B2 |

The reactive scoring models, for mortgage loans and personal loans, use a scale that includes 10 classes for each portfolio, in both cases aggregating pre-existing and new customers. Application credit card scoring classifies credit proposals into four risk classes.

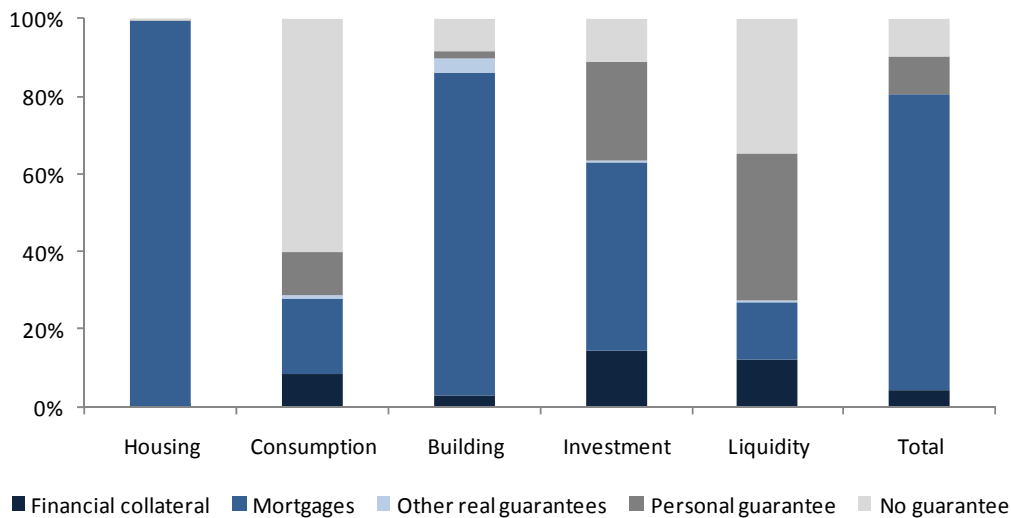
2.4 Risk coverage and mitigation policies

Collateral requirements depend on the size of the unexpected loss for a given loan and typically apply to operations of greater volume, especially those that involve lending for construction or residential housing purchases. When operations involve real collateral, the loan-to-value ratio is taken into consideration for purposes of pricing, as an indicator of the loss severity.

Different coverage policies are defined for different types of credit. The distribution of guarantee type for each credit portfolio segment is shown below:

¹ This seventh risk class also includes companies that are in default within the Portuguese financial system, despite being classified as performing on all credits at Montepio.

Chart 1 – Distribution of types of guarantee by credit segment ²



Risk mitigation through collateralization is considered when calculating the price of operations, either by way of the borrower's credit risk (in the case of real collateral), or through reduction of the exposure level, in situations involving financial collateral (where the market risk of the assets involved is taken into account).

As a rule, personal guarantees are required in retail loans whenever the customer does not comply with debt-to-income rules, while in the context of corporate credit they are standard for loans involving larger amounts, for smaller companies, and wherever there is a need to further mitigate risk, in light of the operation's collateralization.

3. Capital adequacy

3.1 Regulatory Capital

The regulatory capital for solvency purposes includes core and complementary capital, minus the negative components of each.

Core or Tier 1 capital is understood to mean:

- Paid-in share capital;
- Issue premiums on shares and participation securities;
- Legal, statutory and other reserves made up of retained earnings;
- Positive results for the year in progress and previous years, net of provisions, depreciation, tax and expected dividends.

Complementary or Tier 2 capital is understood to mean:

Upper Tier 2

- Revaluation differences on assets available for sale;
- Revaluation reserves on fixed assets;
- Other authorised reserves;
- Subordinated liabilities with no fixed term to maturity;

² In the case of operations with multiple guarantees, the amount in question has been allocated to the guarantee with the greatest liquidity (e.g. financial collateral). The amounts shown under personal guarantee correspond to operations with no other collateralization.

Lower Tier 2

- Participation securities;
- Subordinated loans;
- The released portion of redeemable preference shares;

Negative elements of regulatory capital correspond to:

- Own shares;
- Assets held by the bank that are part of the regulatory capital of a third party;
- Intangible fixed assets;
- Negative results for the year in progress and previous years;
- Negative revaluation reserves.

3.2 Internal capital allocation

CEMG's capital requirements for credit, market and operational risk, as of December 31, 2010, were calculated using the Standardised approach, in accordance with the regulations of the Bank of Portugal (Notices 5/2007, 8/2007 and 9/2007, respectively).

The following table shows the distribution of capital requirements for various types of risk:

Table 2 – Capital Requirements by Risk Type

| | (thousand euros) | | | |
|---------------|------------------|-------------|------------------|---------|
| | Credit Risk | Market Risk | Operational Risk | Total |
| Dez-09 | 737.373 | 2.986 | 62.346 | 802.705 |
| Dez-10 | 767.097 | 1.721 | 55.495 | 824.313 |

- (a) The operational risk requirement for 2009 was calculated in accordance with the basic indicator approach, while for 2010 the Standardised approach was used.

Within capital requirements for credit and counterparty risk, approximately 93% corresponds to the loan portfolio.

3.3 Capital adequacy

The Montepio Group strives to provide CEMG with a level of capital appropriate for the evolution of its business, which will ensure satisfactory solvency indicators, consistent with the regulatory recommendations.

CEMG's Institutional Capital, has been consistently strengthened in recent years. In September, 2010, the Capital was increased by 40 million euros to 800 million euros, reinforcing Core Capital and improving the Tier 1 ratio from 9,08% to 9,12%.

At the same time, CEMG has secured resources in the form of subordinated debt, which are included in the Complementary Own Funds and benefit the Total Solvency Ratio. It is thus concluded that CEMG is adequately capitalized, taking into account the ratios presented above.

In light of the strategic plan drawn up for the three-year period of 2009-2011 and the business plan for the current year, no significant changes are anticipated in the material dimensions of the various types of risk. With regards to retail lending, greater collateralization of new loans is

expected, together with a drop in the average loan-to-value ratio, allowing for lower capital requirements. This guideline has been implemented in recent years as part of the institution's credit policy.

The current strategy of diversification across economic sectors, particularly in the corporate segment, will work in the opposite sense regarding collaterals. Exposure will be increased in sectors not related to civil construction, reducing the collateralization of new loans, although such exposures will be priced to adequately reflect the risks incurred.

The magnitude of such effects will tend to converge in terms of capital requirements. A strategy of gradual capital reinforcement will be pursued, in order to maintain the levels of solvency set forth in the Bank of Portugal's Notice 3/2011, namely, Core Tier I ratio no less than 9% in Dec-11 and 10% in Dec-12.

Montepio's total solvency and Tier 1 ratios are higher than those of the main Portuguese banks, as shown by the tables below.

Table 3 – Solvency ratio, 2004-2010

| Bank | Moody's Rating | Assets (millions € 2010) | Solvency Ratio | | | | | | |
|-------------|----------------|--------------------------|----------------|------|------|------|------|------|------|
| | | | 2010 | 2009 | 2008 | 2007 | 2006 | 2005 | 2004 |
| Montepio | Baa3 | 18.250 | 12,9 | 12,8 | 11,4 | 8,9 | 9,8 | 10,7 | 11,7 |
| Maximum (1) | | 125.871 | 12,5 | 13,1 | 11,3 | 13,3 | 13,1 | 12,9 | 12,1 |
| Minimum (1) | | 12.129 | 10,3 | 11,0 | 10,5 | 9,6 | 9,5 | 11,5 | 9,4 |
| Mean (1)* | | 72.573 | 11,4 | 11,8 | 10,3 | 10,4 | 10,8 | 12,4 | 9,2 |

¹ with reference to the five largest Portuguese banks

* weighted by assets

Table 4 – Tier 1 ratio, 2004-2010

| Bank | Moody's Rating | Assets (millions € 2010) | Tier 1 Ratio | | | | | | |
|-------------|----------------|--------------------------|--------------|------|------|------|------|------|------|
| | | | 2010 | 2009 | 2008 | 2007 | 2006 | 2005 | 2004 |
| Montepio | Baa3 | 18.250 | 9,1 | 9,1 | 8,0 | 6,5 | 7,0 | 6,8 | 7,6 |
| Maximum (1) | | 125.871 | 9,2 | 9,3 | 8,8 | 7,7 | 8,4 | 7,4 | 8,1 |
| Minimum (1) | | 12.129 | 8,5 | 8,3 | 6,6 | 5,5 | 6,6 | 6,4 | 6,2 |
| Mean (1)* | | 72.573 | 8,8 | 8,8 | 6,9 | 6,5 | 7,2 | 7,1 | 5,8 |

¹ with reference to the five largest Portuguese banks

* weighted by assets

The following Tables 5 to 7 provide a summary of solvency figures in 2010, taking into account only Pillar I requirements.

