MARKET DISCIPLINE 2009

Montepio

Market Discipline

2009

June 30, 2009

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Foreword

This document is based on a prudential approach in compliance with the provisions of Bank of Portugal Notice no. 10/2007 regarding the public disclosure of information, which states that the information provided should cover the risks incurred, taking into account strategic goals and the processes and systems of assessment carried out. It takes the end of 2009 as its point of reference.

1. Responsibility Statement

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

- Certifies that procedures deemed necessary were developed and that to the best of his knowledge, all information disclosed is true and accurate;
- Assures the accuracy of all information disclosed;
- Undertakes the prompt disclosure of any significant changes that occur during the following year to the one assessed in the current document.

There were no events considered relevant between the cut-off date of December 2009 and the date of publication.

2. Scope and risk management policies

2.1 Scope

This report has been produced on a consolidated basis for prudential purposes and covers both CEMG and Banco MG Cabo Verde IFI, SA.

2.2 Risk management strategies, processes, structure and organisation

Risk analysis and control in CEMG are assured by the Risk Analysis and Management Department (Portuguese abbreviation - DAGR), which is also responsible for advising the board of directors on measures for risk management. Implementation of risk management and control mechanisms is in general the responsibility of the units where the risks in question arise.

In line with the recommendations of the Basel Committee, the DAGR reports directly to the board of directors and enjoys independence from the departments responsible for the business. In addition, and again in an independent manner, the Internal Audit and Inspection Department executes the adequacy of processes and their implementation from the standpoint of internal and external rules.

The DAGR consists of four units:

(i) Credit Risk Unit - responsible for developing internal credit risk analysis models and incorporating them in decision-making processes, and also for prudential reporting on regulatory capital and internal reports on credit risk;
(ii) Market Risks Unit - performs analysis and prudential 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 the operational risk management;

(iv) Corporate Credit Analysis Unit - Made up of the credit analysts who are responsible for assessing credit proposals and assigning internal credit risk ratings in the corporate segment.

As identified in the risk assessment model developed by the Bank of Portugal, CEMG is exposed to a set of different risks. Most significant among these are credit risk on the retail and corporate portfolios, interest rate risk and liquidity risk.

The institution's risk profile takes into account the capital requirements associated with deals through the definition of decision-making rules and credit pricing.

The main principle of **credit risk** analysis is independence from business decisions, with direct reporting to the board of directors. In this type of analysis, 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 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 maturity of the operation associated with 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 of collateral. Pricing also reflects the strength of the commercial relationship with customers and associates of Montepio Geral Associação Mutualista.

The level at which pricing decisions are taken is defined according to risk adjusted return on equity (ROE), in accordance with the principle that the authority to approve operations with a lower risk-adjusted ROE lies with the higher levels of management.

Rejection criteria are defined in such a way as to minimise the risk of adverse selection, assuring that there is always at least one rejection risk class. Regarding loans to individuals (typically lower amounts), scoring models are used and override authority lies with the Board of Directors or, in a narrower range of situations, with the Head of the Commercial Department. The overrides of the rating in corporate segment are, as a rule, reserved for the decision level immediately above the one of the loan proposal.

Therefore, credit rejections are determined by the occurrence 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. In addition, automatic credit rejection classes have been defined.

The degree of scrutiny in credit risk analysis is based on the scale of the operations concerned. Thus, in the case of loans to individuals (where the loan amounts are typically smaller), application scoring models are used that are specific to the main credit portfolios (e.g. mortgage loans, personal loans and credit cards). Analysis of customers is differentiated according to the period of time for which they have had a relationship with CEMG.

In pre-approved consumer credit campaigns, behavioural scoring is also used to define the terms on which operations are offered, which may subsequently be changed following submission to reactive scoring.

Regarding corporate loans, limits are set for size of operation and overall exposure, along with thresholds for compulsory consultation of DAGR independent credit analysts. The contents of

the reports issued by these analysts vary according to the size of the customer and of the exposure: a broader and deeper analysis is required for larger exposures (companies with sales turnover of more than 500 thousand € or aggregate exposure greater than 1 million €).

In these cases, the reports produced include the internal risk rating, the exposure limit assigned for the loan maturity, taking into account the company's 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 in larger loans.

In addition, customers in this segment must have an internal rating, which must be updated regularly (at least every six months).

Intervention thresholds are also defined for the different decision-making levels, by size of operation and overall customer exposure, type of operation/collateral and pricing. These thresholds are approved by the board of directors. At the top of the decision-making hierarchy is the board of directors, which exercises that authority through the Credit Committee, which includes, among others, the heads of the commercial departments and the DAGR.

In the field of **market risk**, *Value-at-Risk* (VaR) is a fundamental instrument in analysing and imposing limits on exposure. The financial activity is frequently monitored through reports on asset portfolios and also counterparty risk reports. In the case of particularly complex assets with low liquidity, in which VaR accuracy is necessarily less applicable, specific more conservative limits by product type are set.

Stop-loss limits and quantitative limits on exposure to asset classes and rating levels and issuers are also in place.

At the level of **liquidity and interest rate risks**, static and dynamic 12-month gaps are calculated regularly for monitoring CEMG's liquidity position, in accordance with monthly reports submitted to the Bank of Portugal. In this context, CEMG also carries out exercises to simulate potential adverse events. Liquidity situation and its evolution are internally monitored on a daily basis.

Management of market, liquidity and currency risks is assessed by the Asset and Liability Committee (ALCO), which meets monthly and where strategies to control this kind of risks are outlined.

At the level of **operational risk**, an operational risk management system has been implemented that is based on identifying, assessing, monitoring, measuring, mitigating and reporting risks of this type. In terms of organizational structure, there is a department exclusively dedicated to operational risk management, complemented by the existence of operational risk partners in the various units.

The main management tools are periodical self-assessment of risks and controls, capture of loss events stemming from operational risk, supervision and actions to mitigate operational risk, specifically at the level of business continuity, and production of periodical (quarterly and annual) reports on CEMG's operational risk profile.

In 2009, the development of a set of broad Key's Risk Indicator (KRI's) was initiated, by type of activity, namely on the service quality. These indicators are a qualitative management and operational risk control tool, being a risk monitoring tool, by issuing warnings of potential risk situations in CEMG or variations in its risk level.

Concerning business continuity, a specific function is being implemented in the Operational Risk Department, within the DAGR, according to the principles outlined in the circular letter nº. 100/2005, issued by the Bank of Portugal on Contingency Planning.

This new function aims at providing CEMG capacity to assure an adequate response to any risk causing the disruption of the activity, through the design, implementation and regular testing of recovery solutions for Staff, Information Systems and Facilities.

It is also being implemented a three-year Maintenance Plan detailing the activities to be undertaken at various stages and related areas, aiming to ensure the continuous improvement of the Business Continuity Plan.

As regards liquidity, the liquidity contingency plan assesses the availability of various sources of financing in a range of crisis scenarios.

Internal committees focusing on risk management issues are in place, namely the Risk and Internal Control Committee (with a monthly frequency), being DAGR responsible for the coordination and presentation of relevant risk indicators and information. In addition, DAGR also integrates the ALCO Committee, the Investment and Management Committees of Futuro (in charge of Montepio´s Pension Fund management) and also the Monitoring Committee of Montepio's Pension Fund.

