MARKET DISCIPLINE
2012

Market Discipline

2012

June 30, 2013

Montepio

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Foreword

This document uses regulatory reporting information in order to comply with the Bank of Portugal's Notice 10/2007, regarding 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 2012 data.

1. Declaration of Responsibility

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 quality of all information disclosed;
- That any significant changes occurring during or after the preparation of this document will be promptly disclosed.

2. Scope and risk management policies

2.1 Scope

This report pertains to the consolidated accounts of the group, from a regulatory perspective, which includes Caixa Económica Montepio Geral (CEMG); Banco Montepio Geral Cabo Verde - Sociedade Unipessoal, S.A. (IFI); Finibanco, SA; Montepio Crédito[1]; Finivalor – Sociedade Gestora de Fundos Mobiliários, SA and Finibanco Angola, SA.

2.2 Risk management strategies, processes, structure and organization

Risk analysis and control at CEMG are the responsibility of the Risk Division (Direção de Risco - DRI), which advises the board of directors on subjects pertaining to risk management. The 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 is independent 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 departments:

(i) **Credit Risk Department** - responsible for developing internal credit risk analysis models and incorporating them in decision-making processes, and also for internal reports on credit risk;

(ii) **Market Risk Department** - performs analysis and regulatory and internal reporting on market, interest rate, exchange rate and liquidity risks, as well as regulatory reporting on

[1] Previously designated by Finicrédito, SA.

solvency, being also responsible for incorporating that information into the decision-making processes of the trading-room;

(iii) **Operational Risk Department** – is responsible for operational risk management.

CEMG is exposed to a diverse set of risks, with the most significant being credit to retail and corporate 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 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) behavioral (banking relationship).

The degree of scrutiny in credit risk analysis depends on the scale of the operations concerned. Limits have been defined, based on the amount of the operation and total exposure, to identify when it is necessary for a report to be drawn up by credit analysts, who are independent from the commercial decision-making process. These reports 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's capacity to generate cash flows and its financing costs.

CEMG's risk management strategies also take into account the capital requirements associated with its operations, via rules for decision-making and the pricing of credit.

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 minimize the risk of adverse selection, meaning there is always at least one rejection class.

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

Thresholds for participation 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, which is at the top of the decision hierarchy and exercises its authority through the Credit Committee. Participants in this decision-making forum also include the heads of the commercial departments, the Credit Analysis Department and the DRI.

In the field of **market risk**, Value-at-Risk (VaR) and stress testing using extreme scenarios are fundamental for analyzing and imposing limits on exposure. Financial activity is monitored through weekly reports on asset portfolios and also counterparty risk reports. Stop-loss and exposure limits are also defined (for each asset class, portfolio, counterparty, rating level and time period). There are also limits for products which require more complex analysis and for currency exposures. These reports include monitoring of the different exposure limits and analysis of concentration, credit, interest rate and price-variation risk, among others. This analysis takes into account different scenarios, such as 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, with monthly (in the case of liquidity) and bi-annual (in the case of interest rate risk) 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 internally monitored on a daily basis 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 analyzed.
- An analysis of interest rate risk, balance sheet characterization and a sensitivity analysis of the net interest income and earnings of various risk factors are also studied on a monthly basis by 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.

The **operational risk** management system is based on identifying, assessing, monitoring, measuring, mitigating and reporting risks of this type. In terms of CEMG's organizational structure, there is a department exclusively dedicated to operational risk management, complemented by operational risk partners in the different companies and business units of the group.

During 2012, Montepio continued the implementation of the operational risk model in other group entities (Montepio Crédito, Finivalor and Finibanco Angola).

As part of the program to reinforce the operational risk culture, an e-learning training was held for all CEMG employees.

In the "identify and assess" phase, activities, risks and controls, have been reviewed with its annual self-evaluation and risk-tolerance matrix, along with the evaluation of the operational risk profile of new products, processes and activities.

For the "monitoring" phase, the main activities included reinforcing the process of loss event capture and analysis, Key Risk Indicators (KRI) analysis, evaluating the Operational Risk exposure at the Internal Control and Risk Committee and developing periodic reports on the institution's operational risk profile.

Within the "mitigating" phase, Action Plans were suggested for the most significant risks identified by the operational risk tools mentioned above.

The **business continuity plan** is supported for a set of evaluation activities, design, implementation and monitoring, integrated into a continuous improvement cycle. This process is critical to risk mitigation, making business processes more resilient, ensuring the continuity of operations in case of a disruptive event.

In order no extend the business continuity plan to the whole group, significant improvements were done in 2012. The critical business processes and respective Recovery Time Objective (RTO) were reviewed, new recovery systems solutions implemented and recovery business exercises performed.

Internal committees focusing on risk management issues also meet regularly, namely the Risk and Internal Control Committee (monthly), 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 include regular reports on the main types of risk to the board of directors and the business areas involved. 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 summarizing 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.

Risk control techniques and models are based on econometric modeling 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 application 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 which corresponds to default[2].

The application 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.

In the area of **market risk**, in addition to a weekly risk report on CEMG’s total portfolio, reports are prepared on a weekly basis for the trading book, as well as 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 limits on exposure and risk, stop-loss and portfolio composition by rating, country, type of security and issuer.

At the **operational risk** level, a quarterly report concerning the loss data collection is prepared and, additionally, an annual report regarding the Operational Risk Management Cycle implemented at CEMG is issued.

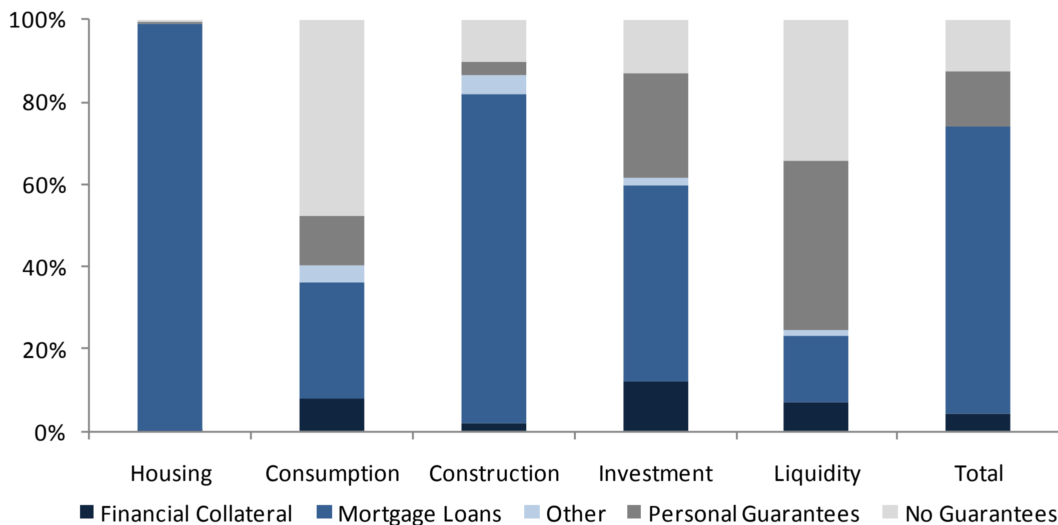
2.4 Risk coverage and mitigation policies

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 potential loss severity.

