

# Capital Adequacy Information on Fortis Bank Polska SA Capital Group as at 31 December 2009 (Pillar 3)



**BNP PARIBAS**  
**FORTIS**

| Bank zmieniającego się świata



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## 1. Introduction

Under the Banking Law Act and its implementing rules banks are imposed specific obligations with respect to capital adequacy, namely that bank funds shall be maintained on a level adequate to risks taken in order to ensure the security of funds deposited.

Consequently, banks are obliged to maintain the total own funds and additional items of the balance sheet (hereinafter: short-term capital) on the level not lower than the higher value of the following:

- a) the sum of capital charges for particular risk types and capital charges for exceeding limits and violation of other standards specified by the Banking Law Act,
- b) the amount estimated by the bank, necessary to cover all identified material risks existing in the bank business and changes of economic environment, which will take into account the expected risk level (internal capital)<sup>1</sup>.

In Note 31.6.1. of the Annual Financial Statements for 2009, Fortis Bank Polska presents information regarding its own funds, short-term capital, minimum capital requirements, as far as required by the Banking Law Act and its implementing rules<sup>ii</sup>.

As provided in the Bank Information Policy, the Bank publishes information in this document under § 3 section 4 of Resolution No. 385/2008 of the Financial Supervision Authority dated 17 December 2008.

In quantitative terms, the information disclosed has been based on calculations pursuant to the provisions binding upon the Bank as at 31 December 2009, namely Resolution No. 380/2008 of the Financial Supervision Authority of 17 December 2008.



Unless specified otherwise, all values presented in the report are based on consolidated data, prepared on the level of Fortis Bank Polska SA Capital Group.

For the needs of this report, Fortis Bank Polska SA Capital Group is defined as a group comprising two entities:

1. Fortis Bank Polska SA
2. Fortis Private Investments Polska SA.

## 2. Subsidiaries and Integration With Dominet Bank SA

The parent company of Fortis Bank Polska SA is BNP Paribas SA based in Paris, France. As at January 21, 2010, the share capital of BNP Paribas SA amounted to EUR 2,371 million and was divided into 1,185,281,764 shares of EUR 2 nominal value each.

BNP Paribas SA is also the parent entity of Fortis Bank SA/NV based in Brussels, that renders its services under BNP Paribas Fortis brand.

The parent entity of Fortis Bank Polska SA is Fortis Bank SA/NV based in Brussels which holds 99.87% of the Bank's shares, of which 78.13% directly and 21.74% through Dominet S.A. Fortis Bank SA/NV share capital is EUR 9,375 million. Fortis Bank issued 483 241 153 shares, of which 74.93% is held by BNP Paribas SA, 25% is owned by the Belgian State through the investment entity SFPI (Société Fédérale de Participations et d'Investissement), whereas the remaining 0.07% is held by dispersed shareholders.

## 3. Subsidiaries and Integration With Dominet Bank SA

### 3.1. Fortis Private Investments Polska SA (FPIP SA)

**Fortis Private Investments Polska SA (FPIP SA)** is an entity wholly owned by Fortis Bank Polska SA. FPIP SA is an investment company operating in the brokerage business that includes:

- providing third party's financial instrument portfolio services, in particular managing financial instruments portfolios of private individuals as well as portfolios of investment funds;
- accepting orders to subscribe or redeem participation titles in UCITS.

The share capital of Fortis Private Investments Polska SA amounts to PLN 9,048 thousand and is divided into 377,000 shares with the nominal value of PLN 24 each.

In connection with the Bank's cooperation with FPIP SA in providing agency services of sale of financial instrument portfolio management, Fortis Bank Polska SA was registered by the Polish Financial Supervision Authority as the investment company's agent in February 2006.

### 3.2. Dominet Bank SA

In 2007 Fortis Bank SA/NV based in Brussels bought 100% of shares of Dominet S.A. – the owner of Dominet Bank S.A. – the Polish retail bank specialising in consumer loans. In March 2007, the Belgian shareholder committed to merge Fortis Bank Polska SA and Dominet Bank S.A. as one of the conditions set forth by the Polish Financial Supervision Authority to issue a permit to exercise voting rights attached to shares of both the banks.