2.3 Scope and nature of risk measurement and information systems

Risk analysis also involves regular internal reporting on the main types of risk to the board of directors and the business areas involved. As regards credit risk, a monthly internal report is produced, with information broken down by commercial department, the main credit portfolio risk indicators and metrics on override levels. In addition a half-yearly report is produced, with more aggregated risk information; a watch list summarising exposures that deserve closer supervision and action is drawn up for the Credit Committee to examine and discuss. A weekly report on IMM counterparty risk is also produced.

In the field of market risk, given the relatively small size of the trading book, a weekly risk report is made on 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) and compliance with VaR, stop-loss and portfolio composition limits by rating, type of security and issuer. It is also produced a weekly report on counterparty risk, where overall exposure figures are reported.

At 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) also includes a reporting module dedicated to reporting, based on data flowing from the Identification and Monitoring stages of the Operational Risk Management Cycle implemented in CEMG, organized and made available to different users according to their profile.

As regards analytical methods relating to credit risk, risk control techniques and models are derived from econometric modelling based on 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 individuals and business. The rating model used in corporate credit and business makes a distinction between the construction sector and other economic sectors, while in lending to individuals specific models are used for the main credit portfolios – mortgage loans, personal loans and credit cards – and a distinction is drawn between individuals who have been customers of CEMG for more than a year and others.

Internal rating models classify companies in seven performing risk classes and a final class corresponding to default[1]. Taking into account relative 1-year frequencies of default, these classifications can be related to the rating classes of the Moody's agency 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 already existing and new customers. Application credit card scoring classifies credit proposals into four risk classes.

Along with application scorings, behavioural scoring models are used to classify the risk associated with each customer in a differentiated manner, depending on the type of relationship with CEMG. These are dynamic models that use only variables that are continuously updated and enable constant oversight of how customer risk levels change over time. Because of the diversity of this portfolio, it is segmented according to the products held by customers, with a model for each of the three segments considered most relevant (mortgage loans, consumer credit and cards/overdrafts).

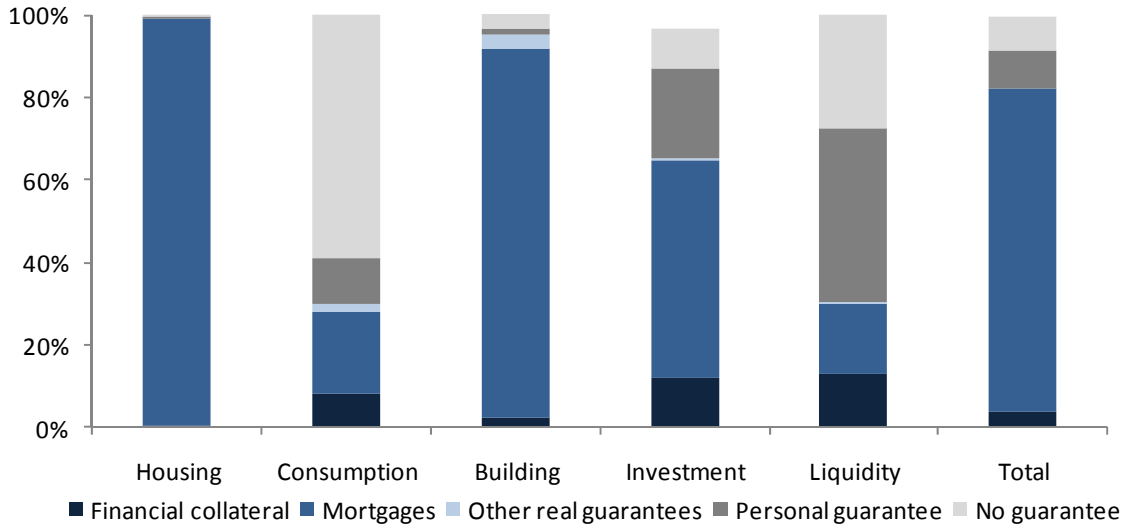
2.4 Risk coverage and mitigation policies

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

[1] Although the seventh risk class also includes companies that are in default within the Portuguese financial system, despite performing in Montepio.

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

Chart 1 - Distribution of types of guarantee by credit segment [2]



Mitigation of risk through collateralisation of operations is taken into account in the pricing of operations, either by way of the borrower's credit risk (e.g. in the case of real collateral), or by way of reduction of the exposure level, in situations involving financial collateral (where the market risk of the assets involved becomes relevant).

As a rule, personal guarantees are required in loans to individuals whenever the customer does not comply with debt-to-income rules, while in the context of corporate credit they are demanded in loans involving larger amounts, smaller companies and wherever there is an intention to further mitigate risk, in light of the collateralisation level of the operation.

3. Capital adequacy

3.1 Regulatory Capital

The regulatory capital for solvency purposes of a credit institution includes core and complementary capital, minus their negative components.

Core or Tier 1 capital means:

- 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.

[2] In the case of operations with multiple guarantees, the amount in question has been allocated to the guarantee with the greatest liquidity (financial collateral). The amounts shown under personal guarantee correspond to operations without any type of collateralization.

Complementary or Tier 2 capital means:

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;

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;
- Shortfalls in provisions.

3.2 Internal capital allocation

The calculation of CEMG capital requirements for credit and market risk, on December 31 2009, was determined according to the standard method and for operational risk under the Basic Indicator Approach, according to regulations of the Bank of Portugal (Notice N.º 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

	Credit Risk	Market Risk	Operational Risk	Total
Dec-08	776.151	5.265	59.053	840.469
Dec-09	737.373	2.986	62.346	802.705

Unit: Eur '000

Among capital requirements for credit and counterparty risk, approximately 90% corresponds to the loan portfolio.

The decrease of capital requirements for credit and counterparty risk, accompanied by the upward trends of own funds has motivated an increase of the prudential ratios, explained in detail in the following section.

3.3 Capital adequacy

CEMG's goal for capital is to achieve a level of resources that enables it to cope with especially adverse circumstances. Therefore, this goal is related to maintaining conditions of access to the wholesale funding market. Thus it is desirable to maintain internal ratings similar to those

currently held (long-term ratings of A- and Baa1, awarded by Fitch Ratings and Moody's respectively).

Bearing in mind the levels of default historically associated with the ratings awarded and with the capital requirements established in Pillar I, and the absence of any large risks, it is considered that these requirements adequately reflect CEMG's capital needs. Nevertheless, in view of its exposure to the real estate sector, CEMG intends to have a Tier 1 ratio not below the minimum recommended by the Bank of Portugal (8%) and a solvency ratio of not less than 10%.

Forecasts were done for the evolution of capital ratios under the Bottom-Up annual stress testing exercise (Notice No. 32/2009 of BoP), based on assumptions and methods stated in various guidelines issued by the Bank of Portugal. In situations where discretionary decisions were allowed, the assumptions adopted were aligned with the scenarios presented, e.g. a slight recovery in the baseline scenario and a further economic slowdown of the Portuguese and the world economy, in the stress scenario.