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

[2] This seventh risk class also includes companies that are in default within the Portuguese financial system, despite being type for each credit portfolio segment is shown below: classified as performing on all credits at Montepio.

Chart 1 – Distribution of types of guarantee by credit segment [3]



Risk mitigation through collateralization is considered when calculating the price of operations, either via 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 for 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 authorized reserves;
- Subordinated liabilities with no fixed term to maturity;

[3] The amounts shown under personal guarantee correspond to operations with no other collateralization.

Lower Tier 2

- 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;
- Total amount of deposits referred to in the Bank of Portugal's Notice 28/2011;
- Negative revaluation reserves.

3.2 Internal capital allocation

CEMG's capital requirements for credit and market risk, as of December 31, 2012, were calculated using the Standardized Approach. For operational risk, calculations used the Standardized approach for CEMG and MG Cabo Verde and the Basic Indicator approach for Finibanco, Montepio Crédito and Finibanco Angola. All calculations are in accordance with the regulations of the Bank of Portugal (Notices 5/2007, 8/2007 and 9/2007).

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

Table 1 – Capital Requirements by Risk Type

(thousands €)

	Credit Risk	Market Risk	Operational Risk	Total
Dec-11	1.004.835	4.420	71.243	1.080.498
Dec-12	1.021.871	4.201	66.235	1.092.307

Within capital requirements for credit and counterparty risk, approximately 94% 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, the primary component of its Own Funds and of Core Tier 1 in particular, has been consistently strengthened in recent years as a consequence of the positive Net Results that CEMG has generated and distributed to the Associação Mutualista. In 2012, the Capital was increased by 50 million € (from 1.245 to 1.295 million €). With this capital increase, the Core Tier 1 ratio reached 10,62% in December 2012.

At the same time, CEMG has maintained resources in the form of subordinated debt, which are included in the Complementary Own Funds and benefit the Total Solvency Ratio.

In light of the internal strategic plan and of the objectives of the Funding and Capital Plan, under the financial aid program to the Portuguese Republic, no significant changes are anticipated in the material dimensions of the various types of risk. Also, the forecasts and analyses verify that CEMG is adequately capitalized under a base case scenario and under an adverse scenario.

With regards to credit risk, higher levels of collateralization for new retail loans are observed, reducing the average loan-to-values ratios, improving the average levels of capital requirements.

The current strategy of diversification across economic sectors, particularly in the corporate segment, will move in the opposite direction where collateral is concerned. However, though exposure is expected to rise in sectors not related to construction, a greater effort to increase the collateralization of new loans will continue.

The strategy of 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, a Core Tier 1 ratio above 10%.

The following Tables 2 to 4 provide a summary of solvency figures throughout 2012, taking into account only Pillar I requirements.

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Table 2 – Capital adequacy for regulatory capital purposes

(thousands €)

		Capital Adequacy - Part 1	Dec-12	Dec-11
1.		**Total regulatory capital for solvency purposes**	1.854.434	1.831.996
1.1.		**Core Capital**	1.464.728	1.393.584
	1.1.1.	Eligible share capital	1.295.000	1.245.000
	1.1.1.1.	Paid-in share capital	1.295.000	1.245.000
	1.1.1.2.	(-) Own shares	0	0
	1.1.1.3.	share issuance premiums	0	0
	1.1.1.4.	Other financial instruments similar to capital	0	0
	1.1.2.	Eligible reserves and results	222.379	122.150
	1.1.2.1.	Reserves	224.662	166.248
	1.1.2.2.	Eligible minority interests	5.863	9.111
	1.1.2.3.	Results from the previous year and provisional results for the current year	858	0
	1.1.2.4.	(-) Negative results from the previous year and negative provisional results for the current year	0	-51.087
	1.1.2.5.	Results from the previous year and provisional results for the current year	0	0
	1.1.2.6.	(-) Net gains from capitalisation of future margin income from securitised assets	0	0
	1.1.2.7.	Revaluation differences eligible for Tier 1 regulatory capital	-9.005	-2.121
	1.1.3.	Fund for general banking risks	0	0
	1.1.4.	Other items eligible for Tier 1 capital	53.863	127.043
	1.1.4.1.	Other eligible instruments	15.000	15.000
	1.1.4.2.	Impact of the transition to the IAS/AAS (negative impact)	2.839	10.367
	1.1.4.3.	Other items eligible for Tier 1 capital	36.025	101.677
	1.1.5.	(-) Other items deductable from Tier 1 capital	-106.514	-100.610
	1.1.5.1.	(-) Intangible fixed assets	-69.273	-90.205
	1.1.5.2.	(-) Amount in excess of the eligibility limit for financial instruments included in Tier 1 capital	0	0
	1.1.5.3.	(-) Other items to be deducted from Tier 1 capital	-37.241	-10.406
1.2.		**Complementary capital**	440.903	471.751
	1.2.1.	Upper Tier 2	10.229	8.950
	1.2.2.	Lower Tier 2	430.674	462.802
	1.2.3.	(-) Deductions from complementary capital	0	0
1.3.		**(-) Deductions from Tier 1 and complementary capital**	-38.280	-30.162
	1.3.a.	Of which: (-) from Tier 1 capital	-19.140	-15.081
	1.3.b.	Of which: (-) from complementary capital	-19.140	-15.081
1.4.		**Total Tier 1 captial for solvency purposes**	1.445.588	1.378.503
1.5.		**Total complementary capital for solvency purposes**	421.763	456.670
1.6.		**(-) Deductions from total regulatory capital**	-12.918	-3.177
1.7.		**Total complementary capital available to cover market risks**	0	0
1.8.		**For the record:**	0	0
	1.8.1	(+) Surplus / (-) Shortfall in value corrections and "provisions" for assets risk weighted via the internal models method	0	0
	1.8.1.1	Amount of value corrections and "provisions" in the internal models method	0	0
	1.8.1.2.	(-) Expected loss determinded by the internal models method	0	0
	1.8.2.	Nominal value of subordinated debt recognised as a positive contributor to own funds	0	0
	1.8.3.	Minimum requirement for social capital	0	0
	1.8.4.	Reference capital for the purpose of large exposures limits	1.854.434	1.831.996