On 8 July 2009, the Polish Financial Supervision Authority issued permit for the merger of both banks.

On 31 July 2009, the legal and operational merger of Fortis Bank Polska SA and Dominet Bank S.A. was completed.

After the merger date, Fortis Bank Polska SA and Dominet S.A. remain under joint control of Fortis Bank SA/NV whose principal shareholder is BNP Paribas.



## 4. Capital Exposures in the Banking Book

Capital exposure category	balance-sheet value [in PLN thousand]	Estimated fair value [in PLN thousand]
interest held in other entities	-	-
equity securities in non-financial entities	17 979	18 722
the bank's capital exposure to financial institutions, credit institutions, domestic and foreign banks expressed by interest or shares held	-	-
the bank's capital exposure to insurance companies	-	-
exposure amount to securitisation positions	-	-
other capital exposures	12	12

## 5. Own Funds Structure

### 5.1. The shareholder structure

Shareholders' structure as at 31 December 2009:

Shareholder	Number of shares held	Share (%) in the equity	Number of votes at the GM	Share (%) in the total number of votes at the AGM
<b>Fortis Bank SA/NV</b>	18,848,593	78.13%	18,848,593	78.13%
<b>Dominet S.A.</b>	5,243,532	21.74%	5,243,532	21.74%
<b>Others</b>	31,381	0.13%	31,381	0.13%
<b>Total:</b>	24,123,506	100.00%	24,123,506	100.00%

The Bank's shares have been quoted on the primary market of the Warsaw Stock Exchange since November 7, 1994. Since the year 2004, the Bank's shares have been quoted in the continuous trading system.

### 5.2. Own Funds

The term "own funds" stands for a notion larger than the term "equity capital". It has been defined in the Banking Law Act chapter entitled "Own Funds, Internal Capital and Financial Management of Banks" and in relevant provisions of the resolutions pertaining to capital adequacy<sup>iii</sup> and own funds<sup>iv</sup>.

**OWN FUNDS** = ORIGINAL OWN FUNDS (TIER 1 CAPITAL) + ADDITIONAL OWN FUNDS (TIER 2 CAPITAL)

**TIER 1 CAPITAL (ORIGINAL OWN FUNDS)** = CORE FUNDS + ADDITIONAL ITEMS OF ORIGINAL OWN FUNDS – DEDUCTIONS FROM TIER 1 CAPITAL

**ADDITIONAL OWN FUNDS (TIER 2 CAPITAL)** = REVALUATION RESERVE OF TANGIBLE FIXED ASSETS + SUBORDINATED LIABILITIES + FUNDS ESTABLISHED FROM OWN OR EXTERNAL FUNDS + SUBORDINATED SECURITIES + OTHER ITEMS – DEDUCTIONS FROM TIER 2 CAPITAL



Specific components of the own funds of Fortis Bank Polska SA as at 31 December 2009 are presented in the table below.

<b>Fund category</b>	<b>[PLN thousand]</b>
Own funds	1 905 192
Tier 1 capital (Original own funds)	1 320 609
Core funds, including:	1 761 615
share capital	1 206 175
additional capital	554 445
reserve capital	995
Additional items of Tier 1 capital, including:	45 639
General risk fund	45 639
Deductions from Tier 1 capital, including:	(472 108)
intangible assets	(42 229)
retained loss, net loss of the current period and loss under approval (negative value)	(429 880)
Other deductions from Tier 1 capital, including:	(14 537)
Unrealised losses on available-for-sale debt instruments	(14 537)
other items decreasing the original own funds	
Tier 2 capital (Additional own funds)	584 583
Subordinated liabilities	582 984
Other items of Tier 2 capital, including:	1 599
Unrealised gains on available-for-sale debt instruments (60%)	1 599
other deductions from Tier 2 capital:	-

## 6. Information on criteria and conditions applicable to selected components of the own funds

### Share capital

Share capital has originated from pecuniary payments made by the company shareholders. The share capital amount is registered in the National Court Register and cannot be changed unless a relevant resolution is taken by the General Meeting of Shareholders and the proper entry is made to the National Court Register. As at 31 December 2009, the share capital of the Bank equalled PLN 1,206,175,300 and was divided into 24,123,506 shares with the nominal value of PLN 50 each.

