

**DISCLOSURE
PURSUANT TO
ARTICLES 26 AND 26A
AUSTRIAN BANKING ACT
(BWG)**

**REPORT ON THE THIRD PILLAR IN
ACCORDANCE WITH BASEL II**

2012



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List of Abbreviations

ABS	Asset Backed Securities
AfS	Available for Sale
ALCO	Asset and Liability Management Committee
ALM	Asset Liability Management
AS	Application Scoring
ATM	At the Money
BCP	Business Continuity Plan
BPV	Basis Point Value
BS	Behavioural Scoring
BWG	Bankwesengesetz (Austrian Banking Act)
CAC	Credit Approval Committee
CAD	Canadian Dollar
CCF	Credit Conversion Factor
CDO	Collateralised Debt Obligation
CDX	Credit Default Swap Index
CEBS	Committee of European Banking Supervisors
CEO	Chief Executive Officer
CHF	Swiss Franc
CLO	Collateralised Loan Obligation
CLS	Continuous Linked Settlement
CPC	Credit Policy Committee
CRD	Capital Requirements Directive
CRO	Chief Risk Officer
EAD	Exposure at Default
ERM	Enterprise Risk Meeting
FACE	Free Available Cash Equivalent
FRA	Forward Rate Agreement
FV	Fair Value
FX	Foreign Exchange
GBP	British Pound
IAS	International Accounting Standards
ICAAP	Internal Capital Adequacy Assessment Process
ISDA	International Swap and Derivatives Association
IFRS	International Financial Reporting Standards
IKS	Internal Control System
IRB	Internal Rating based Approach
IRS	Interest Rate Swap
JPY	Japanese Yen
KSHK	Credit Collateral Catalogue
KPO	Competence and Power Regulation
LCR	Liquidity Coverage Ratio
LGD	Loss Given Default
MR	Market Risk Division
NII	Net Interest Income
OffV	Offenlegungsverordnung (Disclosure Regulation)
OTC	Over the Counter
PD	Probability of Default
RCSA	Risk Control Self-Assessment
RMBS	Residential Mortgage-backed Security

RWA	Risk Weighted Assets
SALCO	Strategic Asset and Liability Committee
SEQ	Sicherheitenerlösquotient (Collateral Return Rate)
SME	Small and Medium-sized Enterprise
SolvaV	Solvabilitätsverordnung (Austrian Solvency Regulation)
S&P	Standard & Poor's
UGB	Unternehmensgesetzbuch (Austrian Uniform Commercial Code)
USD	US Dollar
VaR	Value-at-Risk

1. GENERAL REQUIREMENTS

1.1. Scope of consolidation and consolidation methods

Article 3, lines 1 and 2 OffV

Owing to diverging objectives in the international accounting standards and the Austrian Banking Act (also called BWG in the following), there are two different sets of consolidation regulations, one for accounting purposes and one for regulatory purposes. These two sets of regulations also give rise to two different scopes of consolidation. The following section presents the scopes of consolidation and explains changes that occurred in them in 2012.

1.1.1. Consolidation for accounting purposes

In accordance with IAS 27, the scope of consolidation in the annual financial statements includes BAWAG P.S.K. AG Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse Aktiengesellschaft (BAWAG P.S.K.) with all material subsidiaries owned directly and indirectly.

Total assets and the subsidiary's share in total consolidated profit/loss are the criteria for materiality.

The consolidated financial statements as of 31 December 2012 contained 49 fully consolidated companies and one company included at equity. The book value of associated interests not valued at equity and including banks amounted to EUR 62 million as of 31 December 2012. Controlled companies with a book value of EUR 23 million were not included in the consolidated accounts because of their negligible effect on the assets, financial situation and earnings. Total assets (higher than EUR 10 million) and the subsidiary's share in total consolidated profit/loss (higher than EUR 1 million) are the criteria for inclusion. Subsidiaries with a negligible effect on the consolidated assets, financial situation and earnings are not included in the consolidation.

A leasing group subsidiary previously included in the consolidation, BLH BAWAG Leasing Holding GmbH, was merged with its parent company BAWAG P.S.K. Leasing GmbH in 2012. Further, a foreign subsidiary, BAWAG Capital Finance Ltd.III, was removed from the scope of consolidation on the termination of its liquidation. Finally, BAWAG banka dd was merged with BAWAG P.S.K. in December.

Furthermore, the shares in Zeus Recovery Fund SA held by BAWAG P.S.K. Jersey Capital Ltd. were sold in 2012 to an outside buyer and this subsidiary previously included at equity was therefore removed from the scope of consolidation.

1.1.2. Consolidation for regulatory purposes

Consolidation for regulatory purposes is carried out in accordance with Articles 24 and 30 Austrian Banking Act, with the financial statements of the individual companies and the consolidated financial statements being prepared in accordance with the principles of the Austrian Uniform Commercial Code (also called UGB in the following).