Table 5 – Capital adequacy for regulatory capital purposes

(thousands €)

| Capital adequacy - Part 1 | Dec-10 | Dec-09 |
|---|-----------|-----------|
| 1. Total regulatory capital for solvency purposes | 1.324.048 | 1.285.121 |
| 1.1. Core capital | 956.212 | 923.552 |
| 1.1.1. Eligible share capital | 800.000 | 760.000 |
| 1.1.1.1 Paid-in share capital | 800.000 | 760.000 |
| 1.1.2. Eligible reserves and results | 195.630 | 196.336 |
| 1.1.2.1 Reserves | 196.085 | 196.224 |
| 1.1.2.3 Results from the previous year and provisional results for the current year | 0 | 567 |
| 1.1.2.7 Revaluation differences eligible for base regulatory capital | -455 | -455 |
| 1.1.3. Fund for general banking risks | 0 | 0 |
| 1.1.4. Other items eligible for core capital | 23.704 | 31.082 |
| 1.1.4.1 Impact of transition to the IAS/AAS (negative impact) | 15.792 | 22.207 |
| 1.1.4.2 Other items eligible for core capital | 7.912 | 8.875 |
| 1.1.5. (-) Other items deductible from core capital | -63.122 | -63.866 |
| 1.1.5.1 (-) Intangible fixed assets | -18.254 | -16.151 |
| 1.1.5.3 (-) Other items to be deducted from core capital | -44.868 | -47.714 |
| 1.2. Complementary capital | 405.506 | 396.154 |
| 1.2.1. Upper Tier 2 | 27.506 | 18.154 |
| 1.2.2. Lower Tier 2 | 378.000 | 378.000 |
| 1.2.3. (-) Deductions from complementary capital | 0 | 0 |
| 1.3. (-) Deductions from core and complementary capital | -33.107 | -25.507 |
| 1.3.a. Of which: (-) From core capital (82) | -16.554 | -12.753 |
| 1.3.b. Of which: (-) From complementary capital (83) | -16.554 | -12.753 |
| 1.4. Total core capital for purposes of solvency (87) | 939.658 | 910.799 |
| 1.5. Total complementary capital for purposes of solvency (88) | 388.952 | 383.400 |
| 1.6. (-) Deduction from total regulatory capital (89) | -4.562 | -9.079 |
| 1.7. Total complementary capital available to cover market risks | 0 | 0 |
| 1.8. For the record: | 0 | 0 |
| 1.8.4. Reference capital for the purpose of limits in relation to large risks | 1.324.048 | 1.285.121 |

Table 6 – Capital adequacy for capital requirement purposes

| | | (thousands €) | |
|---------------------------|---|---------------|---------|
| Capital adequacy - Part 2 | | Dec-10 | Dec-09 |
| 2. | Regulatory capital requirements | 824.313 | 802.705 |
| 2.1. | For credit risk, counterparty credit risk, risk of decrease in receivables and delivery risk | 767.097 | 737.373 |
| 2.1.1. | Standardised approach | 767.097 | 737.373 |
| 2.1.1.1. | Risk classes in the standardised approach excluding securitisation positions | 766.340 | 737.373 |
| 2.1.1.1.1. | Claims or conditional claims on central governments and central banks | 11 | 249 |
| 2.1.1.1.2. | Claims or conditional claims on regional governments and local authorities | 1.780 | 716 |
| 2.1.1.1.3. | Claims or conditional claims on public sector entities and other non-profit public institutions | 1.826 | 24 |
| 2.1.1.1.6. | Claims or conditional claims on banks | 33.533 | 23.764 |
| 2.1.1.1.7. | Claims or conditional claims on companies | 283.295 | 234.705 |
| 2.1.1.1.8. | Claims or conditional claims on the retail portfolio | 62.380 | 92.242 |
| 2.1.1.1.9. | Claims or conditional claims secured by real estate | 317.932 | 324.793 |
| 2.1.1.1.10. | Items past due | 41.167 | 51.597 |
| 2.1.1.1.12. | Mortgage bonds and public sector bonds | 431 | 169 |
| 2.1.1.1.13. | Exposures to collective investment undertakings | 458 | 747 |
| 2.1.1.1.14. | Other items | 23.527 | 8.368 |
| 2.1.1.2. | Securitisation exposures in the standardised approach | 757 | 0 |
| 2.1.1.3. | (-) Provisions for general credit risks | 0 | 0 |
| 2.2. | Settlement risk | 0 | 0 |
| 2.3. | Capital requirements for position risk, foreign exchange risk and commodities risk | 1.721 | 2.986 |
| 2.3.1. | Standardised approach | 1.721 | 2.986 |
| 2.3.1.1. | Debt instruments | 1.331 | 2.808 |
| 2.3.1.2. | Equity securities | 389 | 178 |
| 2.3.1.3. | Exchange rate risk | 0 | 0 |
| 2.3.1.4. | Commodities risk | 0 | 0 |
| 2.4. | Capital requirements for operational risk | 55.495 | 62.346 |
| 2.4.1. | Basic indicator method | 0 | 62.346 |
| 2.5. | Regulatory capital requirements - fixed general expenditure | 0 | 0 |
| 2.6. | Temporary capital requirements or other capital requirements | 0 | 0 |

Table 7 – Total Capital adequacy

| | | | (thousands €) | | |
|---|--|----------|---------------|--|--|
| Capital Adequacy - Part 3 | | Dec-2010 | Dec-2009 | | |
| Surplus (+) / Shortfall (-) in regulatory capital | | 499.735 | 482.416 | | |
| Solvency ratio (%) | | 12,85% | 12,81% | | |

4. Counterparty credit risk

4.1 Exposure Limits

Various limits have been defined for the most relevant risks faced in the course of business. In measuring counterparty credit risk, particular attention is paid to large-risk limits, which are set for money market exposures, based on banks' ratings and profit levels.

4.2 Assessment policies of collaterals

Given the credit quality (rating) of counterparties and the limited level of exposure, no guarantees are required for these operations.

4.3 Quantitative information

As illustrated in Table 8, CEMG's counterparty risk exposures are proportionally low compared to the total portfolio (below 10% of total exposure) and mostly associated with central government entities or financial institutions.

Table 8 – Counterparty credit risk

| | (Thousands €) | | | | |
|---|-------------------|---|--------------------------------|------------------------|--------|
| | Original Exposure | Credit risk mitigation techniques with substitution effect in the original net exposure (a) | Exposure after risk mitigation | Risk-weighted exposure | |
| | | | | Dec-10 | Dec-09 |
| | 1 | 2 | 3 | 4 | 5 |
| Repos, borrowing / lending of securities or commodities, long settlement transactions or transactions with the imposition of margin loans | 6.133 | 0 | 6.133 | 1.227 | 3.601 |
| Derivatives | 153.226 | 0 | 153.226 | 35.984 | 30.990 |
| Contractual netting multiproduct | 0 | 0 | 0 | 0 | 0 |

In the calculation of the exposure value—where derivatives, repurchase transactions, borrowing or lending of securities or commodities, long term settlement transactions and lending operations with the imposition of margin are concerned—the Mark-to-Market valuation method is used, as defined in the Bank of Portugal's Notice 5/2007, Annex V, Part 3. This method consists of adding a potential-future-value adjustment to the market value of the exposure, which is calculated by multiplying the notional value by a regulatory factor defined according to the type of contract and its residual maturity.

As of December 31, 2010, CEMG had no credit risk hedging operations via credit derivatives, as shown in Table 9.

Table 9 – Credit Derivatives Hedging

| Risk Class (hedged transactions) | Original Exposure (hedged transactions) | | Notional Amount of the Credit Hedging Derivatives | | | | | (thousands €) | |
|---|---|------|---|---------|---------|-------|-----------|---------------|--|
| | 2010 | 2009 | CDS (1) | TRS (2) | CLN (3) | Other | Total | Total | |
| | | | | | | | 2009 | 2008 | |
| | 1 | 2 | 3 | 4 | 5 | 6 | 7=3+4+5+6 | 8 | |
| CL I - Central government and central banks | | | | | | | | | |
| CL VI - Institutions | | | | | | | | | |

CL I - Central government and central banks

CL VI - Institutions

(1) CDS: Credit Default Swaps

(2) TRS: Total Return Swaps

(3) CLN - Credit Linked Notes

At the same date, CEMG had the following investment exposure to credit derivatives (considered at market value):

Table 10 – Credit Derivatives Instruments

(thousands €)

| Transactions in Credit Derivatives | Long Positions | | Short Positions | |
|---|----------------|-------|-----------------|------|
| | 2010 | 2009 | 2010 | 2009 |
| I. Credit Portfolio (totals): | | | | |
| a) Credit Default Swaps | 765 | 835 | 1.516 | 460 |
| b) Total Return Swaps | | | | |
| c) Credit Linked Notes | 4.681 | 6.699 | | |
| d) Other Credit Derivatives | | | | |
| II. Trading Transactions (totals): | | | | |
| a) Credit Default Swaps | | | | |
| b) Total Return Swaps | | | | |
| c) Credit Linked Notes | | | | |
| d) Other Credit Derivatives | | | | |

Long Positions - Theoretical value of the acquired protection

Short Positions - Theoretical value of the sold protection

5. Credit risk

5.1 Definitions

For accounting purposes, the following definitions apply:

- **Past due credit:** all payments of capital and interest not made on the date they fall due;
- **Loans subject to impairment:** all loans that, according to the analysis carried out individually—for Individually Significant loans—or collectively—for those included in the homogeneous populations—suggest expectations of loss or display impairment signs. These signs are defined by an internal model and include past due loans, restructured credit and registration as a risky user in the Bank of Portugal database;
- **Past due loans:** all loans with payments in arrears;
- **Value corrections:** derive from the regulatory provisioning on CEMG portfolio positions. On the date of initial recognition, credits are recorded at their face value, in accordance with the procedures defined in Bank of Portugal Notice 1/2005.