### Additional capital

Additional capital is established from net profit. Under the Bank Statute, the amount of relevant net profit reserves is set out by the General Meeting of Shareholders. Additionally, share premium is allocated to this capital in the case of share issue.

As the additional capital amount exceeds one third of the share capital, the Bank is not bound by the standards set out in the Polish Code of Commercial Companies and Partnerships and the Statute which provide that 8% of net profit shall be allocated to additional capital.

Under the Statute, additional capital is allocated to cover the Bank's balance sheet losses,

### Reserve capital

Reserve capital is established from net profit under a decision of the General Meeting of Shareholders upon a motion put forward by the Board of Executives of the Bank. Under the Statute, reserve capital is allocated to cover specific losses and expenses.



## **General risk fund**

General Risk Fund is established from net profit under a decision of the General Meeting of Shareholders upon a motion put forward by the Bank Board of Executives. Under the Statute, the general risk fund is allocated to cover unidentified risks related to banking activity.

## **Profit under approval/Net profit of the current reporting period**

Profit under approval shall mean annual net profit. Net profit of the current reporting period is the net profit for any reporting period shorter than an accounting year. The Bank may calculate both the former and the latter towards additional items of the original own funds on the condition that the net profit has been audited by a statutory auditor.

## **Intangible assets**

Intangible assets are identifiable assets which are not physical in nature and are recognised at acquisition cost. Intangible assets are recognised in the balance sheet if they will generate financial benefits in the future and can be reliably measured. The Bank assesses regularly if an intangible asset may be impaired.

## **Subordinated liabilities**

Subordinated liabilities at the end of 2009 amounted to PLN 582,984 thousand.

## **Capital exposure to financial institutions, credit institutions, banks and insurance companies**

In reports prepared on a separate basis, Fortis Bank Polska includes the investment in Fortis Private Investment Polska SA, wholly owned by the Bank in the item of capital exposures to financial institutions, credit institutions, banks and insurance companies. In consolidated reports, the exposure to FPIP SA is not reported.

Under the binding law provisions, capital exposures decrease by half (50% of exposure) Tier 1 capital and by half Tier 2 capital. If the volume of Tier 2 capital is lower than its respective portion of exposure, the difference is deducted from Tier 1 capital.

## **Lacking amount of specific provisions**

The lacking amount of specific provisions shall mean the difference between the level of impairment loss provisions for financial instruments required under IFRS and the actual level of the said provisions created at the Bank. The lacking amount of specific provisions shall decrease by half (i.e. 50% of the value) Tier 1 capital and by half Tier 2 capital. If the volume of Tier 2 capital is lower than its respective portion of the lacking provision amount, the difference is deducted from Tier 1 capital.

## **Unrealised gains/losses on available-for-sale instruments**

Under IFRS, unrealised profit/loss on available-for sale instruments are not recognised in the profit and loss account but rather in the capital. Pursuant to Resolution No. 381/2008 of the Financial Supervision Authority dated 17 December 2008 the item "other items of Tier 2 capital" shall include gains on available-for-sale instruments but only up to 60% of its value before taxes. On the other hand, Banks shall recognise losses on such instruments entirely in the "other deductions from Tier 1 capital".

## **7. Short-term capital**

Pursuant to § 5 item 4 of KNF Resolution no 380/2008, in order to calculate capital adequacy ratio, the Bank that pursues a commercial activity at a significant scale, may take a short-term capital in the amount not exceeding the total of capital requirements determined in the Resolution.

As at 31 December 2009, the short-term capital of Fortis Bank Polska was not recognised.



## 8. Total of own funds plus short-term capital

Category	[PLN thousand]
Own funds	1,905,192
Short-term capital	0
TOTAL	1,905,192

The value of the short-term capital increasing the own funds, taken into account by the Bank, equals zero.