In terms of solvency, it was concluded that the CEMG is adequately capitalized, given the robust levels estimated for the solvency ratio under the stress scenario.

Capital requirements to cover operational risk are calculated in accordance with the basic indicator method and reached approximately 62 million Euros, at the consolidated level in 2009, representing 4.7% of total capital of CEMG.

In light of the strategic plan drawn up for the three-year period 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. As regards lending to individuals, greater collateralisation of new loans is expected, together with a drop in the average loan-to-value ratio, allowing for lower capital requirements.

The strategy of business diversification, particularly in the corporate segment, will work in the opposite sense, increasing exposure to sectors not related to civil construction and so reducing the level of collateralisation of new loans, although based on a pricing strategy that adequately reflects the risks incurred.

It is believed that the magnitude of these effects will tend to be equal. For this reason CEMG will stick to its adopted strategy of gradually increasing capital requirements, with the aim of guaranteeing sound levels of solvency, illustrated by solvency ratios of not less than 10% and Tier 1 ratios of not less than 8%.

CEMG´s solvency ratio and Tier 1 have higher values than the main Portuguese banks, as shown by the tables below.

Table 3 - Solvency ratio, 2005-2009

			Solvency Ratio				
Bank	Moody's Rating	Assets 2009 (EUR '000)	2009	2008	2007	2006	2005
Montepio	Baa1	17.244.767	13,0	11,4	8,9	9,8	10,7
Maximum (1)		120.985.000	12,6	11,3	11,5	13,1	12,9
Minimum (1)		14.442.205	10,0	9,2	9,6	9,2	9,3
Mean (1)*		76.987.881	11,7	10,6	10,4	11,2	12,3

[1] with reference to the five largest Portuguese banks

* weighted by assets

Table 4 –Tier 1 ratio, 2005-2009

			Tier 1 Ratio				
Bank	Moody's Rating	Assets 2009 (EUR '000)	2009	2008	2007	2006	2005
Montepio	Baa1	17.244.767	9,3	8,0	6,5	7,0	6,8
Maximum (1)		120.985.000	9,3	8,8	7,5	8,4	7,4
Minimum (1)		14.442.205	6,2	5,3	5,5	5,7	5,6
Mean (1)*		76.987.881	8,6	7,2	6,5	7,4	7,0

[1] with reference to the five largest Portuguese banks

* weighted by assets

The table below provides a summary of solvency figures in 2009, considering only Pillar I requirements.

Table 5 – Capital adequacy for regulatory capital purposes

Capital adequacy - Part 1	Dec-09	Dec-08
1. **Total regulatory capital for solvency purposes**	1.308.730	1.202.349
1.1. **Core capital**	947.161	839.195
1.1.1. Eligible share capital	760.000	660.000
1.1.1.1 Paid-in share capital	760.000	660.000
1.1.2. Eligible reserves and results	219.945	209.445
1.1.2.1 Reserves	196.224	175.864
1.1.2.3 Results from the previous year and provisional results for the current year	24.176	33.874
1.1.2.7 Revaluation differences eligible for base regulatory capital	-455	-293
1.1.3. Fund for general banking risks	0	0
1.1.4. Other items eligible for core capital	31.082	29.477
1.1.4.1 Impact of transition to the IAS/AAS (negative impact)	22.207	28.623
1.1.4.2 Other items eligible for core capital	8.875	854
1.1.5. (-) Other items deductable from core capital	-63.866	-59.727
1.1.5.1 (-) Intangible fixed assets	-16.151	-14.775
1.1.5.3 (-) Other items to be deducted from core capital	-47.714	-44.952
1.2. **Complementary capital**	396.154	386.420
1.2.1. Upper Tier 2	18.154	8.420
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**	-25.507	-13.758
1.3.a. Of which: (-) From core capital (82)	-12.753	-6.879
1.3.b. Of which: (-) From complementarycapital (83)	-12.753	-6.879
1.4. **Total core capital for purposes of solvency (87)**	934.408	832.316
1.5. **Total complementary capital for purposes of solvency (88)**	383.400	379.541
1.6. **(-) Deduction from total regulatory capital (89)**	-9.079	-9.507
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	1.308.730	1.202.349

Unit: Eur '000

Table 6 – Capital adequacy for capital requirement purposes

Capital adequacy - Part 2	Dec-09	Dec-08
2. Regulatory capital requirements	802.705	840.469
2.1. For credit risk, counterparty credit risk, risk of decrease in receivables and delivery risk	737.373	776.151
2.1.1. Standardised approach	737.373	776.151
2.1.1.1. Risk classes in the standardised approach excluding securitisation positions	737.373	776.151
2.1.1.1.1. Claims or conditional claims on central governments and central banks	249	113
2.1.1.1.2. Claims or conditional claims on regional governments and local authorities	716	821
2.1.1.1.3. Claims or conditional claims on public sector entities and other non-profit public inst	24	0
2.1.1.1.6. Claims or conditional claims on banks	23.764	21.655
2.1.1.1.7. Claims or conditional claims on companies	234.705	203.745
2.1.1.1.8. Claims or conditional claims on the retail portfolio	92.242	169.097
2.1.1.1.9. Claims or conditional claims secured by real estate	324.793	298.660
2.1.1.1.10. Items past due	51.597	70.185
2.1.1.1.12. Mortgage bonds and public sector bonds	169	53
2.1.1.1.13. Exposures to collective investment undertakings	747	4.255
2.1.1.1.14. Other items	8.368	7.567
2.1.1.2. Securitisation exposures in the standardised approach	0	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	2.986	5.265
2.3.1. Standardised approach	2.986	5.265
2.3.1.1. Debt instruments	2.808	5.122
2.3.1.2. Equity securities	178	144
2.3.1.3. Exchange rate risk	0	0
2.3.1.4. Commodities risk	0	0
2.4. Capital requirements for operational risk	62.346	59.053
2.4.1. Basic indicator method	62.346	59.053
2.5. Regulatory capital requirements - fixed general expenditure	0	0
2.6. Temporary capital requirements or other capital requirements	0	0

Unit: Eur '000

Table 7 – Capital adequacy

Capital Adequacy - Part 3	Dec-2009	Dec-2008
Surplus (+) / Shortfall (-) in regulatory capital	506.024	361.880
Solvency ratio (%)	13,04%	11,44%

Unit: Eur '000

4. Counterparty credit risk

4.1 Exposure Limits

Various limits are defined for the main risks found in the course of business. As per counterparty credit risk, particular attention is paid to large-risk limits, being set limits for money market exposures, based on banks' ratings and profit levels.

In corporate loans, exposure limits for the maturity in question are also defined, taking into account the company's capacity to generate cash flows and its financial costs, along with absorption of CEMG's own funds in the event of an unexpected loss on the operations.

4.2 Assessment policies of collaterals

Regarding the mortgage collaterals, property valuations are performed by independent specialists or by an independent department. The revaluation of the assets is made in

accordance with the requirements defined in the Notice N. º 5/2007 of Bank of Portugal, by using the variation of property indexes[3] or by site assessments.