The value corrections for year-end 2009 and 2010 were 494 M€ and 522 M€, respectively. For their part, the totals recovered in 2009 and 2010 amounted to 379 M€ and 412 M€, as shown in Table 11.

Table 11 – Provisions and value corrections

(thousands €)

| | Dec-2010 | Dec-2009 |
|------------------------------|----------------|----------------|
| Initial balance | 493.913 | 383.921 |
| Appropriations | 525.338 | 527.206 |
| Uses | -85.093 | -37.782 |
| Reinstatements/Cancellations | -412.347 | -379.432 |
| Closing balance | 521.811 | 493.913 |

5.2 Portfolio Structure

The distribution of exposures in the loan portfolio by risk class shows a large concentration in the guaranteed by real estate class (CL IX) and corporate loans class (CL VII), as there was in the previous year (Table 12). The decrease in the past due exposures class (CL X) is a consequence of increased provisioning. There was a significant increase in the original exposure in the central governments and central banks class (CL I) due to the investment in sovereign debt, although this implied no change in capital requirements (risk weight of 0%).

Table 12 – Distribution of credit exposures by risk class

| Risk Class | (thousands €) | |
|--|------------------------------|-------------------|
| | Original exposure at default | |
| | Dec-2010 | Dec-2009 |
| CL I - Central government and central banks | 1.347.071 | 260.146 |
| CL II - Regional governments and local authorities | 51.058 | 45.360 |
| CL III - Public sector entities and other non-profit public institutions | 64.659 | 1.472 |
| CL IV - Multilateral development banks | 0 | 0 |
| CL V - International organisations | 0 | 0 |
| CL VI - Institutions | 1.283.219 | 1.240.239 |
| CL VII - Corporates | 3.948.280 | 3.338.008 |
| CL VIII - Retail portfolio | 1.394.491 | 1.948.541 |
| CL IX - Guaranteed by Real Estate | 9.949.429 | 10.109.363 |
| CL X - Past due Loans | 438.472 | 554.442 |
| CL XI - Covered bonds and public sector bonds | 26.904 | 21.136 |
| CL XII - Exposures to collective investment undertakings (CIUs) | 5.728 | 9.341 |
| CL XIII - Other exposures | 429.901 | 237.470 |
| Securitisation exposures using the standardised approach | 22.834 | 0 |
| TOTAL | 18.962.046 | 17.765.516 |

CEMG is commercially present in most regions of the country (Table 13), though a higher concentration is still seen in areas with higher population density (Greater Lisbon, Oporto and Beiras) when analyzing the geographic distribution of the loan portfolio.

Table 13 – Geographic distribution of exposures in the credit portfolio by risk class (as a % of original exposure at default)

| Year | Risk Class | Lisbon | Oporto | Beira Alta, Baixa e Litoral | Estremadura | Trás-Os- Montes e Douro | Minho | Algarve | Azores | Madeira | Alentejo |
|------|--|---------------|---------------|-----------------------------------|--------------|-------------------------------|--------------|--------------|--------------|--------------|--------------|
| 2009 | CL I - Central government and central banks | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,01% | 0,00% |
| | CL II - Regional governments and local authorities | 0,13% | 0,00% | 0,00% | 0,00% | 0,04% | 0,00% | 0,00% | 0,02% | 0,08% | 0,00% |
| | CL VI - Institutions | 0,52% | 0,00% | 0,03% | 0,00% | 0,00% | 0,00% | 0,01% | 0,00% | 0,00% | 0,00% |
| | CL VII - Corporates | 7,76% | 2,07% | 2,23% | 1,37% | 1,29% | 1,24% | 1,17% | 0,45% | 0,73% | 0,22% |
| | CL VIII - Retail portfolio | 4,00% | 2,02% | 1,50% | 0,77% | 1,08% | 0,92% | 0,60% | 0,49% | 0,21% | 0,26% |
| | CL IX - Gauranteed by Real Estate | 21,98% | 9,94% | 6,07% | 5,71% | 4,37% | 4,43% | 3,48% | 2,30% | 1,68% | 1,49% |
| | CL X - Past due Loans | 2,70% | 1,30% | 0,79% | 0,77% | 0,55% | 0,76% | 0,19% | 0,12% | 0,07% | 0,06% |
| | TOTAL | 37,08% | 15,33% | 10,62% | 8,63% | 7,33% | 7,35% | 5,46% | 3,38% | 2,78% | 2,03% |
| 2010 | CL II - Regional governments and local authorities | 0,12% | 0,00% | 0,00% | 0,04% | 0,00% | 0,00% | 0,00% | 0,01% | 0,14% | 0,00% |
| | CL III - Public sector entities and other non-profit public institutions | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,01% | 0,00% | 0,00% | 0,00% | 0,00% |
| | CL VI - Institutions | 1,08% | 0,00% | 0,06% | 0,00% | 0,00% | 0,00% | 0,01% | 0,00% | 0,00% | 0,00% |
| | CL VII - Corporates | 10,23% | 2,49% | 2,69% | 1,60% | 1,28% | 1,63% | 1,31% | 0,50% | 0,83% | 0,26% |
| | CL VIII - Retail portfolio | 2,48% | 1,39% | 1,16% | 0,94% | 0,63% | 0,78% | 0,46% | 0,46% | 0,21% | 0,20% |
| | CL IX - Gauranteed by Real Estate | 21,93% | 9,85% | 6,18% | 4,45% | 5,87% | 4,60% | 3,37% | 2,47% | 1,71% | 1,55% |
| | CL X - Past due Loans | 1,72% | 0,99% | 0,56% | 0,42% | 0,51% | 0,41% | 0,16% | 0,09% | 0,06% | 0,08% |
| | TOTAL | 37,57% | 14,73% | 10,64% | 7,45% | 8,29% | 7,43% | 5,31% | 3,54% | 2,95% | 2,09% |

With regards to the distribution by economic sector of the corporate portfolio (Table 14), the construction sector deserves special attention, despite showing a decrease in its proportion by - 7,6 p.p. compared to Dec-09. There is also a significant proportion of loans in the Real Estate Management and Commerce sectors, with the latter registering a slight increase (about +1,5 p.p.) over the last year.

Table 14 – Economic sector distribution of exposures in the credit portfolio by risk class (as a % of original exposure at default)