## 9. Methods used for calculation of the regulatory capital requirement

The Bank sets forth capital requirements based on the principles defined in Resolution no 380/2008 dated 17 December 2008, issued by the Polish Financial Supervision Authority (KNF)<sup>1</sup>.

Capital requirement	Method adopted pursuant to KNF Resolution no 380/2008
for credit risk	standardised approach
for general interest rate risk	maturity method
for FX risk	basic method
for commodity price risk	simplified method
for equity price risk	simplified method
for specific risk related to debt securities	basic method
for delivery, settlement risk and counterparty credit risk	basic method
for exceeding the exposure concentration limit and limit of large exposures	basic method (for banks which pursue a large-scale commercial activity)
for exceeding the capital concentration limit	basic method
for operational risk	basic indicator approach

Owing to the volume of the operations pursued, it is assumed that the scale of the Bank's commercial activity is significant (trading book activities are recognised).

### 9.1. Capital requirement for credit risk

Balance sheet assets and liabilities and off-balance sheet commitments granted are measured according to rules defined in the International Financial Reporting Standards.

The Bank uses the standard approach to calculate risk-weighted exposure amounts in the banking book. Exposure amounts per their net value are presented in the table below.

<sup>1</sup> Resolution no. 380/2008 of the Commission for Banking Supervision dated March 13, 2007, regarding the scope and detailed rules of setting out capital requirements for specific risks, including the scope and conditions of use of statistical methods and the scope of information enclosed to applications for the issuance of permit for their use, terms and conditions of taking into consideration agreements on assignment of receivables, subparticipation agreements, credit derivative instrument agreements and agreements other than agreements on assignment of receivables and subparticipation agreements for the needs of setting capital requirements, conditions, scope and manner of use of ratings assigned by external creditworthiness institutions and export credit agencies, the manner and detailed rules of calculation of the banks' capital adequacy ratio, the scope and manner of taking into account bank's business in holdings in the calculation of capital requirements and the capital adequacy ratio likewise the determination of additional items in the bank's balance sheet statement recognized jointly with the equity in the capital adequacy computation and the scope, manner and terms of their setting out, including further amendments.



Category	[PLN thousand]
Exposures or contingent exposures to governments and central banks	3,725,389
Exposures or contingent exposures to regional government units and local authorities	120
Exposures or contingent exposures to administrative bodies and entities that run no business activity	4,101
Exposures or contingent exposures to multilateral development banks	-
Exposures or contingent exposures to international organisations	-
Exposures or contingent exposures to institutions	2,006,415
Exposures or contingent exposures to enterprises	5,445,164
Retail exposures or contingent retail exposures	2,428,580
Exposures or contingent exposures secured by real estate	9,159,687
Past-due exposures	468,804
Exposures classified into regulatory high risk categories	42
Exposures on account of secured bonds	-
Securitization positions	-
Short-term exposures towards institutions and entrepreneurs	-
Exposures on account of participation units in collective investment funds	-
Other exposures	737,020

For the needs of the capital requirement calculation, the Bank recognises both the funded and unfunded credit protection. The simplified method is used for financial collateral.

External credit assessment institutions recognized by the Bank include: Fitch Ratings, Moody's Investors Service, Standard and Poor's Ratings Services.

The securitised credit portfolio is excluded from the calculation of credit risk capital requirement. As at 31 December 2009 the securitised credit portfolio comprised car and cash loans sold to Polish Assets SPV Limited (a special purpose vehicle, established to make sale transactions) under Securitisation Agreement signed on 30 January 2006. With respect to the Securitisation Agreement signed, the transfer of a material part of risk has been made by the sale of credit receivables with the exclusion of the repurchase option by the Bank of the exposures previously transferred, in order to derive further benefits related to them and without any commitment of the Bank to again incur the risk related to the sold exposures. The Bank met all the minimum requirements to have the transfer of a material part of risk accepted, as specified in § 32 of Enclosure no. 18 to the KNF Resolution: Thus, all exposures related to the securitisation transaction performance were excluded from the calculation of the regulatory capital adequacy.