Table 3 – Capital adequacy for capital requirements purposes

(thousands €)

Capital Adequacy - Part 2			Dec-12	Dec-11
2.	Regulatory capital requirements		1.092.307	1.080.498
2.1.	For credit risk, counterparty risk, risk of decrease in receivables and delivery risk		1.021.871	1.004.835
2.1.1.	Standardised approach		1.021.871	1.004.835
2.1.1.1.	Risk classes in the standardised approach, excluding securitisation positions		1.021.018	1.004.353
	2.1.1.1.1.	Claims and conditional claims on central governments and central banks	1.129	4.365
	2.1.1.1.2.	Claims and conditional claims on regional governments and local authorities	744	676
	2.1.1.1.3.	Claims and conditional claims on public sector and othe non-profit public institutions	2.752	2.152
	2.1.1.1.4.	Claims and conditional claims on multilateral development banks	0	0
	2.1.1.1.5.	Claims and conditional claims on international organizations	0	0
	2.1.1.1.6.	Claims and conditional claims on insitutions	44.491	56.904
	2.1.1.1.7.	Claims and conditional claims on corporations	416.918	402.477
	2.1.1.1.8.	Claims and conditional claims in the retails portfolio	93.580	94.586
	2.1.1.1.9.	Claims and conditional claims seccured by real estate	256.561	312.286
	2.1.1.1.10.	Past due items	74.600	65.406
	2.1.1.1.11.	Items classified as high risk for regulatory purposes	0	0
	2.1.1.1.12.	Covered bonds and public sector bonds	618	600
	2.1.1.1.13.	Exposures to colective investment undertakings (CIU)	33.280	26.701
	2.1.1.1.14.	Other items	96.346	38.201
2.1.1.2.	Securitisation exposures using the standardised approach		852	482
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		4.201	4.420
2.3.1.	Standardised approach		4.201	4.420
2.3.1.1.	Debt instruments		2.076	3.358
2.3.1.2.	Equity instruments		2.125	1.063
2.3.1.3.	Exchange rate risk		0	0
2.3.1.4.	Commodities risk		0	0
2.4.	Capital requirements for operational risk		66.235	71.243
2.4.1.	Basic indicator method		6.320	5.939
2.4.2.	Standardised approach		59.915	65.304
2.4.3.	Advanced measurement methods		0	0
2.5.	Regulatory capital requirements - fixed general expenditure		0	0
2.6.	Temporary capital requirements or other capital requirements		0	0

Table 4 – Total Capital adequacy

(thousands €)

Capital Adequacy - Part 3	Dec-12	Dec-11
Surplus (+) / Shortfall (-) in total capital	762.127	751.498
Total Capital Ratio (%)	13,58%	13,56%

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 exposure limits, which are 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 6, 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 5 – Counterparty credit risk

(thousands €)

	Original Exposure	Credit risk mitigation techniques with substitution effect in the original net exposure	Exposure after risk mitigation	Risk-weighted exposure	
				Dec-12	Dec-11
	1	2	3	4	5
Repos, borrowing/lending of securities or commodities, long settlement transactions or transactions with imposition of margin loans	11.421	0	11.421	3.474	2.242
Derivatives	114.694	0	114.694	35.716	22.591
Contractual multiproduct netting	0	0	0	0	0

The Mark-to-Market valuation method is used to calculate the exposure value for derivatives, repurchase transactions, borrowing or lending of securities or commodities, long term settlement transactions and lending operations with margin imposition, 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, 2012, CEMG had no credit risk hedging operations via credit derivatives, as shown in Table 6.

Table 6 – Credit Derivatives Hedging

(thousands €)

Risk Class (Hedged transactions)	Original exposure (hedged transactions)		Notional amount covered by credit derivatives					
			CDS (1)	TRS (2)	CLN (3)	Other	Total	Total
	2012	2011					2012	2011
	1	2	3	4	5	6	7=3+4+5+6	8
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

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

Table 7 – Credit Derivatives Instruments

(thousands €)

Transactions in Credit Derivatives	Long Positions		Short Positions	
	2012	2011	2012	2011
I. Credit Portfolio (totals):				
a) Credit default swaps	9	1.198	181	4.418
b) Total return swaps				
c) Credit linked notes	9.934	8.520		
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 aquired 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, as defined by the internal model (including past due loans, restructured credit and registration as a risky user in the Bank of Portugal's database, etc.);
- **Past due loans**: all loans with payments in arrears;
- **Value corrections**: derive from the regulatory provisioning of 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 2011 and 2012 were 770 million € and 922 million €, respectively, as shown in Table 8.

Table 8 – Provisions and value corrections

(thousands €)

Value Corrections and Provisions	Dec-12	Dec-11
Initial Balance	**770.476**	**521.811**
Charge for the year net of reversals	171.621	143.729
Recovery of loans and interest charged-off	-179.651	-43.065
Transfers/Others	159.838	148.001
Closing Balance	**922.284**	**770.476**

5.2 Portfolio Structure

The distribution of exposures in the loan portfolio by risk class shows a large concentration in the Positions Guaranteed by Real Estate and Corporate Loans classes, as there was in the previous year (Table 9).

Table 9 – Distribution of credit exposures by risk class

(thousands €)

Risk Class	Orignial exposure at default		Orignial exposure at default (mean over the course of the year)	
	Dec-12	Dec-11	Dec-12	Dec-11
CL I - Central government and central banks	1.658.369	1.715.596	1.527.860	1.660.611
CL II - Regional governments and local authorities	46.735	42.560	43.966	48.794
CL III - Public sector entities and other non-profit public institutions	35.879	27.594	34.938	37.937
CL IV - Multilateral development banks	0	0	0	0
CL V - International organisations	0	0	0	0
CL VI - Institutions	937.643	1.270.131	1.269.816	1.246.329
CL VII - Corporations	5.669.068	5.555.798	5.274.806	4.809.902
CL VIII - Retail portfolio	1.943.313	1.973.405	1.970.212	2.221.820
CL IX - Garanteed by real estate	8.527.942	9.802.745	9.167.511	9.874.762
CL X - Past due items	798.303	688.811	893.836	555.372
CL XI - Covered bonds and public sector bonds	18.554	22.328	17.880	27.278
CL XII - Exposures to colective investment undertakings (CIU)	408.927	333.761	474.543	76.073
CL XIII - Other items	1.535.805	968.510	1.021.537	749.345
Securitisation exposures using the standardised approach	14.794	15.278	15.000	17.883
TOTAL	**21.595.333**	**22.416.516**	**21.711.905**	**21.326.104**

CEMG is commercially present in most regions (NUTS II[4]) of the country (Table 10), though a higher concentration is still seen in areas with higher population density (Lisbon, North and Center) when analyzing the geographic distribution of the loan portfolio.