| Year | Risk Class | Secondary Sector | | | Tertiary Sector | | | | | | | | |
|--------------|--|------------------|--------------|---------------|-----------------|----------------------------|-------------------------|----------------------|-------------------------|--------------------------------------|---|-------|-------|
| | | Primary Sector | Construction | Other | Real Estate | Wholesale and retail trade | Financial and Insurance | Hotels & restaurants | Transport & warehousing | Public administration ⁽¹⁾ | Consultancy activities, scientific, technical and similar | Other | |
| 2009 | CL I - Central government and central banks | 0,00% | 0,00% | 0,00% | 0 | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,02% | 0,00% | 0,00% |
| | CL II - Regional governments and local authorities | 0,00% | 0,00% | 0,00% | 0 | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,78% | 0,00% | 0,00% |
| | CL VI - Institutions | 0,00% | 0,00% | 0,00% | 0 | 0,00% | 1,60% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,03% |
| | CL VII - Corporates | 0,19% | 23,54% | 6,16% | 6,11% | 7,08% | 1,33% | 1,41% | 2,33% | 0,69% | 0,62% | 1,72% | |
| | CL VIII - Retail portfolio | 0,12% | 5,50% | 0,83% | 2,68% | 1,85% | 0,44% | 0,93% | 0,17% | 0,67% | 0,64% | 1,10% | |
| | CL IX - Gauranteed by Real Estate | 0,01% | 14,63% | 0,14% | 4,84% | 0,61% | 0,18% | 0,58% | 0,02% | 0,13% | 0,06% | 0,36% | |
| | CL X - Past due Loans | 0,04% | 5,58% | 0,80% | 1,01% | 1,06% | 0,02% | 0,32% | 0,23% | 0,06% | 0,21% | 0,60% | |
| TOTAL | 0,35% | 49,24% | 7,94% | 14,64% | 10,59% | 3,57% | 3,25% | 2,75% | 2,34% | 1,52% | 3,81% | | |
| 2010 | CL II - Regional governments and local authorities | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,88% | 0,00% | 0,00% | |
| | CL III - Public sector entities and other non-profit public institutions | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,05% | |
| | CL VI - Institutions | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 3,25% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | |
| | CL VII - Corporates | 0,42% | 25,40% | 6,60% | 8,24% | 7,98% | 2,29% | 2,19% | 2,67% | 1,15% | 1,89% | 3,03% | |
| | CL VIII - Retail portfolio | 0,09% | 2,00% | 0,87% | 0,89% | 2,17% | 0,07% | 0,81% | 0,23% | 0,51% | 0,66% | 0,98% | |
| | CL IX - Gauranteed by Real Estate | 0,02% | 10,79% | 0,41% | 4,21% | 1,37% | 0,09% | 0,68% | 0,03% | 0,20% | 0,14% | 0,39% | |
| | CL X - Past due Loans | 0,01% | 3,49% | 0,57% | 1,06% | 0,56% | 0,02% | 0,17% | 0,13% | 0,05% | 0,09% | 0,17% | |
| TOTAL | 0,54% | 41,68% | 8,46% | 14,41% | 12,08% | 5,72% | 3,86% | 3,06% | 2,80% | 2,78% | 4,62% | | |

(1) Public admin. & defence; Compulsory social security; Human health and welfare

As can be seen in the table below, in terms of distribution by residual maturity, about 60% of assets are long-term (residual maturity greater than 10 years). These assets are mostly in the class “Guaranteed by Real Estate” and consist of housing loans and loans to private investment firms. The portfolio with no set payment plan, which corresponds to about 19% of the overall original exposure, consists broadly of current accounts to support the liquidity of companies (revolving credit).

Table 15 – Residual maturity of the credit portfolio by risk class (as a % of original exposure at default)

| Year | Risk Class | 1 ano < 5 anos < | | MR > 10 anos | Revolving |
|------|--|------------------|-------------|--------------|--------------|
| | | MR < 1 anos | MR < 5 anos | | |
| 2009 | CL I - Central government and central banks | 0,0% | 0,0% | 0,0% | 0,0% |
| | CL II - Regional governments and local authorities | 0,0% | 0,0% | 0,1% | 0,0% |
| | CL VI - Institutions | 0,8% | 0,7% | 1,9% | 52,2% |
| | CL VII - Corporates | 0,1% | 0,4% | 0,0% | 0,1% |
| | CL VIII - Retail portfolio | 4,5% | 2,2% | 2,1% | 1,3% |
| | CL IX - Gauranteed by Real Estate | 2,1% | 1,5% | 2,6% | 1,8% |
| | CL X - Past due Loans | 1,4% | 0,2% | 0,5% | 3,3% |
| | as a % of the original exposure at default | 8,9% | 5,0% | 7,2% | 58,7% |
| 2010 | CL II - Regional governments and local authorities | 0,0% | 0,0% | 0,1% | 0,1% |
| | CL III - Public sector entities and other non-profit put | 0,0% | 0,0% | 0,0% | 0,0% |
| | CL VI - Institutions | 0,2% | 0,3% | 0,0% | 0,0% |
| | CL VII - Corporates | 5,9% | 3,0% | 2,8% | 1,7% |
| | CL VIII - Retail portfolio | 1,8% | 1,4% | 2,1% | 0,6% |
| | CL IX - Gauranteed by Real Estate | 0,9% | 0,7% | 2,5% | 53,6% |
| | CL X - Past due Loans | 0,6% | 0,2% | 0,4% | 2,5% |
| | as a % of the original exposure at default | 9,4% | 5,6% | 7,9% | 58,4% |

5.3 Concentration risk

As mentioned, CEMG has been following an ongoing diversification strategy in order to reduce the proportional exposure to real estate. The impact of concentration risk on capital requirements is evaluated through the calculation of sector and individual concentration indexes (CI), according to the Bank of Portugal's Instruction 5/2011.

The individual CI³ is calculated from the 100 largest exposures, aggregated by client/economic group. The proportion of these exposures in Dec-10 amounted to roughly 13% of the loan portfolio and 15% of the total portfolio⁴.

The sector CI⁵ is calculated based on the classification of clients' economic activities.

Table 16 – Concentration index

| | Credit Portfolio | | Total Exposures | |
|---------------------------------------|------------------|--------|-----------------|--------|
| | Dec-10 | Dec-09 | Dec-10 | Dec-09 |
| Individual concentration index | 0,19 | 0,18 | 0,24 | 0,19 |
| Sectorial concentration index | 22,60 | 28,55 | 18,85 | 22,68 |

The evolution of the sector CI reflects the diversification strategy that the Institution has been pursuing in all portfolios, both at a sector and on asset type level. The individual CI, is slightly

³ Customer Concentration Index = $\sum x^2 / (\sum x * \sum y) * 100$, where x represents the value of total exposure to each customer / economic group belonging to the institution's 100 largest counterparties, and $\sum y$ corresponds to the total exposure of the portfolio.

⁴ Total Portfolio = Loan Portfolio + Portfolios subject to capital requirements (including AFS – Available for Sale, HTM – Held to Maturity, Trading and of balance hedging).

⁵ Sector Concentration Index = $\sum x^2 / (\sum x)^2 * 100$, where x represents the total exposure in each economic sector.

higher than in December 2009 as a result of the increase in the relative weight of the 100 largest exposures within the institution's overall portfolio (Table 16).

With regard to the distribution of the largest exposures by country, the portfolio is mostly concentrated in Portugal (Table 17).

Table 17 – Distribution of exposures by Country

(thousands €)

| Country | Amount | | % Total Exposures | |
|----------------------|---------------|---------------|-------------------|--------|
| | Dec-10 | Dec-09 | Dec-10 | Dec-09 |
| Portugal | 16.143 | 15.992 | 94,7% | 92,6% |
| Spain | 119 | 151 | 0,7% | 0,9% |
| USA | 112 | 99 | 0,7% | 0,6% |
| Italy | 109 | 128 | 0,6% | 0,7% |
| Ireland | 94 | 104 | 0,6% | 0,6% |
| Great Britain | 83 | 119 | 0,5% | 0,7% |
| France | 62 | 145 | 0,4% | 0,8% |
| Other | 329 | 537 | 1,9% | 3,1% |
| Total | 17.052 | 17.276 | | |

5.4 Past Due and Impaired Loans

The distribution of the past due exposures and the related impairment provisioning reflect the concentration of the activity in the business sectors of construction, real estate and commerce.

The geographical distribution of past due loans (Table 18), shows a larger concentration in the Greater Lisbon, Greater Oporto and Beiras regions, reflecting the overall portfolio's geographical distribution and similar to the figures for the previous year.