The capital requirement for credit risk calculated by the standardised approach set forth in Enclosure no 4 to KNF Resolution no 380/2008 is presented in the table below.

Category name	Net value (in PLN thousand)	Risk-weighted value (in PLN thousand)
<b>Banking book assets</b>		
assets with a risk weight of 0%	1,605,666	0
assets with a risk weight of 20%	1,757,873	356,652
assets with a risk weight of 35%	384,929	134,707
assets with a risk weight of 50%	32,602	19,995
assets with a risk weight of 75%	6,305,559	4,714,241
assets with a risk weight of 100%	7,264,440	6,775,593
assets with a risk weight of 150%	38,851	58,277
<b>Total</b>	<b>17,389,921</b>	<b>12,059,465</b>



<b>Off-balance sheet commitments in banking book</b>	0	0
Off-balance sheet commitments with product risk weight of 0%	0	0
Off-balance sheet commitments with product risk weight of 20%	28,471	1,899
Off-balance sheet commitments with product risk weight of 35%	6,369	248
Off-balance sheet commitments with product risk weight of 50%	28,362	4,850
Off-balance sheet commitments with product risk weight of 75%	353,481	60,629
Off-balance sheet commitments with product risk weight of 100%	3,017,156	427,600
Off-balance sheet commitments with product risk weight of 150%	0	0
<b>Total</b>	<b>3,433,839</b>	<b>495,226</b>

### **Collateral monitoring and risk mitigation methods**

The basic principle adopted by the Bank in the credit risk management is assessment of the borrower's capacity to repay the debt (customer creditworthiness). In addition to repayment capacity, the quality of credit exposures is also affected by the quality of the collateral held. Hence, the quality and value of the collateral taken is precisely and thoroughly assessed, based on the clearly defined rules provided in the internal procedures.

The Bank uses personal collateral, property collateral, mortgages, whereas receivables or bank accounts are mainly used as supplementary collateral. The important criterion for approving offered collateral is liquidity. Type of collateral varies with type of exposure and customer segment.

For receivables due from individuals, personal collateral is generally taken. For real estate financing, a mortgage is the basic collateral together with temporary collateral that remains valid until the mortgage has been established. Insurance covering the receivables arising under the loan is also used.

Mortgages are taken as collateral to secure debts from small and medium enterprises. For this customer segment, collateral established on trade receivables and movables is also commonplace. Collateral used for corporate customers is similar to the collateral typical of SME segment. Under agreements concluded with the Bank customers, receivables arising from derivative transactions are secured in the pecuniary form.

Collateral established on securities is rarely used. This type of collateral is common for the subsidiary.

The value of accepted collateral is monitored and its liquidity is determined. This applies in particular to mortgages, for which emergency procedures were formulated to determine the course of action to be taken in response to real estate value decrease. The value of real estate collateral which exceeds the defined level is always verified by the internal Real Estate Experts.

### **Credit risk reporting and measurement**

The crucial element of credit risk management is constant monitoring of the level of exposures and collateral value. Monitoring is performed on a current basis by departments in risk area lines responsible for specific customer segments. Additionally, monitoring responsibility lies with the Credit Risk Strategy, Reporting and Control Line and is made for the purposes of the Risk Committee and Credit Risk Management and Provisioning Committee.

## **9.2. Capital requirements for market risk**

Capital requirements for market risk were determined by basic methods, in line with Enclosures no 6-10 to KNF Resolution no 380/2008.

The capital requirement for general interest rate risk is determined by the maturity method.

FX position that constitutes the basis for computation of capital requirement for structural FX positions was not excluded from the calculation. In view of the fact that the total FX position did not exceed 2% of own funds as at 31 December 2009 the capital requirement for FX risk stood at zero.



The Bank does not make transactions for which commodities are a primary instrument. Capital requirement for commodity price risk does not occur.

The Bank does not make transactions for which equity securities are an underlying instrument. Capital risk for equity securities price risk does not arise.