Table 8 – Property Revaluation

Property for housing	- At least once every three years, on an automatic basis using real estate indexes. - Regarding loans exceeding 5% of own funds or 500.000 euros, the property assessment must be reviewed by a specialist.
Property for commercial purposes	- The property value should be updated at least once a year, automatically by using indexes. - Regarding loans exceeding 5% of regulatory capital or 1 million euros, the property assessment must be reviewed by a specialist at least every three years.

The allocation of such guarantees to exposures will be more detailed in section 6.

4.3 Quantitative information

Entities to which CEMG faces counterparty risk are usually Governments or financial institutions, bearing a low weight (below 10%).

Table 9 – Counterparty credit risk

	1	2	3	4	5
Repos, borrowing / lending of securities or commodities, long term settlement transactions or loans involving margin calls	7.691	0	7.691	1.538	2.964
Derivatives	142.541	0	142.541	30.990	12.283
Multiproduct contractual netting	0	0	0	0	0

Unit: Eur '000

In the calculation of the exposure value - concerning derivative instruments, repurchase transactions, borrowing or lending of securities or commodities, long term settlement transactions and lending operations with the imposition of margin – the Mark-to-Market evaluation method is used , as defined in Part 3 of Annex V of Notice N.º 5/2007 of Bank of Portugal. This method consists in adding the potential future value to the market value of the exposure, being calculated by multiplying the notional value by a prudential factor defined according to type of contract and its residual maturity.

As of 31.12.2009, CEMG had the following figures related to credit risk hedging through the use of credit derivatives (in nominal value).

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

Table 10 – Credit Derivatives Hedging

Risk Class (hedged transactions)	Original Exposure (hedged transactions)		Notional Amount of the Credit Hedging Derivatives					
			CDS (1)	TRS (2)	CLN (3)	Other	Total	Total
	2009	2008					2009	2008
	1	2	3	4	5	6	7=3+4+5+6	8
CL I - Central Governments and Central Banks	8.833	4	5.000				5.000	
CL VI - Institutions	15.368	25.000	10.000				10.000	10.000

(1) CDS: Credit Default Swaps

(2) TRS: Total Return Swaps

(3) CLN - Credit Linked Notes

Unit: Eur '000

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

Table 11 – Credit Derivatives Instruments

Transactions in Credit Derivatives	Long Positions		Short Positions	
	2009	2008	2009	2008
I. Credit Portfolio (total):				
a) Credit Default Swaps	835	1.063	460	1.027
b) Total Return Swaps				
c) Credit Linked Notes	9.795	14.821		
d) Other Credit Derivatives				
II. Trading Transactions (total):				
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

Unit: Eur '000

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, which are defined in an internal model (include past due loans, restructured credit, customer rating/score and registration as a risky user in the Bank of Portugal database, etc…);
- Past due loans: all loans with payments in arrears.

As regards the credit portfolio, value corrections derive from the creation of provisions. On the date of initial recognition, credits are recorded at their face value, in accordance with the procedures defined in Bank of Portugal Notice Nº. 1/2005. The provisions created in accordance with the rules defined in Notice Nº. 3/95 follows a risk coverage criterion defined by Bank of Portugal.

The concept of risk subject to impairment for the credit portfolio is defined when financial statements are produced on a consolidated basis. For individual accounts, CEMG adopts the setting up of provisions on the basis of the rules set out in Bank of Portugal Notice Nº. 3/95. For the purposes of consolidated accounts, loans over 2 million Euros are subject to individual analysis and the expected loss is determined, leading to the creation of provisions in an equal amount. Loans up to 2 million Euros are subject to collective analysis and provisions are created according to the respective PD and LGD that have been fixed, on the basis of CEMG's historical information and the trend set by the prevailing economic situation.

The value corrections observed in 2008 and 2009 achieved 384 and 494 million Euros, respectively. For their part, the sums recovered in 2008 and 2009 amounted to 328 million € and 379 million €, respectively.

Table 12 – Provisions and value corrections

	Dec-2009	Dec-2008
Initial balance	**383.921**	**298.047**
Appropriations	527.206	425.566
Uses	-37.782	-11.983
Reinstatements/Cancellations	-379.432	-327.710
Closing balance	**493.913**	**383.921**

Unit: Eur '000

5.2 Portfolio Structure

Concerning the distribution of exposures in the loan portfolio by risk class, there is a larger concentration in loans bearing a Real Estate Guarantee and corporate loans, in line with the previous year. It was also observed a transition from the Retail class to “Positions with Real Estate Guarantees”, arising from the revaluation of the collaterals. The decrease in the class of past due exposures is a consequence of the increase occurred in the provisions.

Table 13 – Distribution of credit exposures by risk class

Risk Class	Original exposure at default	
	Dec-2009	Dec-2008
CL I - Central Governmenst and central banks	260.146	208.847
CL II - Regional Governments and local authorities	45.360	51.414
CL III - Public sector entities and other non-profit public institutions	1.472	0
CL IV - Multilateral development banks	0	0
CL V - International organisations	0	0
CL VI - Institutions	1.240.239	1.069.728
CL VII - Corporates	3.338.008	3.092.853
CL VIII - Retail portfolio	1.948.541	3.184.226
CL IX - Real estate collateralised positions	10.109.363	9.051.359
CL X - Past due exposures	554.442	1.256.859
CL XI - Covered bonds and public sector bonds	21.136	5.582
CL XII - Exposures to collective investment undertakings (CIUs)	9.341	53.187
CL XIII - Other exposures	237.470	219.550
TOTAL	**17.765.516**	**18.193.606**

Unit: Eur '000

Analyzing the geographical distribution of the loan portfolio, a higher concentration in areas with higher population density (Great Lisbon and Oporto and Beiras) is still observed, being CEMG commercially present in most regions of the country.

Table 14 – Geographical 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
2008	CL I - Central governments 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%	0.07%	0.00%	0.00%	0.02%	0.08%	0.00%
	CL VI - Institutions	0.44%	0.00%	0.03%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
	CL VII - Corporates	7.75%	2.40%	2.12%	0.96%	0.93%	1.20%	1.18%	0.40%	0.57%	0.20%
	CL VIII - Retail portfolio	7.33%	3.53%	1.88%	1.18%	1.32%	1.57%	0.94%	0.71%	0.37%	0.41%
	CL IX - Secured on real estate property	20.30%	8.87%	5.47%	2.67%	3.50%	3.45%	1.21%	2.04%	1.45%	5.73%
	CL X - Exposures in default	3.14%	1.57%	0.86%	0.45%	0.51%	0.60%	0.13%	0.12%	0.11%	0.07%
	TOTAL	**39.10%**	**16.38%**	**10.36%**	**5.27%**	**6.33%**	**6.82%**	**3.46%**	**3.29%**	**2.59%**	**6.41%**
2009	CL I - Central governments 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	0,54%	0,00%	0,03%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%
	CL VII - Corporates	7,84%	2,09%	2,16%	1,38%	1,32%	1,22%	1,15%	0,45%	0,74%	0,26%
	CL VIII - Retail portfolio	4,01%	2,03%	1,51%	0,78%	1,09%	0,93%	0,61%	0,49%	0,21%	0,26%
	CL IX - Secured on real estate property	22,08%	9,99%	6,10%	5,75%	4,40%	4,45%	3,50%	2,31%	1,69%	1,50%
	CL X - Exposures in default	2,44%	1,25%	0,76%	0,73%	0,53%	0,73%	0,18%	0,11%	0,06%	0,06%
	TOTAL	**37,03%**	**15,36%**	**10,57%**	**8,63%**	**7,38%**	**7,33%**	**5,44%**	**3,39%**	**2,79%**	**2,08%**

Regarding the distribution of the corporate portfolio by economic sector, Construction, Real Estate and Commerce must be highlighted.