Undertakings involving an equity interest of more than 10 per cent

Undertakings	IFRS		Bank Group as per Article 30 BWG			Not part of Bank Group
	fully consolidated	at equity	fully consolidated	proportionally	deducted from own funds	
Credit institutions						
BAWAG P.S.K. AG	x		x			
BAWAG Allianz Vorsorgekasse AG				x		
BAWAG Malta Bank Ltd	x		x			
BAWAG P.S.K. INVEST GmbH	x		x			
BAWAG P.S.K. Wohnbaubank AG	x		x			
easybank AG	x		x			
WKBG Wiener Kreditbürgschafts- und Beteiligungs AG					x	
Österreichische Verkehrskreditbank AG	x		x			
PayLife Bank GmbH					x	
Real estate sub-group	5		5			4
Leasing sub-group	18		29	4	2	
Other corporates	20	1	22		6	22

Table 1

The BAWAG P.S.K. Group availed itself of the option in Article 24 (3a) Austrian Banking Act with respect to eight small financial institutions and ancillary service providers, as the inclusion of the capital and the capital requirements of these companies is not material to the consolidated capital and consolidated capital requirement.

As of 31 December 2012, a total of 62 companies were fully consolidated in the BAWAG P.S.K. Group in accordance with Article 30 Austrian Banking Act. Five subsidiaries were proportionally consolidated and ten subsidiaries were deducted from own funds. For regulatory purposes, 26 equity interests in which the BAWAG P.S.K. Group held more than a 10 per cent stake and which are neither credit institutions nor financial institutions or that do not fall for other reasons under the definition of groups of credit institutions set forth in Article 30 Austrian Banking Act were neither consolidated nor deducted from own funds. As all subsidiaries subject to banking regulations are included in the consolidation or their book values were deducted from own funds, there is no case of a shortfall in own funds as described in Article 3, line 4 Disclosure Regulation (also called OffV in the following).

1.2. Impediments to the transfer of own funds

Article 3, line 3 OffV

There are currently no known restrictions or other significant impediments to the transfer of own funds within the BAWAG P.S.K. Group.

1.3. Total of shortfall in own funds of all subsidiaries not included in the scope of consolidation

Article 3, line 4 OffV

No shortfalls in own funds are known of among the subsidiaries not consolidated but rather deducted from own funds.

2. RISK MANAGEMENT

2.1. Internal Capital Adequacy Assessment Process (ICAAP)

Article 5, line 1 OffV

The Internal Capital Adequacy Assessment Process (ICAAP) and the risk bearing capability are part of the Basel II regulations known as Pillar II. These defined processes and methods ensure that banks can afford the risks they enter into, i.e. that the existing risk coverage capacity is adequate to cover any risks that may arise.

The ability to bear risks is calculated monthly in the economic risk bearing capability. The full Managing Board deals with this calculation and its components monthly at the Enterprise Risk Meeting (ERM).

The following risk categories are quantified and juxtaposed with the risk coverage capacity available:

- ▶ **Credit risks:** Credit risk at BAWAG P.S.K. is subdivided into the following types of risks:
 - **Default risk:** Designates the risk of a complete or partial loss of exposures because of a customer's inability or unwillingness to pay. This category includes the default risk from credit transactions with customers of all segments as well as the issuer risk from investment in securities. The default risks also contain concentration risks, such as risks from foreign currency loans etc.
 - **Participation risk:** Pertains to the risk of possible losses from the provision of own capital to investment companies (consolidated participations).
 - **Creditworthiness/migration risk or spread risk:** Designates the risk of a loss in the value of exposures because the debtor's rating worsens without a default having occurred. The creditworthiness risk is attributable to a deterioration of the credit quality or the debtor's rating. Spread risks basically exist even without the credit quality diminishing if there is an increase in the yield premium for bonds with the same currency and term (e.g. due to a different risk appetite in the market or emerging liquidity effects). In terms of accounting, these risks affect the debt instruments of the company's own stock if the market value losses lead to a valuation change with an effect on profit or loss or on capital.
 - **Counterparty risk:** Occurs in transactions with a value date in the future which were entered into with a fixed price agreement and for which market-related value changes could occur during the term up to the value date. All conditional and unconditional futures contracts and credit derivatives fall under this category. If the counterparty defaults on a transaction of this kind prior to rendering full performance, BAWAG P.S.K. might under certain circumstances have to cover the position on the market with a new counterparty at the conditions valid at the time. If the market value has changed unfavourably for the Bank compared to the original transaction, the Bank incurs replacement losses equal to the difference between the originally agreed and the current market value.
 - **Settlement risk:** Comprises the advance payment risk/performance risk and the core settlement risk. The advance payment/performance risk results from BAWAG P.S.K. rendering a unilateral advance payment from a mutual transaction. It persists until the counterparty renders the full counter-payment. The core settlement risk occurs when a transaction is not fully settled immediately upon its conclusion. Unlike the counterparty risk, however, the settlement risk does not occur in futures contracts for which a future point in time was explicitly agreed for performance. It does exist in back-to-back transactions for which there can be a period of several days between the conclusion of the contract and performance owing to customary market practices.