Capital requirement for specific risk related to debt securities as at 31 December 2009 equalled zero since the portfolio comprised only instruments with low specific risk within the meaning of Enclosure no 9 to Resolution no 380/2009.

### 9.3. Capital requirement for delivery settlement risk as well as counterparty risk

The bank adopts the market valuation method to determine the balance sheet equivalent of off-balance sheet transactions. When calculating the requirement, the Bank does not take into account master agreements for set-offs.

### 9.4. Capital requirements for exceeding the exposure concentration limit and limit of large exposures

Capital requirements for exceeding the exposure concentration limit and limit of large exposures as at 31 December 2009 equalled zero since no limits defined respectively in Enclosures 12 and 13 to Resolution no 380/2008 were exceeded.

### 9.5. Capital requirement for operational risk

The Bank uses the basic indicator approach (BIA) to calculate the capital requirement for operational risk.

Based on the BIA method, capital requirement for operational risk equals the product of the three-year average annual gross income multiplied by a fixed percentage value of 15%.

## 10. Total capital requirement

The table below presents the capital requirements for particular risks as at :31 December 2009

Risk category	Capital requirement [PLN thousand]
Total capital requirement	1 137 639
Total capital requirement for credit risk	1 006 635
Market risk, including:	5 062
Total capital requirement for general interest rate risk	5 062
Total capital requirement for FX risk	-
Total capital requirement for commodity price risk	-
Total capital requirement for equity securities price risk	-
Total capital requirement for specific risk of debt securities prices	-
Total capital requirement for settlement risk, delivery risk and counterparty credit risk	20 102
total capital requirement for exceeding the exposure concentration limit and limit of large exposures	-
total capital requirement for exceeding the capital concentration limit	-
Total capital requirement for operational risk	105 840

The capital requirement of the Group is chiefly determined by the capital requirements of the Bank.

Total capital requirement of FPIP SA as at totalled PLN 320,498 and resulted solely from the capital requirement for credit risk. 31 December 2009



## 11. Capital Adequacy Ratio

The capital adequacy ratio of the Fortis Bank Polska Capital Group is computed in percents as a fraction multiplied by 100 where:

1. the numerator is the value of own funds increased by a short-term capital (for 2009 the short-term capital was zero)
2. the denominator is a total capital requirement multiplied by 12.5.

Category as at 31 December 2009	[PLN thousand]
the value of own funds increased by a short-term capital	1 905 192
Total capital requirement	1 137 639
Capital Adequacy Ratio	13,40%

## 12. Internal Capital Adequacy Assessment

### 12.1. Risk categories in the ICAAP process

Within the ICAAP process, on account of the pursued activity Fortis Bank Polska SA analyses the significance of the following risk types:

- liquidity risk;
- credit risk;
- interest rate risk in the banking book;
- interest rate risk in the trading book;
- FX risk;
- operational risk;
- business risk.

The Bank always considers liquidity risk and credit risk significant. The significance of the remaining types of risk is assessed each single time.

FPIP SA does not determine internal capital in the internal capital adequacy assessment process.

### 12.2. Internal capital as at 31 December 2009

At least once a year the Bank revises the relevance of particular risks resulting from the pursued activity. Based on this assessment the risks that need to be covered with internal capital are identified. Total amount of internal capital considers the capital necessary to cover all types of risks and the risk diversification element. Internal capital is estimated with the use of correlation matrix that enables to consider the effect of diversification between the estimated risks. The value of correlation ratios is indicated by an expert.

As at the Bank indicated a non-zero value of internal capital for the following types of risk: credit risk, interest rate risk, FX risk, operational risk and business risk. Credit risk comprised the greatest portion of the total amount of internal capital. 31 December 2009

### 12.3. Methodologies of Internal Capital Adequacy Assessment Process (ICAAP) for Specific Risks

Internal capital methodology as presented hereunder is currently converging towards BNPP Group framework embodying risk type definitions and policies. Nevertheless, for 2009 quantitative methods still mainly rely on the Fortis approaches.

#### Liquidity Risk



Liquidity risk is the risk for the Bank to be unable to fulfil its obligations at an acceptable cost in a given currency and location.