Table 15 – 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 and Insurance	Hotels & restaurants	Transport & warehousing	Public administration (1)	Other
2008	CL I - Central governments and central banks	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.02%	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%	0.91%	0.00%
	CL VI - Institutions	0.00%	0.00%	0.00%	0.00%	0.00%	1.43%	0.00%	0.00%	0.00%	0.00%
	CL VII - Corporates	0.18%	24.14%	4.46%	5.96%	5.98%	0.98%	1.13%	1.99%	0.61%	2.10%
	CL VIII - Retail portfolio	0.09%	5.88%	0.62%	2.75%	1.65%	0.24%	0.89%	0.39%	0.40%	1.40%
	CL IX - Secured on real estate property	0.01%	19.92%	0.10%	5.56%	0.48%	0.13%	0.24%	0.01%	0.17%	0.30%
	CL X - Exposures in default	0.01%	4.82%	0.66%	1.37%	1.04%	0.01%	0.44%	0.02%	0.10%	0.42%
	TOTAL	**0.29%**	**54.75%**	**5.85%**	**15.64%**	**9.15%**	**2.80%**	**2.70%**	**2.42%**	**2.20%**	**4.21%**
2009	CL I - Central governments and central banks	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,03%	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%	0,78%	0,00%
	CL VI - Institutions	0,00%	0,00%	0,00%	0,00%	0,00%	1,60%	0,00%	0,00%	0,00%	0,03%
	CL VII - Corporates	0,19%	23,59%	6,18%	6,12%	7,09%	1,33%	1,41%	2,34%	0,68%	2,35%
	CL VIII - Retail portfolio	0,12%	5,51%	0,84%	2,69%	1,85%	0,44%	0,93%	0,17%	0,67%	1,74%
	CL IX - Secured on real estate property	0,01%	14,66%	0,14%	4,85%	0,61%	0,18%	0,58%	0,02%	0,13%	0,42%
	CL X - Exposures in default	0,04%	5,54%	0,79%	1,00%	1,06%	0,02%	0,32%	0,23%	0,06%	0,66%
	TOTAL	**0,35%**	**49,31%**	**7,94%**	**14,66%**	**10,62%**	**3,57%**	**3,25%**	**2,75%**	**2,34%**	**5,20%**

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

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 Class Positions with Guarantee Real Estate and consist of housing loans and credit for private investment firms. About 20% of the original exposure has no payment plan set, consisting broadly in current accounts to support liquidity of companies (revolving credit).

Table 16 – Residual maturity of the credit portfolio by risk class (as a % of original exposure at default)

Year	Risk Class	MR < 1	1 ano < MR < 5 anos	5 anos < MR < 10 anos	MR > 10 anos	Revolving
2008	CL I - Central governments 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%	0.1%	0.0%
	CL VI - Institutions	0.3%	0.1%	0.0%	0.0%	0.1%
	CL VII - Corporates	5.4%	2.0%	1.3%	1.1%	7.8%
	CL VIII - Retail portfolio	2.0%	1.3%	3.0%	9.2%	3.7%
	CL IX - Secured on real estate property	0.6%	0.6%	1.1%	44.7%	7.7%
	CL X - Exposures in default	1.2%	0.2%	0.5%	4.0%	1.7%
	as a % of the original exposure at default	**9.5%**	**4.2%**	**6.1%**	**59.2%**	**21.0%**
2009	CL I - Central governments and central banks	0,0%	0,0%	0,0%	0,0%	0,0%
	CL II - Regional governments and local authorities	0,0%	0,0%	0,1%	0,1%	0,0%
	CL VI - Institutions	0,1%	0,4%	0,0%	0,0%	0,1%
	CL VII - Corporates	4,6%	2,2%	2,1%	1,3%	8,4%
	CL VIII - Retail portfolio	2,1%	1,5%	2,6%	1,8%	4,0%
	CL IX - Secured on real estate property	0,8%	0,7%	1,9%	52,4%	6,0%
	CL X - Exposures in default	1,4%	0,2%	0,5%	2,9%	1,8%
	as a % of the original exposure at default	**8,9%**	**5,0%**	**7,2%**	**58,6%**	**20,3%**

5.3 Concentration risk

As mentioned, CEMG has an ongoing strategy of diversifying its business in order to reduce the weight of exposure to real estate. The impact of concentration risk on capital requirements is assessed through an approach based on calculation of sector and customer concentration indexes (CI), according to Instruction Nº. 2/2010 of Bank of Portugal.

The customer CI[4] is calculated from the 100 largest exposures, aggregated by client/economic group. The weight of these exposures on 31-Dec-2009 amounted to roughly 11% of the loan portfolio and 13% of the total portfolio. In the previous year, the weight of the top 100 largest exposures were identical regarding the loan portfolio, representing about 12% of the total portfolio.

The sector CI[5] is calculated based on the customers' classification of economic activities.

Table 17 – Concentration index

	Credit Portfolio		Total Exposures	
	Dec-09	Dec-08	Dec-09	Dec-08
Customer concentration index	0,18	0,19	0,22	0,18
Sector concentration index	28,57	33,92	22,27	26,75

The evolution of sector and customer CIs reflects the diversification strategy of the business that the institution has been pursuing, both at a sector and an asset type level.

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

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

Regarding the distribution of the largest exposures by country, the portfolio is mostly concentrated in Portugal.

Table 18 – Distribution of exposures by Country

Country	Amount		% Total Exposures	
	Dec-09	Dec-08	Dec-09	Dec-08
Portugal	16.695.161	16.364.859	92,8%	93,4%
Spain	151.443	171.917	0,8%	1,0%
France	145.771	0	0,8%	0,0%
Italy	128.118	123.319	0,7%	0,7%
Great Britain	119.433	0	0,7%	0,0%
Ireland	104.019	0	0,6%	0,0%
Other	644.255	859.885	3,6%	4,9%

Unit: Eur '000

5.4 Past Due and Impaired Loans

The distribution of the past due exposures and the related impairment provisions reflect the concentration of the activity in the businesses of construction, wholesale and retail trade, car and motorcycles repair and real estate.

The geographical distribution of past due loans, shows a larger concentration in the Great Lisbon, Great Oporto and Beiras regions, reflecting portfolio´s geographical portfolio and in line with the figures observed in the previous year.