Table 18 – Breakdown of past due and impaired exposures

| Year | Total exposures | % exposures past due | % covered by impairment provisions | |
|-----------------------------|--|----------------------|------------------------------------|--------------|
| Dec-09 | Primary Sector | 0,4% | 34,8% | |
| | Secondary | | | |
| | Construction | 56,2% | 41,6% | |
| | Other | 8,1% | 25,7% | |
| | Third Sector | | | |
| | Wholesale and retail trade; motor vehicles and motorcycles repair | 10,7% | 19,5% | |
| | Real Estate | 10,2% | 29,9% | |
| | Other | 6,0% | 19,3% | |
| | Hotels and restaurants | 3,2% | 29,4% | |
| | Transport and warehousing | 2,3% | 53,9% | |
| | Consultancy activities, scientific, technical and similar | 2,1% | 38,3% | |
| | Public admin. and defence; social security, human health and welfare | 0,6% | 13,4% | |
| | Financial and insurance | 0,2% | 42,5% | |
| | | Total | 100,0% | 35,0% |
| | Dec-09 | Lisbon | 36,9% | 19,9% |
| Oporto | | 17,9% | 24,9% | |
| Beira Alta, Baixa e Litoral | | 10,8% | 24,2% | |
| Estremadura | | 10,5% | 18,3% | |
| Minho | | 10,3% | 29,6% | |
| Trás-Os-Montes e Douro | | 7,5% | 24,3% | |
| Algarve | | 2,6% | 22,7% | |
| Azores | | 1,6% | 19,4% | |
| Madeira | | 0,9% | 23,3% | |
| Alentejo | | 0,9% | 24,3% | |
| | | Total | 100,0% | 22,5% |
| Dec-10 | Primary Sector | 0,1% | 39,1% | |
| | Secondary | | | |
| | Construction | 55,2% | 43,4% | |
| | Other | 9,0% | 42,7% | |
| | Third Sector | | | |
| | Real Estate | 16,8% | 34,5% | |
| | Wholesale and retail trade; motor vehicles and motorcycles repair | 8,8% | 42,3% | |
| | Hotels and restaurants | 2,7% | 54,9% | |
| | Other | 2,6% | 51,6% | |
| | Transport and warehousing | 2,1% | 84,9% | |
| | Consultancy activities, scientific, technical and similar | 1,4% | 34,5% | |
| | Public admin. and defence; social security, human health and welfare | 0,8% | 8,5% | |
| | Financial and insurance | 0,2% | 13,2% | |
| | | Total | 100,0% | 42,7% |
| | Dec-10 | Lisbon | 34,4% | 27,3% |
| Oporto | | 19,8% | 26,8% | |
| Beira Alta, Baixa e Litoral | | 11,2% | 33,1% | |
| Minho | | 10,3% | 27,4% | |
| Estremadura | | 8,3% | 27,1% | |
| Trás-Os-Montes e Douro | | 8,3% | 38,7% | |
| Algarve | | 3,2% | 35,2% | |
| Azores | | 1,9% | 23,1% | |
| Madeira | | 1,6% | 25,6% | |
| Alentejo | | 1,1% | 27,7% | |
| | | Total | 100,0% | 28,9% |

5.5 Standard Approach

The capital requirement for credit and counterparty risk is determined in accordance with the Standard Approach as defined in the Bank of Portugal's Notice 5/2007. Depending on the nature of the counterparty, asset portfolio positions are assigned to one of several risk classes, and ratings provided by Moody's, S&P and Fitch are used in the attribution of risk weights.

This attribution is common to all risk classes and is in accordance with Notice 5/2007, as follows:

- When different ratings are simultaneously issued by separate recognised agencies, the second highest of the two best risk weights applies;
- In the case of bonds or similar securities, the issue rating is used, and the issuer rating applied only in cases where an issue rating is not available;
- Existing ratings are used consistently for all exposures in all classes.

The value of risk-weighted exposures is calculated based on the exposure value, net of provisions and value corrections, considering the effect of credit risk mitigation techniques—namely real and personal credit protections—and after the application of conversion factors to off-balance sheet elements.

As of December 2010, the distribution of CEMG's portfolio among the different classes and risk weights are presented in detail in the following table.

Table 19 – Regulatory capital, counterparty and credit risk requirements

(thousands €)

| | Risk weight | | | | | | | | | | Total |
|--|--|---------------|------------------|------------------|------------------|------------------|------------------|----------------|----------|-------------------|-----------|
| | 0% | 10% | 20% | 35% | 50% | 75% | 100% | 150% | Other | | |
| 1. Original Exposure by risk class | CL I - Central government and central banks | 1.346.371 | 0 | 700 | 0 | 0 | 0 | 0 | 0 | 0 | 1.347.071 |
| | CL II - Regional governments and local authorities | 0 | 0 | 10.751 | 0 | 40.306 | 0 | 0 | 0 | 0 | 51.058 |
| | CL III - Public sector entities and other non-profit public institutions | 0 | 0 | 31.362 | 0 | 33.297 | 0 | 0 | 0 | 0 | 64.659 |
| | CL IV - Multilateral development banks | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| | CL V - International organisations | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| | CL VI - Institutions | 0 | 0 | 918.489 | 0 | 227.693 | 0 | 137.038 | 0 | 0 | 1.283.219 |
| | CL VII - Corporates | 0 | 0 | 2.787 | 0 | 13.827 | 0 | 3.931.666 | 0 | 0 | 3.948.280 |
| | CL VIII - Retail portfolio | 0 | 0 | 0 | 0 | 0 | 1.394.491 | 0 | 0 | 0 | 1.394.491 |
| | CL IX - Gauranteed by Real Estate | 0 | 0 | 0 | 8.477.383 | 699.802 | 460.317 | 311.927 | 0 | 0 | 9.949.429 |
| | CL X - Past due Loans | 0 | 0 | 0 | 0 | 0 | 0 | 283.597 | 154.875 | 0 | 438.472 |
| | CL XI - Covered bonds and public sector bonds | 0 | 13.431 | 8.992 | 0 | 4.480 | 0 | 0 | 0 | 0 | 26.904 |
| | CL XII - Exposures to collective investment undertakings (CIUs) | 0 | 0 | 0 | 0 | 0 | 0 | 5.728 | 0 | 0 | 5.728 |
| | CL XIII - Other exposures | 96.372 | 0 | 49.308 | 0 | 0 | 0 | 284.221 | 0 | 0 | 429.901 |
| | Securitisation exposures using the standardised approach | 0 | 0 | 16.422 | 0 | 477 | 0 | 5.935 | 0 | 0 | 22.834 |
| TOTAL Originator exposures: | 1.442.743 | 13.431 | 1.038.811 | 8.477.383 | 1.019.883 | 1.854.808 | 4.960.113 | 154.875 | 0 | 18.962.046 | |
| 2. Exposures by risk class (exposures weight base) | CL I - Central government and central banks | 1.346.371 | 0 | 700 | 0 | 0 | 0 | 0 | 0 | 1.347.071 | |
| | CL II - Regional governments and local authorities | 0 | 0 | 10.751 | 0 | 40.204 | 0 | 0 | 0 | 50.955 | |
| | CL III - Public sector entities and other non-profit public institutions | 0 | 0 | 31.361 | 0 | 33.096 | 0 | 0 | 0 | 64.457 | |
| | CL IV - Multilateral development banks | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| | CL V - International organisations | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| | CL VI - Institutions | 0 | 0 | 858.248 | 0 | 222.825 | 0 | 136.102 | 0 | 0 | 1.217.175 |
| | CL VII - Corporates | 0 | 0 | 2.787 | 0 | 102.222 | 0 | 3.489.517 | 0 | 0 | 3.594.526 |
| | CL VIII - Retail portfolio | 0 | 0 | 0 | 0 | 42.484 | 1.011.350 | 0 | 0 | 0 | 1.053.834 |
| | CL IX - Gauranteed by Real Estate | 0 | 0 | 0 | 8.477.383 | 699.802 | 460.317 | 311.927 | 0 | 0 | 9.949.429 |
| | CL X - Past due Loans | 0 | 0 | 0 | 0 | 1.343 | 0 | 283.547 | 153.581 | 0 | 438.472 |
| | CL XI - Covered bonds and public sector bonds | 0 | 13.431 | 8.992 | 0 | 4.480 | 0 | 0 | 0 | 0 | 26.904 |
| | CL XII - Exposures to collective investment undertakings (CIUs) | 0 | 0 | 0 | 0 | 0 | 0 | 5.728 | 0 | 0 | 5.728 |
| | CL XIII - Other exposures | 96.372 | 0 | 49.308 | 0 | 0 | 0 | 284.221 | 0 | 0 | 429.901 |
| | Securitisation exposures using the standardised approach | 0 | 0 | 16.422 | 0 | 477 | 0 | 5.935 | 0 | 0 | 22.834 |
| TOTAL Exposures: | 1.442.743 | 13.431 | 978.568 | 8.477.383 | 1.146.934 | 1.471.667 | 4.516.978 | 153.581 | 0 | 18.201.286 | |
| 3. TOTAL exposures risk weigh (=Σ (2."x"risk weights)) | 0 | 1.343 | 195.714 | 2.967.084 | 573.467 | 1.103.750 | 4.516.978 | 230.372 | 0 | 9.588.708 | |
| capital requirements by risk class (2."x" risk weights "x" 8%) | CL I - Central government and central banks | 0 | 0 | 11 | 0 | 0 | 0 | 0 | 0 | 11 | |
| | CL II - Regional governments and local authorities | 0 | 0 | 172 | 0 | 1.608 | 0 | 0 | 0 | 1.780 | |
| | CL III - Public sector entities and other non-profit public institutions | 0 | 0 | 502 | 0 | 1.324 | 0 | 0 | 0 | 1.826 | |
| | CL IV - Multilateral development banks | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| | CL V - International organisations | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| | CL VI - Institutions | 0 | 0 | 13.732 | 0 | 8.913 | 0 | 10.888 | 0 | 0 | 33.533 |
| | CL VII - Corporates | 0 | 0 | 45 | 0 | 4.089 | 0 | 279.161 | 0 | 0 | 283.295 |
| | CL VIII - Retail portfolio | 0 | 0 | 0 | 0 | 1.699 | 60.681 | 0 | 0 | 0 | 62.380 |
| | CL IX - Gauranteed by Real Estate | 0 | 0 | 0 | 237.367 | 27.992 | 27.619 | 24.954 | 0 | 0 | 317.932 |
| | CL X - Past due Loans | 0 | 0 | 0 | 0 | 54 | 0 | 22.684 | 18.430 | 0 | 41.167 |
| | CL XI - Covered bonds and public sector bonds | 0 | 107 | 144 | 0 | 179 | 0 | 0 | 0 | 0 | 431 |
| | CL XII - Exposures to collective investment undertakings (CIUs) | 0 | 0 | 0 | 0 | 0 | 0 | 458 | 0 | 0 | 458 |
| | CL XIII - Other exposures | 0 | 0 | 789 | 0 | 0 | 0 | 22.738 | 0 | 0 | 23.527 |
| | Securitisation exposures using the standardised approach | 0 | 0 | 263 | 0 | 19 | 0 | 475 | 0 | 0 | 757 |
| TOTAL capital requirements: | 0 | 107 | 15.657 | 237.367 | 45.877 | 88.300 | 361.358 | 18.430 | 0 | 767.097 | |