[4] NUTS II is the *Unidades Territoriais para Fins Estatísticos de Nível II* used by the National Institute of Statistics (INE).

Table 10 – Geographic distribution of exposures in the credit portfolio by risk class (as a % of original exposure at default)

Year	Risk Class	Geografic distribution of exposures (as a % of original exposure at default)							
		Lisbon	North	Center	Algarve	Alentejo	Azores	Madeira	Angola
2011	CL I - Central government and central banks	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%
	CL II - Regional governments and local authorities	0,10%	0,00%	0,04%	0,00%	0,00%	0,02%	0,06%	0,00%
	CL III - Public sector entities and other non-profit public institutions	0,00%	0,01%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%
	CL VI - Institutions	1,25%	0,01%	0,10%	0,01%	0,00%	0,00%	0,00%	0,00%
	CL VII - Corporations	12,39%	6,54%	4,65%	1,57%	0,76%	0,46%	0,71%	0,39%
	CL VIII - Retail portfolio	3,12%	3,55%	2,29%	0,71%	0,46%	0,35%	0,16%	0,05%
	CL IX - Garanteed by real estate	23,32%	13,22%	7,75%	2,96%	2,41%	1,90%	1,43%	0,00%
	CL X - Past due items	2,69%	2,49%	1,27%	0,34%	0,27%	0,07%	0,08%	0,02%
	TOTAL	**42,87%**	**25,82%**	**16,10%**	**5,60%**	**3,91%**	**2,80%**	**2,45%**	**0,47%**
2012	CL II - Regional governments and local authorities	0,15%	0,00%	0,04%	0,00%	0,00%	0,02%	0,05%	0,00%
	CL III - Public sector entities and other non-profit public institutions	0,01%	0,02%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%
	CL VI - Institutions	0,84%	0,07%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%
	CL VII - Corporations	13,63%	7,29%	4,68%	1,32%	0,74%	0,51%	0,43%	0,76%
	CL VIII - Retail portfolio	3,24%	3,68%	2,36%	0,73%	0,52%	0,35%	0,15%	0,07%
	CL IX - Garanteed by real estate	20,70%	12,53%	7,10%	2,77%	2,27%	1,88%	1,43%	0,00%
	CL X - Past due items	3,48%	3,38%	1,73%	0,53%	0,37%	0,09%	0,08%	0,01%
	TOTAL	**42,04%**	**26,97%**	**15,92%**	**5,35%**	**3,90%**	**2,85%**	**2,13%**	**0,83%**

With regards to the distribution of the corporate portfolio by economic sector (Table 11), the construction sector deserves special attention, despite showing a decrease in its proportion, by -2,7 p.p., compared to Dec-11. There is also a significant proportion of loans in the Commerce and Real Estate Management sectors, with the latter registering a slight decrease (about -1,2 p.p.) over last year.

Table 11 – Economic sector distribution of exposures in the credit portfolio by risk class (as a % of original exposure at default)

Year	Risk Class	Primary Sector	Secondary Sector		Tertiary Sector							
			Construction	Other	Real estate	Wholesale and retail trade	Financial & Insurance	Hotels, Restaurants, etc.	Transport & Warehousing	Public administration (1)	Consultancy, Scientific, technical and similar activities	Other
2011	CL I - Central government and central banks	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%
	CL II - Regional governments and local authorities	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,55%	0,00%	0,00%
	CL III - Public sector entities and other nonprofit 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%	3,33%	0,00%	0,00%	0,00%	0,00%	0,00%
	CL VII - Corporations	0,95%	21,07%	9,49%	7,65%	9,60%	4,12%	2,24%	2,62%	1,18%	1,66%	3,93%
	CL VIII - Retail portfolio	0,17%	1,65%	1,07%	0,85%	2,37%	0,09%	0,81%	0,35%	0,48%	0,62%	1,06%
	CL IX - Garanteed by real estate	0,04%	6,38%	0,37%	3,51%	1,09%	0,28%	0,66%	0,04%	0,27%	0,09%	0,47%
	CL X - Past due items	0,07%	4,05%	0,99%	1,30%	1,44%	0,06%	0,25%	0,17%	0,03%	0,11%	0,37%
	TOTAL	**1,23%**	**33,15%**	**11,92%**	**13,31%**	**14,51%**	**7,88%**	**3,97%**	**3,17%**	**2,51%**	**2,48%**	**5,87%**
2012	CL II - Regional governments and local authorities	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,64%	0,00%	0,00%
	CL III - Public sector entities and other nonprofit public institutions	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,06%
	CL VI - Institutions	0,00%	0,00%	0,00%	0,00%	0,00%	2,21%	0,00%	0,00%	0,00%	0,00%	0,00%
	CL VII - Corporations	0,94%	21,48%	10,46%	8,19%	9,02%	5,09%	1,93%	2,69%	1,47%	2,02%	4,53%
	CL VIII - Retail portfolio	0,22%	1,54%	1,18%	0,85%	2,39%	0,09%	0,81%	0,37%	0,65%	0,61%	1,15%
	CL IX - Garanteed by real estate	0,03%	1,98%	0,19%	1,21%	0,65%	0,12%	0,45%	0,04%	0,30%	0,06%	0,21%
	CL X - Past due items	0,11%	5,45%	1,81%	1,89%	2,65%	0,24%	0,53%	0,28%	0,19%	0,22%	0,82%
	TOTAL	**1,30%**	**30,46%**	**13,65%**	**12,13%**	**14,70%**	**7,75%**	**3,72%**	**3,39%**	**3,24%**	**2,90%**	**6,76%**

(1) Public Administration and Defense; Social Security; Human health and w elfare

In terms of distribution by residual maturity, as seen in the following table, about 50% 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 investment loans to corporations. The portfolio with no set payment plan, which corresponds to about 16% of the overall original exposure, consists broadly of liquidity facilities for companies (revolving credit).