Table 19 – Breakdown of past due and impaired exposures

Year		Total exposures	% exposures past due	% covered by impairment provisions
Dec-08	Breakdown by main sectors (of the corporate segment)	Primary Sector	0,1%	18,1%
		Secondary		
		Construction	54,2%	23,0%
		Other	7,4%	12,9%
		Third Sector		
		Real Estate	15,4%	28,2%
		Wholesale and retail trade	11,7%	17,1%
		Financial and insurance	0,1%	19,4%
		Hotels and restaurants	4,9%	29,3%
		Transport and warehousing	0,3%	5,0%
		Public admin. and defence; social security; human health and welfare	1,1%	9,8%
		Other	4,7%	21,1%
		Total	100,0%	22,4%
	Breakdown by main geographical regions	Lisbon	39,0%	24,9%
		Oporto	20,8%	27,4%
		Beira Alta, Baixa e Litoral	11,3%	24,5%
		Minho	8,0%	22,8%
		Alentejo	7,9%	25,6%
		Trás-Os-Montes e Douro	6,7%	24,9%
		Estremadura	2,5%	24,4%
		Algarve	1,6%	24,0%
		Azores	1,5%	26,3%
		Madeira	0,7%	28,4%
		Total	100,0%	25,3%
Dec-09	Breakdown by main sectors (of the corporate segment)	Primary Sector	0,4%	32,5%
		Secondary		
		Construction	57,0%	31,5%
		Other	8,1%	19,4%
		Third Sector		
		Wholesale and retail trade; motor vehicles and motorcycles repair	10,9%	18,0%
		Real Estate	2,4%	53,8%
		Hotels and restaurants	3,3%	27,7%
		Transport and warehousing	0,5%	8,7%
		Education	0,2%	47,4%
		Consultancy activities, scientific, technical and similar	10,3%	28,3%
		Other service activities	2,1%	36,4%
		Other	4,8%	20,1%
		Total	100,0%	28,6%
	Breakdown by main geographical regions	Lisbon	35,6%	32,5%
		Oporto	18,2%	35,6%
		Beira Alta, Baixa e Litoral	11,1%	30,7%
		Minho	10,6%	33,8%
		Estremadura	10,6%	23,7%
		Trás-Os-Montes e Douro	7,7%	27,7%
		Algarve	2,7%	27,3%
		Azores	1,6%	26,0%
		Madeira	0,9%	36,9%
		Alentejo	0,9%	36,7%
		Total	100,0%	31,5%

5.5 Standard Approach

The calculation of capital requirements for credit and counterparty risk is determined in accordance with the Standard Approach as defined in Notice No. 5/2007 of Bank of Portugal. Depending on the nature of the counterparty, the asset portfolio positions are distributed by the several risk classes and ratings provided by Moody's, S & P and Fitch are used for the assignment of risk weights.

This practice is generalised to all risk classes and the assignment is in accordance with Notice No. 5/2007, as follows:

- When there are simultaneously different ratings issued by recognised agencies, the second highest among the two lower risk weights applies;
- In the case of bonds or similar securities, the issue rating is considered, and only in cases where there is none , the issuer rating applies;
- The ratings are used consistently for all exposures in all classes.

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

In December 2009, the CEMG portfolio distribution by the different classes and risk weights are presented in detail in the following table.

Table 20 – Regulatory capital, counterparty and credit risk requirements

		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	246.040	0	13.121	0	984	0	0	0	0	260.146
	CL II - Regional governments and local authorities	0	0	45.360	0	0	0	0	0	0	45.360
	CL III - Public sector entities and other non-profit public institutions	0	0	1.472	0	0	0	0	0	0	1.472
	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	1.171.063	0	134	0	69.042	0	0	1.240.239
	CL VII - Corporates	0	0	6.089	0	29.400	0	3.302.518	0	0	3.338.008
	CL VIII - Retail portfolio	0	0	0	0	0	1.948.541	0	0	0	1.948.541
	CL IX - Secured on real estate property	0	0	797	8.416.165	894.776	523.666	273.959	0	0	10.109.363
	CL X - Exposures in default	0	0	0	0	0	0	373.213	181.229	0	554.442
	CL XI - Covered bonds and public sector bonds	0	21.136	0	0	0	0	0	0	0	21.136
	CL XII - Exposures to collective investment undertakings (CIUs)	0	0	0	0	0	0	9.341	0	0	9.341
	CL XIII - Other exposures	99.130	0	42.182	0	0	0	96.157	0	0	237.470
	TOTAL Originator exposures:	**345.170**	**21.136**	**1.280.084**	**8.416.621**	**925.361**	**2.475.780**	**4.804.349**	**186.116**	**0**	**17.765.516**
2. Exposures by risk class (exposures weight base)	CL I - Central government and central banks	246.035	0	13.121	0	984	0	0	0	0	260.141
	CL II - Regional governments and local authorities	0	0	44.721	0	0	0	0	0	0	44.721
	CL III - Public sector entities and other non-profit public institutions	0	0	1.472	0	0	0	0	0	0	1.472
	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	1.139.912	0	134	0	68.997	0	0	1.209.042
	CL VII - Corporates	0	0	55.710	0	29.400	0	2.907.964	0	0	2.993.075
	CL VIII - Retail portfolio	0	0	25.771	0	0	1.530.495	0	0	0	1.556.266
	CL IX - Secured on real estate property	0	0	797	8.416.165	894.776	523.666	273.959	0	0	10.109.363
	CL X - Exposures in default	0	0	69	0	0	0	373.213	181.161	0	554.442
	CL XI - Covered bonds and public sector bonds	0	21.136	0	0	0	0	0	0	0	21.136
	CL XII - Exposures to collective investment undertakings (CIUs)	0	0	0	0	0	0	9.341	0	0	9.341
	CL XIII - Other exposures	99.130	0	42.182	0	0	0	96.157	0	0	237.470
	TOTAL Exposures:	**345.165**	**21.136**	**1.323.755**	**8.416.165**	**925.295**	**2.054.162**	**3.729.631**	**181.161**	**0**	**16.996.468**
3. TOTAL exposures risk weigh (=∑ (2."x"risk weights))		**0**	**2.114**	**264.751**	**2.945.658**	**462.647**	**1.540.621**	**3.729.631**	**271.741**	**0**	**9.217.163**
capital requirements by risk class (2. "x" risk weights "x" 8%)	CL I - Central government and central banks	0	0	210	0	39	0	0	0	0	249
	CL II - Regional governments and local authorities	0	0	716	0	0	0	0	0	0	716
	CL III - Public sector entities and other non-profit public institutions	0	0	24	0	0	0	0	0	0	24
	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	18.239	0	5	0	5.520	0	0	23.764
	CL VII - Corporates	0	0	891	0	1.176	0	232.637	0	0	234.705
	CL VIII - Retail portfolio	0	0	412	0	0	91.830	0	0	0	92.242
	CL IX - Secured on real estate property	0	0	13	235.653	35.791	31.420	21.917	0	0	324.793
	CL X - Exposures in default	0	0	1	0	0	0	29.857	21.739	0	51.597
	CL XI - Covered bonds and public sector bonds	0	169	0	0	0	0	0	0	0	169
	CL XII - Exposures to collective investment undertakings (CIUs)	0	0	0	0	0	0	747	0	0	747
	CL XIII - Other exposures	0	0	675	0	0	0	7.693	0	0	8.368
	TOTAL capital requirements:	**0**	**169**	**21.180**	**235.653**	**37.012**	**123.250**	**298.370**	**21.739**	**0**	**737.373**

Unit: Eur '000

6. Credit risk mitigation techniques

Two types of techniques are used to reduce credit risk on the positions held: personal guarantees that have the effect of replacing the exposure and financial collateral that directly reduces the value of the exposure.