6. Credit risk mitigation techniques

Both personal guarantees, which substitute the risk of one counterparty for another, and financial collateral, which directly reduce the value of the exposure, are used to reduce credit risk on the positions held in the loan portfolio. Mortgage collateral is also a relevant risk mitigating in the CEMG portfolio.

CEMG does not generally use on- or off-balance sheet compensation methods, and does not originate credit derivatives for its loan portfolio.

Exposures with risk mitigation via risk substitution are mostly corporate/business loans guaranteed by Mutual Guarantee companies (Norgarante, Lisgarante and Garval).

Lending operations in which risk is reduced directly correspond mainly to those collateralized by financial securities, namely term deposits, gold, bonds and shares included in a main index of a recognized stock exchange, as laid down in Annex VI to Bank of Portugal Notice 5/2007.

With regards to the mortgage collateral, property evaluations are performed by independent specialists or by an independent department. The re-evaluation of the assets is done in accordance with the requirements defined in Notice 5/2007, using the variation of property indexes⁶ or on-site assessments.

Table 20 – Property Re-evaluation

| | |
|----------------------------------|--|
| Property for housing | <ul style="list-style-type: none"> - At least once every three years, automatically, using real estate variation indices. - For loans exceeding 5% of regulatory capital of the Institution or 500.000 euros, the assessment of the property must be reviewed by an evaluator. |
| Property for commercial purposes | <ul style="list-style-type: none"> - At least once a year, automatically through the use of indices, using real estate variation indices. - For loans exceeding 5% of regulatory capital or 1 million euros, the assessment of the property must be reviewed by an evaluator at least every three years. |

⁶ Provided by external entities, based on data provided by Credit Institutions and Real Estate Brokers.

Table 21 – Credit risk mitigation techniques

(thousands €)

| Risk Class | Net position | Credit risk reduction techniques with the effect of substitution in net exposure | | | | | Reduction techniques with no effect on the value of exposure | | |
|--|-------------------|--|--------------------|------------------------|--------------------------------|--|--|--|---|
| | | Personal protection, value of protection | | Real credit protection | | Effect of replacement in exposure ⁽¹⁾ | Volatility adjustment to exposure value | Financial collateral: fully adjusted value of protection | |
| | | Guarantees | Credit derivatives | Simple method | Other forms of real protection | | | | |
| | | | | | | 1 | 2 | 3 | 4 |
| Total exposure | 18.962.046 | 133.123 | 0 | 0 | 0 | 56.537 | 0 | 319.204 | |
| CL I - Central government and central banks | 1.347.071 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| CL II - Regional governments and local authorities | 51.058 | 0 | 0 | 0 | 0 | 0 | 0 | 55 | |
| CL III - Public sector entities and other non-profit public institutions | 64.659 | 0 | 0 | 0 | 0 | 0 | 0 | 104 | |
| CL VI - Institutions | 1.283.219 | 900 | 0 | 0 | 0 | 450 | 0 | 60.189 | |
| CL VII - Corporates | 3.948.280 | 88.395 | 0 | 0 | 0 | 44.198 | 0 | 176.056 | |
| CL VIII - Retail portfolio | 1.394.491 | 42.484 | 0 | 0 | 0 | 10.621 | 0 | 82.799 | |
| CL IX - Gauranteed by Real Estate | 9.949.429 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| CL X - Past due Loans | 438.472 | 1.343 | 0 | 0 | 0 | 1.268 | 0 | 0 | |
| CL XI - Covered bonds and public sector bonds | 26.904 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| CL XII - Exposures to collective investment undertakings (CIUs) | 5.728 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| CL XIII - Other exposures | 429.901 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| Securitisation exposures using the standardised approach | 22.834 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |

⁽¹⁾ - This field is calculated as follows: $G \cdot P_1 - G \cdot P_2$, where G is the value of the guarantee, P_1 the original weighting and P_2 the weighting after taking the guarantee into account.

Table 22 – Concentration Analysis – Personal and real credit protection

(thousands €)

| | Personal credit protection | | Real credit protection - Integral method on financial collateral | |
|--|---|--------|--|---------|
| | Guarantees | | Collateral (financial) eligible | |
| | Dec-10 | Dec-09 | Dec-10 | Dec-09 |
| | CL I - Central government and central banks | 0 | 0 | 0 |
| CL II - Regional governments and local authorities | 0 | 0 | 55 | 119 |
| CL III - Public sector entities and other non-profit public institutions | 0 | 0 | 104 | 0 |
| CL VI - Institutions | 900 | 15 | 60.189 | 23.657 |
| CL VII - Corporates | 88.395 | 49.621 | 176.056 | 140.414 |
| CL VIII - Retail portfolio | 42.484 | 25.771 | 82.799 | 116.181 |
| CL IX - Gauranteed by Real Estate | 0 | 0 | 0 | 0 |
| CL X - Past due Loans | 1.343 | 69 | 0 | 0 |
| CL XI - Covered bonds and public sector bonds | 0 | 0 | 0 | 0 |
| CL XII - Exposures to collective investment undertakings (CIUs) | 0 | 0 | 0 | 0 |
| CL XIII - Other exposures | 0 | 0 | 0 | 0 |
| Securitisation exposures using the standardised approach | 0 | 0 | 0 | 0 |

7. Securitisations

7.1 Performed operations

As of 31 December, 2010, CEMG was involved in six traditional credit securitisation operations as originator, namely: Pelican Mortgages 1; Pelican Mortgages 2; Pelican Mortgages 3, Pelican Mortgages 4, Pelican Mortgages 5 and Pelican SME 1 (Table 23). In all of these operations, the main goal was to achieve greater flexibility in managing the bank's balance sheet, with a positive impact, inter alia, on the liquidity indicators.

The degree of involvement, understood as the quotient between the volume of global debt exposures assigned in securitisation transactions and the sum of consolidated assets (plus the overall volume of assigned positions), was below 20%.

For regulatory purposes, none of the aforementioned securitisations involved a significant transfer of credit risk.

7.2 Methods of calculation of risk-weighted exposures

Given that none of the securitisation operations meets the criteria set out in Annex I to Bank of Portugal Notice 7/2007—which defines the conditions for a significant transfer of credit risk—the loans involved are not excluded from the calculation of risk-weighted assets. Capital requirements are therefore not calculated for the securitisation exposures held and losses on these positions are not considered.

With regard to securitisations where CEMG acts as an investor, the risk-weighted exposure is calculated according to Notice 7/2007 of the Bank of Portugal, using the Standardised Approach. Credit ratings issued by Fitch, Moody's and S&P were used to determine the credit quality of each securitisation position.

7.3 Accounting policies

Until 31 December 2004, in accordance with the accounting principles defined by the Bank of Portugal, loans transferred by CEMG through securitisation deals were derecognised. Securities acquired under those operations were considered as assets available for sale and provisioned according to the rules defined by Bank of Portugal's Instruction 27/2000. Following the publication of the Bank of Portugal's Instruction 2/2008, the provisioning of these securities was subject to the impairment rules as defined in IAS 39.

In line with IFRS 1, no changes have been made to the derecognition criterion adopted in CEMG's individual financial statements for all issues carried out prior to 1 January, 2004. All operations carried out after that date are analysed according to the rules set out in IAS 39, if a substantial portion of the risks and benefits associated with the assets are transferred, or control over the assets is transferred, those assets may be derecognised.