Table 12 – Residual maturity of the credit portfolio by risk class (as a % of original EAD)

Year	Risk Class	Residual maturity (as a % of original exposure at default) RM < 1	1 year < RM < 5 years	5 years < RM < 10 years	RM > 10 years	Revolving
2011	CL I - Central government and central banks	0,0%	0,0%	0,0%	0,0%	0,0%
	CL II - Regional governments and local authorities	0,0%	0,0%	0,2%	0,0%	0,0%
	CL III - Public sector entities and other non-profit public institutions	0,0%	0,0%	0,0%	0,0%	0,0%
	CL VI - Institutions	0,5%	0,3%	0,0%	0,0%	0,6%
	CL VII - Corporations	9,0%	3,8%	4,1%	2,2%	8,5%
	CL VIII - Retail portfolio	2,0%	2,7%	2,4%	1,1%	2,5%
	CL IX - Garanteed by real estate	0,6%	0,6%	2,8%	45,7%	3,2%
	CL X - Past due items	1,6%	0,6%	0,6%	2,8%	1,6%
	Total original exposure at default	**13,6%**	**7,9%**	**10,2%**	**51,8%**	**16,3%**
2012	CL II - Regional governments and local authorities	0,1%	0,0%	0,2%	0,0%	0,0%
	CL III - Public sector entities and other non-profit public institutions	0,0%	0,0%	0,0%	0,0%	0,0%
	CL VI - Institutions	0,2%	0,2%	0,1%	0,0%	0,4%
	CL VII - Corporations	7,7%	3,8%	5,1%	2,8%	9,9%
	CL VIII - Retail portfolio	1,8%	2,4%	2,6%	1,8%	2,5%
	CL IX - Garanteed by real estate	0,5%	0,4%	2,7%	44,5%	0,6%
	CL X - Past due items	2,9%	0,9%	0,8%	3,0%	2,1%
	Total original exposure at default	**13,1%**	**7,8%**	**11,5%**	**52,1%**	**15,6%**

5.3 Concentration risk

As mentioned, CEMG has an ongoing diversification strategy in order to reduce the proportion of exposure related to the real estate sector. 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 CI[5] is calculated from the 100 largest exposures, aggregated by client/economic group. The proportion of these exposures in Dec-12 amounted to roughly 13% of the loan portfolio and 17% of the total portfolio[6].

The sector CI[7] is calculated based on the classification of clients' economic activities.

Table 13 – Concentration indices

	Credit Portfolio		Total Portfolio	
	Dec-12	Dec-11	Dec-12	Dec-11
Individual CI	0,18	0,19	0,29	0,29
Sector CI	15,0	17,0	13,6	15,5

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

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

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

The decrease in the sector CI reflects the diversification strategy that the Institution has been pursuing in all portfolios, both at a sector and on an asset type level.
With regard to the distribution of the largest exposures by country, the portfolio is almost entirely concentrated in Portugal (Table 14).

Table 14 – Distribution of exposures by Country

(thousands €)

Country	Exposure by country		% Total Portfolio	
	Dec-12	Dec-11	Dec-12	Dec-11
Portugal	17.579	18.692	96,0%	95,5%
Spain	85	136	0,5%	0,7%
Ireland	68	75	0,4%	0,4%
United Kingdom	85	108	0,5%	0,6%
France	67	73	0,4%	0,4%
Others	435	480	2,4%	2,5%
Total	18.320	19.565		

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, commerce and real estate .

The geographical distribution of past due loans (Table 15) shows, in line with the total portfolio for 31 December, 2011, a larger concentration in the Lisbon, North and Central regions, reflecting the overall portfolio´s geographical distribution.

Table 15 – Breakdown of past due and impaired exposures

Year	Breakdown	Total exposures		% Exposures past due	% Covered by impairment provisions
Dec-11	Breakdown by main economic sectors (Corporate segment)	Primary Sector		0,8%	35,9%
		Secondary Sector	Construction	45,8%	36,8%
			Others	11,2%	38,1%
		Tertiary Sector	Wholesale and retail trade	16,3%	42,7%
			Real estate activities	14,6%	36,2%
			Other	4,2%	41,1%
			Hotels, Restaurants, etc.	2,8%	36,9%
			Transport & Warehousing	1,9%	53,7%
			Consultancy, Scientific, technical and similar activities	1,3%	35,9%
			Financial & Insurance	0,7%	52,9%
			Public admin. and defense; Social Security; Human health and welfare	0,3%	37,1%
		Total		100,0%	38,5%
	Breakdown by main geografic regions	Lisbon		37,1%	32,4%
		North		34,4%	36,0%
		Center		17,6%	34,2%
		Algarve		4,6%	27,2%
		Alentejo		3,8%	29,9%
		Madeira		1,1%	19,7%
		Azores		1,0%	27,5%
		Angola		0,3%	0,0%
		Total		100,0%	33,3%
Dec-12	Breakdown by main economic sectors (Corporate segment)	Primary Sector		0,7%	43,6%
		Secondary Sector	Construction	38,4%	34,6%
			Others	12,8%	48,3%
		Tertiary Sector	Wholesale and retail trade	18,7%	45,7%
			Real estate activities	13,3%	37,2%
			Other	5,7%	45,7%
			Hotels, Restaurants, etc.	3,7%	27,4%
			Transport & Warehousing	2,0%	42,6%
			Financial & Insurance	1,7%	56,4%
			Consultancy, Scientific, technical and similar activities	1,5%	37,9%
			Public admin. and defense; Social Security; Human health and welfare	1,4%	20,4%
		Total		100,0%	39,6%
	Breakdown by main geografic regions	Lisbon		36,0%	31,5%
		North		34,9%	41,9%
		Center		17,9%	33,8%
		Algarve		5,5%	26,6%
		Alentejo		3,8%	32,1%
		Azores		1,0%	28,9%
		Madeira		0,8%	22,6%
		Angola		0,1%	4,7%
		Total		100,0%	35,2%

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

- When different ratings are simultaneously issued by separate recognized 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 2012, the distribution of CEMG's portfolio among the different classes and risk weights are presented in detail in the following table.