The Bank recognises that despite the material impact of liquidity risk on the Bank's activity, in practice it is difficult to justify the liquidity risk mitigation by applying a capital buffer. Therefore, the Bank has not allocated any internal capital to liquidity risk.

### **Credit risk**

Credit risk is the risk of incurring an economic loss on loans and receivables, existing or potential due to prior commitments, resulting from the credit quality migration of the Bank's debtors, which may eventually come to default. The probability of default and the expected recovery on the loan or receivable in the event of default are key components of the credit quality assessment.

Credit risk arises in relation to lending activities as well as market, investment and payment transactions that potentially expose the Bank to the default risk of the counterpart.

For the needs of the internal capital assessment process, credit risk is measured by applying the credit VaR concept and risk parameters such as LGD, PD, EAD. The Bank calculates unexpected losses using this methodology and taking into account the diversification between business lines. Next, by using capital multipliers, unexpected losses are converted into internal capital for credit risk.

### **Market risk (interest rate and currency risks) and Interest rate risk in the Banking Book**

Market risk is defined as the risk of incurring an economic loss as a result of adverse changes in market parameters, those ones being directly tradable or not.

Tradable market parameters include, but are not limited to, foreign exchange rates, security and commodity prices, derivatives prices, as well as related factors such as interest rates, credit spreads, implied volatility or implied correlation.

Non-tradable market parameters are derived from assumptions based on models or statistical analysis, such as correlations.

Liquidity is an important component of market risk. In situations of scarce liquidity or absence of liquidity, goods or instruments may not be tradable at their estimated value.

Interest Rate Risk in the Banking Book is the risk of incurring an economic loss as a result of mismatches in interest rates, maturities or nature between assets and liabilities. The interest rate risk in the banking book is measured in non-trading portfolios.

As far as internal capital is concerned, the following risk categories have been recognised: interest rate risk in the banking book, interest rate risk in the trading book and currency risk. The capital requirements for market risk are calculated at the Bank using VaR and with the assumption of maintaining the position for the time period of one year with the confidence level of 99.97%.

### **Operational risk**

Operational risk is the risk of incurring an economic loss due to inadequate or failed internal processes, or due to external events, whether these events are deliberate, accidental or natural occurrences. The management of operational risk is underpinned by an analysis of the cause - event - effect chain.

The internal processes may involve issues including human resources and systems. External events include but are not limited to floods, fire, earthquakes and terrorist attacks. Credit or market events such as default or a change in value that affects credit and market risks do not fall within the scope of operational risk. Operational risk encompasses legal risk, tax risk, information system risk and compliance risks.

For the needs of calculating internal capital needed to cover expected or unexpected losses related to operational risk, the Bank applies a methodology based on the Basic Indicator Approach or BIA which is also applied to calculate Pillar 1 capital requirements.

Under the Bank's assumption, in order to allocate internal capital the said indicator shall be computed in line with the approach specified in Resolution No. 380/2008 of the Financial Supervision Authority, Attachment 14, Part II "Basic Indicator Approach". In order to calculate an unexpected loss, the Bank



shall multiply the capital requirement computed under BIA by the indicator established using an expert approach.

### **Business, reputation, and strategic risks**

Business risk (called also Break-even risk) is the risk of negative operating income (excluding impact of other risks like market risk or operational risk) due to the inability to match costs to revenues. This situation may result from changes of the business environment and lack of flexibility in the cost structure that would let adjust costs in due course.

By reputation risk, we mean the risk of damaging the trust of the customers, counterparties, suppliers, employees, shareholders, regulators and any other stakeholders whose trust is an essential condition for the Bank to carry out its day-to-day operations.

Strategic risk is the risk of market share price fall because of the Bank's strategic choices.

The Bank calculates internal capital for business, strategic risk, and reputation risk. Risks of this group are assessed with respect to defined event types and according to two measures: potential loss level and level of concern. The risk related to integration processes was also recognised in the category of business risks.