7.4 Quantitative information

Table 23 – Securitisation Operations

| | Securitisation Operations | | | | | |
|---|---------------------------|--------------------|----------------|----------------|----------------|----------------|
| | Pelican 1 | Pelican 2 | Pelican 3 | Pelican 4 | Pelican 5 | Pelican SME 1 |
| Tradicional securitisation | | | | | | |
| Originator(s) | CEMG | CEMG | CEMG | CEMG | CEMG | CEMG |
| Issuer(s) | Oceanus - SGFTC, SA | Banco Finantia, SA | Sagres STC, SA | Sagres STC, SA | Sagres STC, SA | Sagres STC, SA |
| Information on the operations | | | | | | |
| Start date | 19-Dez-02 | 29-Set-03 | 30-Mar-07 | 20-Mai-08 | 25-Mar-09 | 22-Jun-10 |
| Legal maturity | Sep-37 | Sep-36 | Sep-54 | Sep-56 | Dec-61 | Jul-36 |
| Step-up clause (date) | n.a. | Set-10 | Mar-16 | Jun-17 | Jun-18 | Jul-13 |
| Revolving (years) | n.a. | n.a. | n.a. | n.a. | n.a. | 3 |
| Securitized assets (in millions of euros) | 650 | 700 | 750 | 1.000 | 1.000 | 1.167 |
| Amount outstanding (in millions of euros) | 104 | 189 | 396 | 866 | 905 | 1.115 |
| Information on involvement of the originator(s) | | | | | | |
| Existence of situations of "implicit support" | não | não | não | não | não | não |
| Assets ceded (by institution)/Securitized assets (total) (%) | 100,0% | 100,0% | 100,0% | 100,0% | 100,0% | 100,0% |
| Initial capital gain/Value of repurchased first-loss position | 0,00 | 0,00 | 0,00 | 0,00 | 0,00 | 0,00 |

n.a. = not applicable

Table 24 – Outstanding exposure amount on securitised loans

| | (Million €) | |
|-------------------------------------|-------------|---|
| | Amount | Of which: relating to exposures subject to impairment or past due |
| <i>Pelican 1</i> | 104 | 4 |
| <i>Pelican 2</i> | 189 | 3 |
| <i>Pelican 3</i> | 396 | 2 |
| <i>Pelican 4</i> | 866 | 6 |
| <i>Pelican 5</i> | 905 | 5 |
| <i>Pelican SME 1</i> | 1.115 | 24 |
| Tradicional securitisations (total) | 3.574 | 43 |

Table 25 – Credit risk – Securitisation Operations: Standardised Approach

| Type of Securitisation (traditional / synthetic) | Exposure value | | risk weighted exposure | |
|--|---|--------|------------------------|--------|
| | Amount deducted to regulatory capital (-) | Amount | Dec-10 | Dec-09 |
| | | | 9 | 10 |
| | 2 | 3 | 9 | 10 |
| B=Investor positions : total | 22.834 | 0 | 9.458 | 5.370 |
| B1 - Balance sheet exposures | 22.834 | 0 | 9.458 | 5.370 |
| Senior tranches | 22.834 | 0 | 9.458 | 5.370 |
| Mezzanine tranches | 0 | 0 | 0 | 0 |
| First loss tranches | 0 | 0 | 0 | 0 |
| B2 - Exposures to memorandum items and derivatives | 0 | 0 | 0 | 0 |
| C=Issuer positions : total | 0 | 0 | 0 | 0 |
| C1 - Balance sheet exposures | 0 | 0 | 0 | 0 |
| C2 - Exposures to memorandum items and derivatives | 0 | 0 | 0 | 0 |

Table 26 – Credit risk – Securitisation Operations: Activities Summary

(millions €)

| | risk exposure | | Gains / losses recognized on sales | |
|--|---------------|--------------|--|----------|
| | | | Dec-10 | Dec-09 |
| | Dec-10 | Dec-09 | Dec-10 | Dec-09 |
| Securitisations (total) | 3.574 | 2.627 | 0 | 0 |
| Assets | 3.574 | 2.627 | 0 | 0 |
| Most senior | 3.574 | 2.627 | 0 | 0 |
| Mezzanine | 0 | 0 | 0 | 0 |
| First loss | 0 | 0 | 0 | 0 |
| Off-Balance sheet items and derivatives | 0 | 0 | 0 | 0 |
| Synthetic securitisations (total) | 0 | 0 | 0 | 0 |
| Assets | 0 | 0 | 0 | 0 |
| Most senior | 0 | 0 | 0 | 0 |
| Mezzanine | 0 | 0 | 0 | 0 |
| First loss | 0 | 0 | 0 | 0 |
| Off-Balance sheet items and derivatives | 0 | 0 | 0 | 0 |

8. Position, credit, counterparty and settlement risk on the trading book

8.1 Methods of calculation of capital requirements

The trading book portfolio is composed by positions held with the aim of achieving short-term gains, either through sales or by revaluation. Capital requirements are calculated using the Standardised approach.

8.2 Methods for assessing risk on the trading book

The trading book is fully covered by the “standardised approach to the trading book”.

In accordance with the Standardised Approach, the financial assets are split into two classes: Debt instruments (including derivatives and comparable debt instruments) and Equity securities (including derivatives on equity instruments and comparable assets).

The capital requirement for each asset class is calculated according to the specific risk and overall risk hedging for each asset class. Thus, according to the Standardised Approach, the following methodologies are applied to each type of exposure:

Debt Instruments

- **General Risk:** refers to the risk of loss caused by unfavourable changes in interest rates. In order to calculate the regulatory capital requirements for general risk, a method based on maturity is used, in accordance with Section II-B, Part 2 of Annex II of the Bank of Portugal’s Notice 8/2007.
- **Specific Risk:** refers to the risk of loss due to factors associated with the issuer, and the regulatory capital requirements for these risks are based on the methodology described in Section II-A, Part 2 of Annex II to Notice 8/2007, considering the changes introduced by the Bank of Portugal’s Notice 8/2010, which results in the weighting of assets in accordance with the sector and the credit quality of the issuer.

Equities

- **General Risk:** refers to the risk of loss caused by unfavourable changes in the stock market. To calculate the regulatory capital requirements for general risk, the method described in Sections III-B and III-C, Part 2 of Annex II of the Bank of Portugal's Notice 8/2007 is used, resulting in the multiplication of the overall net position by 8%;
- **Specific Risk:** refers to the risk of loss due to factors associated with the issuer. The regulatory capital requirements for these risks are based on the methodology described in Section III-A, Part 2 of Annex II of Notice 8/2007, which results in the multiplication of the gross position overall by 4%.

8.3 Quantitative information

Table 27 – Regulatory capital requirements (trading book)

| Trading book risks | | (thousands €) | |
|--------------------|--|---------------------------------|--------|
| | | Regulatory capital requirements | |
| | | Dec-10 | Dec-09 |
| 1. | Position risk | | |
| 1.1. | Standardised approach to trading book | 1.721 | 2.986 |
| 1.1.1. | Debt instruments | | |
| 1.1.1.1. | Specific risk | 855 | 2.595 |
| 1.1.1.2. | General risk | 476 | 213 |
| 1.1.2. | Equity securities | | |
| 1.1.2.1. | Specific risk | 112 | 55 |
| 1.1.2.2. | General risk | 277 | 122 |
| 2. | Counterparty credit risk | | |
| 2.1 | Bonds | 0 | 84 |
| 2.2 | Derivatives | 349 | 276 |
| 2.3 | Other | 0 | 110 |

In quantitative terms, using the methods described above, the regulatory capital requirements for the trading portfolio as of 31 December, 2010 amounted to 1.720.765 € (see Table 27). This represents a reduction of calculated requirements by 42% compared to 2009, caused by the reduction of debt instrument positions.

9. Exchange rate and commodity risks on the banking and trading books

9.1 Method of calculation of minimum regulatory capital requirements

The method used by CEMG to calculate the regulatory capital requirements to cover currency and commodity risks is the Standardised approach, as defined in Annexes V and VI of the Bank of Portugal's Notice 8/2007.

9.2 Evaluation method of exchange and commodities risk

For the calculation of regulatory capital requirements, according to Annex V of the Bank of Portugal's Notice 8/2007, the standardised method imposes a weight of 8% (or 4% when dealing with closely correlated currencies) on the aggregate net positions in foreign currencies, if this sum exceeds 2% of total regulatory capital.

With regards to commodity risk, due to the inexistence of outright or derivative commodity exposures as of 31 December, 2010, application of the calculations described in Annex VI of the Bank of Portugal's Notice 8/2007 is not required.

9.3 Quantitative information

Given that as of 31 December, 2010, the net foreign currency position represented approximately 0.22% of the regulatory capital, and given the limits described in the previous section, there was no allocation of capital to cover currency risk.

10. Equity exposures in the banking book

10.1 Management goals

Investment in equity in CEMG's banking book assumes marginal proportions, with regards to both the portfolios managed and the balance sheet.

This conservative attitude towards risk has meant that, under the adverse conditions that have characterised the stock market, there was no significant negative impact on profitability or regulatory ratios.