Table 16 – Regulatory capital, counterparty and credit risk requirements

(thousands €)

		Risk weights									Total
		0%	10%	20%	35%	50%	75%	100%	150%	Outros	
1. Original exposure by risk class	CL I - Central government and central banks	1.601.161	0	53.870	0	0	0	3.337	0	0	1.658.369
	CL II - Regional governments and local authorities	0	0	46.735	0	0	0	0	0	0	46.735
	CL III - Public sector entities and other non-profit public institutions	0	0	0	0	0	0	35.879	0	0	35.879
	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	382.120	0	10	0	553.748	1.765	0	937.643
	CL VII - Corporations	0	0	1.525	0	8.815	0	5.655.091	3.637	0	5.669.068
	CL VIII - Retail portfolio	0	0	0	0	0	1.943.313	0	0	0	1.943.313
	CL IX - Garanteed by real estate	0	0	0	7.943.641	129.291	348.684	106.326	0	0	8.527.942
	CL X - Past due items	0	0	0	0	0	0	518.646	279.657	0	798.303
	CL XI - Covered bonds and public sector bonds	0	3.885	0	0	14.669	0	0	0	0	18.554
	CL XII - Exposures to colective investment undertakings (CIU)	0	0	0	0	0	0	394.783	14.144	0	408.927
	CL XIII - Other items	155.925	0	219.443	0	0	0	1.160.437	0	0	1.535.805
	Securitisation exposures using the standardised approach	0	0	5.174	0	0	0	9.620	0	0	14.794
	TOTAL of original exposures:	**1.757.087**	**3.885**	**708.868**	**7.943.641**	**152.785**	**2.291.997**	**8.437.868**	**299.203**	**0**	**21.595.333**
2. Exposures by risk class (basis for RW application)	CL I - Central government and central banks	1.601.161	0	53.870	0	0	0	3.337	0	0	1.658.369
	CL II - Regional governments and local authorities	0	0	46.498	0	0	0	0	0	0	46.498
	CL III - Public sector entities and other non-profit public institutions	0	0	0	0	0	0	34.403	0	0	34.403
	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	59.627	0	335.561	0	10	0	486.372	1.765	0	883.335
	CL VII - Corporations	0	0	1.525	0	8.815	0	5.201.306	3.637	0	5.215.283
	CL VIII - Retail portfolio	0	0	0	0	0	1.559.658	0	0	0	1.559.658
	CL IX - Garanteed by real estate	0	0	0	7.943.641	129.291	345.401	103.039	0	0	8.521.371
	CL X - Past due items	0	0	0	0	0	0	529.838	268.445	0	798.283
	CL XI - Covered bonds and public sector bonds	0	3.885	0	0	14.669	0	0	0	0	18.554
	CL XII - Exposures to colective investment undertakings (CIU)	0	0	0	0	0	0	394.783	14.144	0	408.927
	CL XIII - Other items	155.925	0	219.443	0	0	0	1.160.437	0	0	1.535.805
	Securitisation exposures using the standardised approach	0	0	5.174	0	0	0	9.620	0	0	14.794
	TOTAL exposures:	**1.816.714**	**3.885**	**662.071**	**7.943.641**	**152.785**	**1.905.059**	**7.923.134**	**287.991**	**0**	**20.695.280**
3. TOTAL risk weighted exposures (=Σ (2."x"risk weights))		**0**	**388**	**132.414**	**2.780.274**	**76.393**	**1.428.794**	**7.923.134**	**431.987**	**0**	**12.773.385**
Capital requirements by risk class (2. "x" risk weights "x" 8%)	CL I - Central government and central banks	0	0	862	0	0	0	267	0	0	1.129
	CL II - Regional governments and local authorities	0	0	744	0	0	0	0	0	0	744
	CL III - Public sector entities and other non-profit public institutions	0	0	0	0	0	0	2.752	0	0	2.752
	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	5.369	0	0	0	38.910	212	0	44.491
	CL VII - Corporations	0	0	24	0	353	0	416.104	436	0	416.918
	CL VIII - Retail portfolio	0	0	0	0	0	93.580	0	0	0	93.580
	CL IX - Garanteed by real estate	0	0	0	222.422	5.172	20.724	8.243	0	0	256.561
	CL X - Past due items	0	0	0	0	0	0	42.387	32.213	0	74.600
	CL XI - Covered bonds and public sector bonds	0	31	0	0	587	0	0	0	0	618
	CL XII - Exposures to colective investment undertakings (CIU)	0	0	0	0	0	0	31.583	1.697	0	33.280
	CL XIII - Other items	0	0	3.511	0	0	0	92.835	0	0	96.346
	Securitisation exposures using the standardised approach	0	0	83	0	0	0	770	0	0	852
	TOTAL capital requirements:	**0**	**31**	**10.593**	**222.422**	**6.111**	**114.304**	**633.851**	**34.559**	**0**	**1.021.871**

6. Credit risk mitigation techniques

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

Loans 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 presented in Annex VI to Bank of Portugal's Notice 5/2007.

With regards to mortgage collateral, property evaluations are performed by independent specialists or an independent department. The re-evaluation of these assets is done in accordance with the requirements defined in Notice 5/2007, using real estate price variation indices[8] or on-site assessments.

Table 17 – Property Re-evaluation

Property for housing	- 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	- 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.

[8] Based on data provided by Credit Institutions and Real Estate Brokers.

Table 18 – Credit risk mitigation techniques

(thousands €)

Risk Class	Net exposure	Credit risk mitigation techniques with a substitution effect on net exposure					Mitigation techniques which reduce the value of exposure	
		Personal protection, mitigation amount		Real credit protection		Efect of substitution on exposure[1]	Volatility ajustment to exposure value	Financial Colateral: mitigation amount
		Guarantees	Credit derivatives	Simple Method	Other			
	1	2	3	4	5	6	7	8
Total exposure	**21.595.333**	**185.051**	**0**	**0**	**0**	**63.216**	**0**	**353.757**
CL I - Central government and central banks	1.658.369	0	0	0	0	0	0	0
CL II - Regional governments and local authorities	46.735	0	0	0	0	0	0	107
CL III - Public sector entities and other non-profit public institutions	35.879	0	0	0	0	0	0	1.278
CL VI - Institutions	937.643	59.627	0	0	0	57.616	0	52.817
CL VII - Corporations	5.669.068	112.366	0	0	0	0	0	188.131
CL VIII - Retail portfolio	1.943.313	0	0	0	0	0	0	104.834
CL IX - Garanteed by real estate	8.527.942	966	0	0	0	0	0	6.571
CL X - Past due items	798.303	12.092	0	0	0	5.600	0	20
CL XI - Covered bonds and public sector bonds	18.554	0	0	0	0	0	0	0
CL XII - Exposures to colective investment undertakings (CIU)	408.927	0	0	0	0	0	0	0
CL XIII - Other items	1.535.805	0	0	0	0	0	0	0
Securitisation exposures using the standardised approach	14.794	0	0	0	0	0	0	0

[1] - This field is calculated as follows: G*P 1 - G*P 2 , where G is the amount of the guarantee, P 1 the original RW and P2 the RW after taking into account the guarantee.