Exposures with risk mitigation through effect of replacement correspond mostly to corporate loans guaranteed by Mutual Guarantee companies (Norgarante, Lisgarante and Garval).

Lending operations in which risk is reduced directly correspond to those collateralised by financial securities, namely term deposits, gold, bonds and shares included in a main index of a recognised stock exchange, as laid down in Annex VI to Bank of Portugal Notice Nº. 5/2007.

Table 21 – Credit risk mitigation techniques

Risk Class	Net position	Credit risk reduction techniques with the effect of substitution in net exposure					Reduction techniques with na 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	5	6	7	8
Total exposure	**17.765.516**	**75.476**	**0**	**0**	**0**	**53.960**	**0**	**280.491**
CL I - Central government and central banks	260.146	0	0	0	0	0	0	0
CL II - Regional governments and local authorities	45.360	0	0	0	0	0	0	119
CL III - Public sector entities and other non-profit public institutions	1.472	0	0	0	0	0	0	119
CL VI - Institutions	1.240.239	15	0	0	0	0	0	23.657
CL VII - Corporates	3.338.008	49.621	0	0	0	39.697	0	140.414
CL VIII - Retail portfolio	1.948.541	25.771	0	0	0	14.174	0	116.181
CL IX - Secured on real estate property	10.109.363	0	0	0	0	0	0	0
CL X - Exposures in default	554.442	69	0	0	0	89	0	0
CL XI - Covered bonds and public sector bonds	21.136	0	0	0	0	0	0	0
CL XII - Exposures to collective investment undertakings (CIUs)	9.341	0	0	0	0	0	0	0
CL XIII - Other exposures	237.470	0	0	0	0	0	0	0

[1] - This field is calculated as follows: $G*P_1 - G*P_2$, where G is the value of the guarantee, P_1 the original weighting and P_2 the weighting after taking the guarantee into account.

Unit: Eur '000

Table 22 – Concentration Analysis – Personal and real credit protection

	Personal credit protection		Real credit protection - Integral method on financial collateral	
	Guarantees		Collateral (financial) eligible	
	Dec-09	Dec-08	Dec-09	Dec-08
CL I - Central government and central banks	0	0	0	0
CL II - Regional governments and local authorities	0	0	119	0
CL III - Public sector entities and other non-profit public institutions	0	0	119	81
CL VI - Institutions	15	0	23.657	1.241
CL VII - Corporates	49.621	2.614	140.414	374.195
CL VIII - Retail portfolio	25.771	52	116.181	116.812
CL IX - Secured on real estate property	0	0	0	0
CL X - Exposures in default	69	56	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

Unit: Eur '000

7. Securitisations

7.1 Performed operations

As at 31-12-2009, CEMG was involved as originator in five traditional credit securitisation operations, namely: *Pelican Mortgages* Nº1; *Pelican Mortgages* Nº2; *Pelican Mortgages* Nº3, *Pelican Mortgages* Nº4 and *Pelican Mortgages* Nº5. In all these operations the main goal was to promote 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 outstanding principal and the sum of consolidated assets and outstanding principal) was below 20%. For prudential purposes, none of the mentioned securitisation operations represented 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 Nº. 7/2007, the exposures at default covered by them are not excluded from the calculation of risk-weighted exposures. Risk-weighted exposures are therefore not calculated for the securitisation exposures held and not recorded losses of these positions.

Regarding securitisations where CEMG acted as an investor, the method of calculating the risk-weighted exposure is defined by the Notice Nº. 7/2007 of Bank of Portugal, required for the Standardised Approach. In order to determine the degree of credit quality associated with each

securitization position, the respective credit ratings issued by Fitch, Moody's and S & P were used.

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 available for sale assets and provisioned according to the rules defined by Bank of Portugal's Notice Nº. 27/2000. Following the publication of the Bank of Portugal's Instruction Nº 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 have to be analysed according to the derecognition rules set out in IAS 39, i.e., if a substantial portion of the risks and benefits associated with the assets are transferred, or control over the assets is transferred, those assets must be derecognised.

7.4 Quantitative information

Table 23 – Securitisation Operations

	Securitisation Operations				
	Pelican 1	Pelican 2	Pelican 3	Pelican 4	Pelican 5
Tradicional securitisation					
Originator(s)	CEMG	CEMG	CEMG	CEMG	CEMG
Issuer(s)	Oceanus - SGFTC, SA	Banco Finantia, SA	Sagres STC, SA	Sagres STC, SA	Sagres STC, SA
Information on the operations					
Start date	19-Dec-02	29-Sep-03	30-Mar-07	20-May-08	25-Mar-09
Legal maturity	2037	2036	2054	2056	2061
Step-up clause (date)	n.a.	Sep-10	Mar-16	Jun-17	Jun-18
Revolving (years)	n.a.	n.a.	n.a.	n.a.	n.a.
Securitized assets (in millions of euros)	650	700	750	1.000	1.000
Amount outstanding (in millions of euros)	116	211	435	908	957
Information on involvement of the originator(s)					
Existence of situations of "implicit support"	no	no	no	no	no
Assets ceded (by institution)/Securitised assets (total) (%)	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

n.a. = not applicable

Table 24 – Outstanding exposure amount on securitised loans

	Amount	Of which: relating to exposures subject to impairment or past due
Pelican 1	116,1	11
Pelican 2	210,8	5
Pelican 3	435,2	2
Pelican 4	908,1	2
Pelican 5	956,7	1
Tradicional securitisations (total)	2.626,9	20

Unit: Million Eur

Table 25 – Credit risk – Securitisation Operations

Type of Securitisation (traditional / synthetic)	Exposure value		risk weighted exposure	
		Amount deducted to regulatory capital (-)	Dec-09	Dec-08
	2	3	9	10
B=Investor positions : total	26.852	0	5.370	5.413
B1 - Balance sheet exposures	26.852	0	5.370	5.413
Senior tranches	26.852	0	5.370	5.413
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

Unit: Eur '000

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

8.1 Methods of calculation of capital requirements

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 may be split in two classes: Debt instruments (including derivatives and comparable debt instruments) and Equity securities (including derivatives on equity instruments and comparable.

The capital requirement for each asset class is calculated according to the needs of 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, it is used the method based on maturity in accordance with Section II-B, Part 2 of Annex II to the Bank of Portugal’s Notice No. 8/2007.
- Specific Risk: refers to the risk of loss due to factors associated with the issuer, being the regulatory capital requirements for these risks based on the methodology described in Section II-A, Part 2 of Annex II to the Bank of Portugal’s Notice No. 8 / 2007, which results in the assets weighting 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 Nº. 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 the Bank of Portugal's Notice N.º 8/2007, which results in the multiplication of the gross position overall by 4%.