## **13. Risk Management**

The risk management system includes the Supervisory Board, the BoE, committees and departments of the Risk Division. The Board of Executives is responsible for efficient and adequate functioning of the entire risk management system. Activities of the Board of Executives are supported by the appointed committees, including: the Risk & ALM Committee, Credit Risk Management and Provisioning Committee, Business Continuity Committee and Information Security Committee. The Credit Committee has a specific role as a body authorised to take credit decisions at Fortis Bank Polska SA up to the level specified by the maximum credit limit, set up by the Supervisory Board of the Bank.

The risk management at the Bank is supervised by one member of the Board of Executives who at the same time chairs the Risk & ALM Committee and Credit Committee.

The risk area has been functionally divided into five lines responsible for: credit risk of individual customers; SME customer risk; large credit exposures; credit risk strategy, reporting and control line and integrated risk management. The line responsible for large credit exposures also covers the restructuring and debt recovery functions. Apart from the restructuring and debt recovery functions also the credit administration function is common for the customers of all segments. Credit decisions are taken in the credit risk assessment departments, separately for particular customer segments. Support functions, in particular supervision over projects related to risk area, are entrusted to the Strategy, Reporting and Credit Risk Control line. Monitoring of market risk, liquidity risk and operational risk is performed by the Integrated Risk Management line. This line is also responsible for the tasks related to the ICAAP process.

Risk division is not the only one that is responsible for risk management at the Bank. Basic responsibility is assumed by business lines which constitute the first, extremely important element in the risk management process. They are responsible for the identification of risk at the sales process level and have a significant influence on the risk profile of the entire Bank. The Risk line should be considered a second stage in the risk management process, having a control function. The entire process is completed by the Compliance and Audit Departments. Apart from the mentioned units, also units from the TOPS and Finance lines have significant supporting functions.

Details regarding the organisation of risk management in Fortis Bank Polska SA Capital Group and descriptions of management of specific types of risks in the affiliated entity, Fortis Private Investments Polska SA for 2009, are presented in Additional Note 31 to the Financial Statements.

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<sup>1</sup> cf. Art.128 para. 1 item 2) of the Banking Law Act dated August 29, 1997 (Journal of Laws of 2002, No. 72, item 665 as amended).



<sup>ii</sup> cf. Article 111a of the Banking Law Act of 29 August 1997 (unified text in the Journal of Laws of 2002, no 72, item 665, as amended) and Para. 3, item 4 of KNF Resolution no 385/2008 of 17 December 2008 on detailed principles and manner of public disclosure of the capital adequacy qualitative and quantitative information by banks, and the scope of information to be disclosed (Official Journal of KNF dated 2008, no. 8, item 39);

KNF Resolution no. 380/2008 dated March 13, 2007, regarding the scope and detailed rules of setting out capital requirements for specific risks, including the scope and conditions of use of statistical methods and the scope of information enclosed to applications for the issuance of permit for their use, terms and conditions of taking into consideration agreements on assignment of receivables, subparticipation agreements, credit derivative instrument agreements and agreements other than agreements on assignment of receivables and subparticipation agreements for the needs of setting capital requirements, conditions, scope and manner of use of ratings assigned by external creditworthiness institutions and export credit agencies, the manner and detailed rules of calculation of the banks' capital adequacy ratio, the scope and manner of taking into account bank's business in holdings in the calculation of capital requirements and the capital adequacy ratio likewise the determination of additional items in the bank's balance sheet statement recognized jointly with the equity in the capital adequacy computation and the scope, manner and terms of their setting out (Official Journal of KNF dated 2008, no 8, item 34, as amended).

KNF Resolution no. 381/2008 dated 17 December 2008 regarding other reductions of Tier 1 funds, their amount, scope and conditions of decreasing bank's Tier 1 funds by such reductions, other bank's balance sheet items included into Tier 2 capital, their amount, scope and conditions of including them into bank's Tier 2 capital, reductions of Tier 2 capital, their amount, scope and conditions of decreasing bank's Tier 2 capital by such reductions; likewise the scope and manner of taking into account bank's business in holdings in the calculation of equity capital (Official Journal of KNF dated 2008, no 8, item 35).