Table 19 – Concentration Analysis – Personal and real credit protection

(thousands €)

	Personal credit protection		Real credit protection - Integral method for financial colateral	
	Guarantees		Eligible (financial) collateral	
	Dec-12	Dec-11	Dec-12	Dec-11
CL I - Central government and central banks	0	0	0	0
CL II - Regional governments and local authorities	0	0	107	130
CL III - Public sector entities and other non-profit public institutions	0	0	1.278	535
CL VI - Institutions	59.627	885	52.817	53.068
CL VII - Corporations	112.366	46.198	188.131	213.517
CL VIII - Retail portfolio	0	42.484	104.834	110.739
CL IX - Garanteed by real estate	966	0	6.571	0
CL X - Past due items	12.092	8.061	20	53
CL XI - Covered bonds and public sector bonds	0	0	0	0
CL XII - Exposures to colective investment undertakings (CIU)	0	0	0	0
CL XIII - Other items	0	0	0	0
Securitisation exposures using the standardised approach	0	0	0	0

7. Securitizations

7.1 Current involvement

As of 31 December, 2012, CEMG was involved in the following traditional credit securitization operations as originator: Pelican Mortgages 1, Pelican Mortgages 2, Pelican Mortgages 3, Pelican Mortgages 4, Pelican Mortgages 5 and Pelican SME 1 (Table 20). As a result of the acquisition of Finibanco Holding, CEMG took on, and is thus considered the originator of Aqua Mortgage 1 and Aqua Finance 3 (via Montepio Crédito). In all of these operations, the main goal was to achieve greater flexibility in managing the bank's balance sheet, with a positive impact on liquidity indicators, for instance.

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

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

7.2 Calculation Methods for risk-weighted exposures

Given that none of these securitization 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 securitization exposures held and losses on these positions are not considered.

With regard to securitizations where CEMG acts as an investor, the risk-weighted exposure is calculated according to Notice 7/2007 of the Bank of Portugal, using the Standardized Approach. Credit ratings issued by Fitch, Moody's and S&P were used to determine the credit quality of each securitization 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 securitization deals were derecognized. Securities acquired as a result of those operations were considered as assets available for sale and provisioned according to the rules defined in the 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 securitizations issued carried out prior to 1 January, 2004. All operations carried out after that date are analyzed according to the rules set out in IAS 39, which stipulates that 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 derecognized.

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7.4 Quantitative information

Table 20 – Securitization Operations

(thousands €)

	Securitisation Operations								
	Pelican 1	Pelican 2	Pelican 3	Pelican 4	Pelican 5	Pelican 6	Pelican SME 1	Aqua Mortgage 1	Aqua Finance 3
Traditional securitisation									
Originator	CEMG	CEMG	CEMG	CEMG	CEMG	CEMG	CEMG	CEMG	Montepio Crédito
Issuer	Navegator SGFTC, SA	Banco Finantia, SA	Sagres STC, SA	Sagres STC, SA	Sagres STC, SA	Sagres STC, SA	Sagres STC, SA	Tagus STC, SA	Tagus STC, SA
Information on the operations									
Start date	19-Dec-02	29-Sep-03	30-Mar-07	20-May-08	25-Mar-09	5-Mar-12	22-Jun-10	09-Dec-08	30-Jun-09
Legal maturity	Sep-37	Sep-36	Sep-54	Sep-56	Dec-61	Dec-63	Jul-36	Dec-63	Dec-23
Step-up clause (date)	n.a.	Sep-10	Mar-16	Jun-17	Jun-18	n.a.	Jul-13	n.a.	n.a.
Revolving (years)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	3	2	3
Securitised assets (in millions of euros)	650	700	750	1.000	1.000	1.040	1.167	233	173
Outstanding amount (in millions of euros)	81	157	347	810	833	1.020	562	194	169
Information on involvement of originator(s)									
Existence of situations of "implicit support"	no	no	no	no	no	no	no	no	no
Assets ceded (by institution)/Securitised Assets (total) (%)	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%
Inicial capital-gains/Value of repurchased firstloss position	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00

n.a. = not aplicable

Table 21 – Outstanding exposure amount on securitized loans

(thousands €)

	Amount	Of which: relating to exposures subject to impairment or past due
Pelican 1	81	2
Pelican 2	157	1
Pelican 3	347	1
Pelican 4	810	2
Pelican 5	833	2
Pelican 6	1.020	4
Pelican SME 1	562	17
Aqua Mortgage 1	194	4
Aqua Finance 3	169	13
Traditional securitisations (total)	4.174	45

Table 22 – Credit risk – Securitization Operations: Standardized Approach

(thousands €)

Type of securitisation (tradicional/synthetic)	Exposure amount		Risk weighted exposure	
		Amount deducted from regulatory capital	Dec-12	Dec-11
	2	3	9	10
B=Investor positions: total	14.794	0	10.655	6.023
B1 - On-balance sheet exposures	14.794	0	10.655	6.023
Securitisations	14.794	0	10.655	6.023
Resecuritisations	0	0	0	0
B2 - Off-balance sheet items and derivatives	0	0	0	0
C=Issuer positions: total	0	0	0	0
C1 - On-balance sheet exposures	0	0	0	0
C2 - Off-balance sheet items and derivatives	0	0	0	0

Table 23 – Credit risk – Securitization Operations: Activities Summary

(thousands €)

Type of securitisation (tradicional/synthetic)	Securitised exposure		Risk weighted exposure		Gains / Losses recognised on sales	
	Dec-12	Dec-11	Dec-12	Dec-11	Dec-12	Dec-11
Tradicional securitisations (total)	4.174	3.868	0	0	0	0
On-balance sheet exposures	4.174	3.868	0	0	0	0
Securitisations	4.174	3.868	0	0	0	0
Resecuritisations	0	0	0	0	0	0
Off-balance sheet items and derivatives	0	0	0	0	0	0
Synthetic securitisations (total)	0	0	0	0	0	0
On-balance sheet exposures	0	0	0	0	0	0
Securitisations	0	0	0	0	0	0
Resecuritisations	0	0	0	0	0	0
Off-balance sheet items and derivatives	0	0	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 of positions held with the aim of achieving short-term gains, either through sales or by revaluation. Capital requirements are calculated using the Standardized Approach.