8.3 Quantitative information

Table 26 – Regulatory capital requirements (trading book)

	Trading book risks	Regulatory capital requirements	
		Dec-09	Dec-08
1.	**Position risk**		
1.1.	**Standardised approach to trading book**	2.986	5.265
1.1.1.	**Debt instruments**		
1.1.1.1.	Specific risk	2.595	5.090
1.1.1.2.	General risk	213	32
1.1.2.	**Equity securities**		
1.1.2.1.	Specific risk	55	48
1.1.2.2.	General risk	122	96
2.	**Counterparty credit risk**		
2.1	Bonds	84	82
2.2	Derivatives	276	74
2.3	Other	110	1.297

Unit: Eur '000

Using the methods described above, the regulatory capital requirements for the trading portfolio in 31-12-2009 amounted to 2.985.697 €. This represents a reduction of 2.279.692 € vis-á-vis 2008, motivated 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 Notice N.º 8/2007 of Bank of Portugal.

9.2 Evaluation method of exchange and commodities risk

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

Regarding commodity risk, due to the inexistence of outright or derivative commodity exposures as of 31/12/2009, the method described in Annex VI of Notice No. 8/2007 of Bank of Portugal was not used.

9.3 Quantitative information

Given that in 31/12/2009 the net foreign currency position represented approximately 0.25% of the regulatory capital, 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, regarding both the portfolios under management and the balance sheet, as evidenced by the fact that the equity exposure (listed and unlisted) at fair value represented only 0.22% of the balance sheet.

This conservative profile towards risk has meant that, under the adverse conditions that have been characterising the stock market, significant negative impacts on profitability or prudential ratios were not faced.

10.2 Accounting techniques and assessment methods used

Capital losses on equity exposures have been 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. Thus capital losses on equity belonging to the trading book are recognised in results immediately. Falls in the value of shares categorised as available for sale are classified as impairment and recognised in results if greater than 30% or if the situation has persisted 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 27 – Equity exposure

	Listed shares		Unlisted shares		TOTAL	
	31-12-2009	31-12-2008	31-12-2009	31-12-2008	31-12-2009	31-12-2008
Acquisition cost	4.391	4.170	33.405	34.739	37.796	38.909
Fair value	4.211	2.644	33.078	34.638	37.290	37.282
Market price	4.211	2.644			4.211	2.644
Result for the year arising from sales and settlements					732	2.100
Total unrealised gains and losses					-1.117	-1.604
Total gains and losses inherent in latent revaluations					**611**	**-23**

Unit: Eur '000

11. Operational risk

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

Regulatory capital requirements to cover operational risk are calculated in accordance with the basic indicator method, which represents 15% of the last three years average of the relevant positive yearly indicator.

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

On 31/12/2009, regulatory capital requirements for operational risk on a consolidated basis amounted to € 62 million (6% above the levels observed in 2008), according to the Basic Indicator Approach.

Table 28 – Operational risk capital requirement

Method	Relevant indicator			Regulatory capital requirement (consolidated)
	2007	2008	2009	
Basic indicator approach	397.164	404.333	445.429	62.346

Unit: Eur '000

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 DAGR. Management of interest rate risk by CEMG takes as reference the principles recommended by the *Bank for International Settlements*.

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

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

These methods use the following simulation components:

- 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);
- Contracting strategies (amounts, pricing and repricing);
- Projection of interest and exchange rates;
- Coefficients of early settlement and mobilisation.

The repricing gap method calculates the value of assets and liabilities that renew interest rate within a certain period ("time bucket"), normally one month. The difference between the value of assets and liabilities that renew 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;
- Coefficients of early mobilisation (of deposits and credit) are calculated on the basis of historical information.

Remunerated assets and liabilities that are not directly indexed to a market rate and do not renew interest rate automatically are treated according to their specific nature. The following are of particular note:

- Overdrafts on demand deposits: 30% of their balance falling due undergoes repricing in the first three months of simulation;
- Non-indexed credit to customers: this is credit of residual magnitude. Contracts that establish quarterly and half-yearly repricing are considered, for purposes of repricing, with reference to the contractual interest rate revision date. Other contracts are treated as being subject to rate revision between 1 and 2 years; these are essentially long-standing non-indexed mortgage loan contracts not usually subject to rate revision. It should also be mentioned that the value of contracts under which capital regularly falls due or is repaid impacts on the gaps in the months in which the event is expected to occur;
- *Demand deposits*: on the basis of statistical analysis of the historical behaviour of their balances and degree of permanence, these deposits have been divided into volatile and core. Volatile deposits have rates of remuneration higher than those of the tariff and are regarded as undergoing repricing in the first month of simulation. Core deposits are treated as undergoing repricing between one and two years; it should be noted that the remuneration on these deposits is altered only by administrative means.
- Term deposits: the repricing date coincides with the deposit's maturity date. CEMG has deposits remunerated at the tariff rate and deposits remunerated at differentiated rates, higher than those on the tariff, granted to some customers. In producing the repricing model, term deposits as a whole are treated as liable to renegotiation of their interest rate on the maturity date, thus affecting the value of gaps.
- Structured deposits: the maturity and remuneration rate of these products are established when they are issued. Regarding predetermined but variable interest rate deposits (e.g., step up), the repricing date coincides with the expiration date.
- Deposit bonds issued at a fixed rate: issues of fixed-rate deposit bonds by CEMG have associated interest rate swaps; therefore they affect repricing gaps on the dates the pay leg of the swap is refixed.

12.2 Stress tests

The stress tests carried out most frequently are interest rate shocks. However CEMG regularly conducts other tests, prompted by both external (Bank of Portugal) and internal requests. In this context, scenario tests (annual frequency) and sensitivity analyses (semi-annual frequency) covering a larger number of risk factors and simulation assumptions have been conducted.

The stress tests carried out are designed essentially to evaluate the impact of changes in simulation assumptions on results, market value and capital and liquidity levels.

Some examples of shocks assumed and/or to be assumed: shocks on the yield curve, significant changes in credit spreads on new debt taken, changes in business growth rates and in the financing structure.

Monitoring the results of stress tests exercise is a responsibility of the top management. The monthly Asset and Liability Committee (ALCO) analyses the impacts of several adverse shocks, particularly interest rates, and define measures / strategies for immunization or mitigation of any adverse effects expected.

12.3 Quantitative information - interest rate risk

Shown below is the form for semi-annual reporting to the Bank of Portugal of "Interest rate risk (banking book)" on a consolidated basis, which considers the impact of a rate shock of (+-) 200 b.p.:

Table 29 – Interest rate risk (banking book)

			31-12-2009	31-12-2008
Effect on equity of a parallel shift of 200 b.p. in interest rate:	Amount	+	40.209	18.413
		-	-40.209	-18.413
	% regulatory capital	+	3,03%	1,53%
		-	-3,03%	-1,53%
				Unit: Eur '000

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

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

In accordance with the methodology laid down in Instruction Nº.19/2005, the impact on equity of a parallel shift of + 200 b.p. in the interest rate curve is 3% of the regulatory capital. The sensitivity of the banking book to interest rate risk is thus within the guideline limits defined by the BIS in "*Principles for the Management and Supervision of Interest Rate Risk*" (20% limit).