10.2 Accounting techniques and assessment methods used

Capital losses on equity exposures (Table 28) are accounted for according to: the portfolios in which these securities are classified, the cumulative value of those losses and how long the losses have existed for. Capital losses on equity registered in the trading book have an immediate effect on results. Reductions in the value of shares categorised as available for sale are classified as impairment and affect results if greater than 30% or if the situation persists for a period of more than 12 months. In the remaining cases, capital losses are recorded in revaluation reserves, affecting equity.

10.3 Quantitative information

Table 28 – Equity exposure

| | (thousands €) | | | | | |
|---|---------------|------------|-----------------|------------|------------|------------|
| | Listed shares | | Unlisted shares | | TOTAL | |
| | 31-12-2010 | 31-12-2009 | 31-12-2010 | 31-12-2009 | 31-12-2010 | 31-12-2009 |
| Acquisition cost | 7.793 | 4.391 | 32.717 | 33.405 | 40.510 | 37.796 |
| Fair value | 6.638 | 4.211 | 32.390 | 33.078 | 39.028 | 37.290 |
| Market price | 7 | 4.211 | | | 6.638 | 4.211 |
| Result for the year arising from sales and settlements | | | | | 3.102 | 732 |
| Total unrealised gains and losses | | | | | -1.595 | -1.117 |
| Total gains and losses inherent in latent revaluations | | | | | 113 | 611 |

11. Operational risk

Operational risk consists of the risk of losses as a result of shortcomings or failures in internal processes, human resources, systems or external factors.

Montepio obtained authorisation from the Bank of Portugal, effective 30 June 2010, to adopt the Standard Method (TSA) for the calculation of minimum capital requirements for operational risk.

These capital requirements, on a consolidated basis, were 55, 5 million Euros as of December 31, 2010 (while the application of the basic indicator approach would result in a value of 63,1 million Euros for the same date).

The regulatory capital requirement to cover operational risk is calculated as the last three-year average of the relevant positive yearly indicator, across each of the business lines, multiplied by a factor assigned to each business line, according to the Bank of Portugal's definitions.

The accounting information taken into consideration in calculating the relevant indicator is aligned with Bank of Portugal's Instruction 23/2007, with the exception of accounts that do not stem from CEMG's current activity, according to the provisions of article nº.5, subparagraph d) of Annex I to Bank of Portugal's Notice 9/2007.

The criteria for each business segment follow the Bank of Portugal's Notice 9/2007. The table below describes the relationship between the business segments and the list of activities in CEMG:

Table 29 – Mapping of Business Lines

| Business Lines | Activities |
|------------------------|---|
| Corporate finance | - Underwriting; |
| Trading and sales | - Proprietary positions; - MMI Brokerage; - Reception and transmission of orders in relation to one or more financial instruments; - Execution of orders on behalf of clients; |
| Payment and settlement | - Issue and administration of payment services; - Payments operations; |
| Commercial banking | - Retail deposits and investment funds; |
| Retail banking | - Private lending; - Finance leases; - Guarantees; |
| Agency services | - Safekeeping and administration of financial instruments on behalf of clients, including custody and related services, such as treasury/collateral management; |
| Retail brokerage | - Reception and transmission of orders in relation to one or more financial instruments; - Execution of orders on behalf of clients. |

Table 30 – Capital Requirements of Operational Risk

| Method | Relevant indicator | | | (thousands €) |
|------------------------|--------------------|----------------|----------------|---|
| | 2008 | 2009 | 2010 | Regulatory capital requirement (consolidated) |
| Corporate finance | 178 | 574 | 900 | 99 |
| Trading and sales | -104.599 | 32.384 | 48.574 | -1.419 |
| Retail brokerage | 7.774 | 6.175 | 6.196 | 806 |
| Commercial banking | 107.360 | 129.071 | 134.917 | 18.567 |
| Retail banking | 366.165 | 245.847 | 189.411 | 32.057 |
| Payment and settlement | 24.132 | 25.997 | 29.885 | 4.801 |
| Agency services | 3.285 | 4.590 | 3.794 | 583 |
| Asset Management | 0 | 0 | 0 | 0 |
| Total | 404.295 | 444.638 | 413.678 | 55.495 |

12. Analysis of sensitivity of Capital requirements

12.1 Interest rate risk on the banking book

Identifying, measuring and controlling interest rate risk on CEMG's banking book are among the tasks of the DRI. CEMG's interest rate risk management is based on the principles recommended by the *Bank for International Settlements*.

Measurement and assessment of the interest rate risk on CEMG's banking book essentially use two methods:

- Repricing gap (most commonly used);
- Market value/duration.

These methods use the following components in constructing the simulation:

- Remunerated assets and liabilities that make up CEMG's balance sheet (balance, currency, repricing date, maturity date, contract interest rate, type of indexing rate, interest rate renewal period and type of repayment);
- Off-balance sheet accounts (in particular interest rate swaps);
- New volumes strategies (amounts, pricing and repricing);
- Projection of interest and exchange rates;

The repricing gap method calculates the value of assets and liabilities that renew their interest rate within a certain period ("time bucket"), normally one month. The difference between the value of assets and liabilities that renew their interest rate within a certain period represents a gap, which will be positive (negative) if the total value of assets is higher (lower) than the total value of liabilities.

The repricing models can be:

- Static: concerned only with the balance sheet and off-balance sheet position at the end of each month;
- Dynamic: concerned with the balance sheet and off-balance sheet position forecast for subsequent months, on the basis of the initial situation and the expected development of the various business variables, in particular amounts, interest rate renewal periods, early settlements and mobilisations.

The models are based on the following methodological approaches:

- Remunerated assets and liabilities are grouped according to repricing period, type of reference rate and purpose of operation;
- Fixed-rate remunerated assets and liabilities are regarded as undergoing repricing on their maturity date;
- Currently, coefficients do not consider early mobilisation (of deposits and credit), using the residual maturity of the contracts instead.

For remunerated assets and liabilities that are not directly indexed to a market rate, the repricing date corresponds to the expiration date.

On-demand deposits are regarded subject to repricing every one to two years, noting that changes to the remuneration of these deposits are made only administratively.

Deposit bonds issued at a fixed rate by CEMG have associated interest rate swaps and therefore affect repricing gaps on the dates the pay leg of the swap is refixed.

12.2 Stress tests

Sensitivity analysis / stress testing is carried out biannually for the CEMG's relevant risks. For 31 December, 2010, a scenario analysis was also performed in the context of national stress tests (Bank of Portugal's Instruction 32/2009), assessing the impact of adverse macroeconomic and financial scenarios, on credit, market and interest rate risk.

For credit risk, the biannual analysis typically focuses on shocks to the main risk parameters, such as increased past due loans, significant devaluation of the collateral or failure of the five largest exposures in the loan portfolio. The conclusion drawn from this exercise is that the ratios of CEMG are sufficiently robust to cope with the type of shocks simulated.

The institution also conducts, in terms of market risk, a monthly impact analysis of parallel movements of the yield curve on interest rate risk, as per Instruction 19/2005. Regular sensitivity analyses are also performed for the ALCO Committee including interest rate shifts, changing haircuts for ECB accepted collateral in refinancing operations, variations in exposures to large depositors and impacts on net interest income caused by the change in spreads. Measures/strategies for immunisation or containment of any adverse effects expected are then defined.

Sensitivity analyses are also carried out, every six months, in the field of operational risk, in addition to participation in the stress testing exercises promoted by the Bank of Portugal, in cooperation with the other areas of the DRI. The last exercise performed did not reveal any relevant vulnerability which would justify the need for corrective measures.

The results of these analyses are communicated to the board of directors and used in strategic decisions such as pricing, loan criteria and in the development of products offered.

12.3 Quantitative information - interest rate risk

The following is the information reported semi-annually to the Bank of Portugal on "Interest rate risk (banking book)", on a consolidated basis, considering the impact of a rate shock of (+-) 200 b.p.:

Table 31 – Interest rate risk (banking book)

| | | | (thousands €) | |
|---|-------------------------|---|---------------|------------|
| | | | 31-12-2010 | 31-12-2009 |
| Effect on equity of a parallel shift of 200 b.p. in interest rate: | Amount | + | 51.181 | 40.209 |
| | | - | -51.181 | -40.209 |
| | % regulatory capital | + | 3,94% | 3,03% |
| | | - | -3,94% | -3,03% |

"+ " = parallel shift of 200 b.p. in interest rate, in ascending order

"- " = parallel shift of 200 b.p. in interest rate, in descending order

Calculated in accordance with the methodology laid down in Instruction 19/2005, the impact on equity of a parallel shift of + 200 b.p. in the interest rate curve is 3,94% of the regulatory capital (see Table 31). The sensitivity of the banking book to interest rate risk is thus within the guidelines defined by the BIS in "Principles for the Management and Supervision of Interest Rate Risk" (20% limit).