8.2 Methods for assessing risk on the trading book

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

In accordance with the Standardized 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 Standardized Approach, the following methodologies are applied to each type of exposure:

Debt Instruments

- General Risk: refers to the risk of loss caused by unfavorable 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 unfavorable 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 8%;
- Positions in collective investment undertaking: in accordance with Section VI, Part 2 of Bank of Portugal's Notice 8/2007, these positions are subject to an own funds requirement of 32%.

8.3 Quantitative information

Table 24 – Regulatory capital requirements (trading book)

(thousands €)

	Trading book risks	Regulatoty capital requirements	
		Dec-12	Dec-11
1.	**Position risk**		
1.1.	**Standardised approach to the trading book**	4.201	4.420
1.1.1.	**Debt instruments**		
1.1.1.1.	Specific risk	1.396	1.640
1.1.1.2.	General risk	680	1.718
1.1.2.	**Equities**		
1.1.2.1.	Specific risk	1.063	660
1.1.2.2.	General risk	1.063	402
2.	**Counterparty credit risk**		
2.1	Bonds	0	0
2.2	Derivatives	606	902
2.3	Other	0	0

In quantitative terms, using the methods described above, the regulatory capital requirements for the trading portfolio as of 31 December, 2012, amounted to 4.201.900 €. In comparison with the previous year, there are no significant changes in terms of capital requirements for the trading portfolio. This stability results from maintaining the same structure/composition of the trading portfolio during the two time periods in analysis.

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 Standardized 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 standardized 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, 2012, application of the calculations described in Annex VI of the Bank of Portugal's Notice 8/2007 was not required.

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9.3 Quantitative information

As of 31 December, 2012, the net foreign currency position represented approximately 0,04% of the regulatory capital, therefore there was no allocation of capital to cover currency risk, given the limits described in the previous section.

10. Equity exposures in the banking book

10.1 Management goals

Equity investment 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 characterized 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 are accounted for according to the portfolios in which these securities are classified, the cumulative value of the losses and the length of time for which the losses have existed. Capital losses on equity registered in the trading book have an immediate effect on results. Reductions in the value of shares categorized 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 25 – Equity exposure

(thousands €)

	Listed shares		Unlisted shares		Total	
	Dec-12	Dec-11	Dec-12	Dec-11	Dec-12	Dec-11
Acquisition cost	20.855	14.108	379.305	379.305	400.160	393.413
Fair value	19.957	12.094	375.767	377.713	395.724	389.907
Market price	19.957	12.094			19.957	12.094
Results for the year arising from sales and settlements					1.306	-638
Total unrealized gains and losses					1.072	-465
Total gains and losses inherent in latent revaluations					**-5.508**	**-3.141**

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 authorization 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. With the larger perimeter of consolidation in 2011, this method is being implemented in the remaining companies within the group.

As of December 31, 2012, the operational risk capital requirements for CEMG and MG Cabo Verde were calculated using the Standard Approach (TSA). For Finibanco, Montepio Crédito and Finibanco Angola, the requirements were calculated according to the Basic Indicator Approach (BIA). As a result, the consolidated capital requirements to cover operational risk were 66,2 million € on December 31, 2012.

In the Basic Indicator Approach, regulatory capital requirement to cover operational risk is calculated as the average of the relevant positive yearly indicator over the last three years, multiplied by 15%. In the Standard Method this capital requirement corresponds to the average of the relevant positive yearly indicator, across each of the business lines, over the last three years, 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 26 –Business Line Mapping

Business Line	Activity
Corporate Finance	- Underwriting; - Consulting services on capital structure, industrial strategy and other related or consulting questions, along with services related to mergers and acquisitions by companies;
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 banking	- Retail deposits and investment funds; - 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.
Asset Management	- OICVM management.

Table 27 – Capital Requirements of Operational Risk

(thousands €)

Business Line	Relevant Indicator			Regulatory capital requirement
	2010	2011	2012	
Total	500.199	475.938	433.442	66.235
1.Total of activities subject to Basic Indicator method	39.408	42.595	44.405	6.320
2.Total of activities subject to Standard method	460.791	433.343	389.038	59.915
2.1. Corporate Finance	900	1.107	2.317	
2.2. Trading and sales	605	1.943	-30.753	
2.3. Retail brokerage	6.801	5.105	7.999	
2.4. Commercial banking	170.573	226.332	305.742	
2.5. Retail banking	246.869	163.341	65.484	
2.6. Payment and settlement	30.724	31.256	33.094	
2.7. Agency services	4.319	4.259	5.156	
2.8. Asset Management	0	0	0	

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 uses 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, based on the initial situation and the expected development of various business variables, such as volumes, interest rate renewal periods, early settlements and mobilizations.

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 take into account the residual maturity of the contracts, instead of considering early mobilization (of deposits and credit).

For remunerated assets and liabilities that are not directly indexed to a market rate, the repricing date corresponds to the expiration date. Likewise, the same process is applied to the fixed leg of interest rate swaps.

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.

12.2 Stress tests

CEMG performs quarterly stress tests exercises taking into account adverse macroeconomic and financial scenarios defined by Bank of Portugal, under the financial aid program to the Portuguese Republic.

In addition to the stress tests reported to the Bank of Portugal, CEMG regularly conducted other impact studies that intend to provide an analytical view of the bank's position in terms of liquidity, profits and capital when subject to unfavorable scenarios stemming from changes in risk factors such as interest rates, credit spreads, deposit runoffs, eligible asset evaluation haircuts applied by the Central European Bank (ECB), credit ratings (for CEMG and issuing bodies), portfolio and collateral losses, among other factors.

The results under the adverse scenarios, including those resulting from the adverse macroeconomic scenarios defined by Bank of Portugal under the financial aid program to the Portuguese Republic, show that CEMG continues to enjoy suitable capitalization levels.

The impact studies and results are disclosed to and discussed with the board of directors, being the subsequent conclusions incorporated in the strategic decision making processes, namely in the determination of levels of solvency, liquidity, exposure to specific risks (counterparty and price risks) and global risks (interest rate, foreign exchange and liquidity risks), as well as in the pricing, loan criteria and development of products offered.

12.3 Quantitative information - interest rate risk

The following is the information reported biannually 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 28 – Interest rate risk (banking book)

(thousands €)

			Dec-12	Dec-11
Efect on equity od a parallel shift of 200 b.p. in interest rate	Amount	+	142.686	51.643
		-	-142.686	-51.643
	% Regulatory capital	+	7,69%	3,08%
		-	-7,69%	-3,08%

"+" = upward parallel shift of 200 b.p. in the interest rate

"-" = downward parallel shift of 200 b.p. in the interest rate

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 7,69% of the regulatory capital (see Table 28). 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).