- Country risks: The country risk exists in connection with credit extended to foreign borrowers or with the acquisition of bonds from foreign issuers or other assets having an origin outside Austria. It contains the transfer risk, the risk that agreed capital payments (payment of interest and/or repayment of principal) are rendered either not at all or only incompletely or late due to international payment restrictions or due to illiquidity or refusal to pay by a governmental debtor or guarantor.
- The credit risk also includes securitisation risks¹ and risks from the use of techniques for mitigating credit risk.

The credit risks are quantified and consolidated for the BAWAG P.S.K. Group in the risk bearing capability – the quantification is based on an internally implemented IRB model (request for application in Pillar I submitted in June 2012) and via estimated probabilities of default (PDs) and losses given default (LGDs). The IRB approach is taken with respect to risk bearing capability to ensure a more risk-sensitive quantification of risk as opposed to the capital adequacy assessment for regulatory purposes, which applies the regulations of the standardised approach. Additional capital surcharges are applied for the risk-sensitive assessment of the “ppu portfolio”², and intra-credit risk concentrations in connection with loans to major customers/to groups of affiliated customers. Valuation gains/losses from FV and AfS securities in IFRS equity are taken into account to the extent that these items are recognised at their IFRS book values. Participation risk³ and real estate risk are treated as separate risk categories and therefore not taken into account in the credit risk for the corresponding asset items.

- ▶ **Market price risks:** The essential market risks are in the trading book, in the interest risk banking book and in other market risks (especially credit spread risk). The trading-book and interest-rate risks are measured with value-at-risk models whereas a scenario-based approach is used for measuring credit spread risks.
- ▶ **Operational risks:** Operational risks are quantified using the standardised approach for OP risk analogously to the method used for regulatory calculations.
- ▶ **Other risks:** This category includes:
 - *Participation risks:* Participations which are held directly and indirectly by the Bank Group and which are not consolidated are quantified by using the PD/LGD approach. If no current internal rating is available in exceptional cases, the risk is quantified in line with the rating regulations applying risk class “7” (worst non-default risk class). Potential impairment risks that reduce the risk coverage capacity are taken into account with lower market values. Consolidated participations are examined in a look-through approach, whereby the individual transactions of these companies are quantified according to the risk categories involved, namely credit and market price risks.
 - *Liquidity risks:* Structural liquidity risks are quantified based on current liquidity gaps applying assumed potential deteriorations of spreads in connection with a notional spread widening on the market. Dispositive liquidity risks are controlled operationally in Asset Liability Management.
 - *Real estate risk:* This risk is quantified at 8 per cent of the market value of real estate, whereby half of the hidden reserves is deducted from the market value (in connection with figuring in 50 per cent of the hidden reserves in the risk coverage capacity).
- ▶ **Identified risks with simplified quantification:** Capital quantified using simplified valuation models is provided to cover the strategic risk, reputation risk, capital risk, compliance risk (including, inter alia, the risk from money laundering and terrorist financing) as well as the market liquidity risk.

1) BAWAG P.S.K. itself has not yet conducted any securitisations and has thus far acted solely as an investor in structured securitisation.

2) “Partial use” refers to credit transactions for which capital is allocated according to the standardised approach.

3) All direct and indirect participations (equity exposures) **not required to be consolidated** are used for quantifying the participation risk.

The individual risks are subsequently added to total bank risk in the risk bearing capability (assuming a correlation factor of 1) and compared with the risk coverage capacity of the BAWAG P.S.K. Group. The total available risk coverage capacity must adequately cover the total bank risk at all times in this case. This task is accomplished with a capital buffer reflecting the risk appetite of the Managing Board and maintained as a reserve for non-recognised risks as well as a further buffer (capital buffer for flexible risk allocation at the discretion of the Managing Board) and a monthly monitoring and escalation process based on a traffic signal system.

The **economic risk coverage capacity** includes components of IFRS equity and of core capital and subordinate capital as well as hidden reserves and hidden losses from strategic real estate and participations. The IFRS portfolio provision is also included in the risk coverage capacity.

In deviation from regulatory eligibility, subordinate capital issues are recognised in the risk coverage capacity at their nominal volume because if liquidation occurs, the issues have subordinate status in being repaid. This factor is offset by higher risk surcharges. To avoid double counting, valuation gains or losses from the FV valuation of own issues are neutralised. Hidden reserves in strategic real estate are taken into account after deduction of a conservative liquidity discount. Notional impairment risks of participations are deducted from the hidden reserves/hidden losses.

The calculation of the economic coverage capacity is based largely on IFRS (and UGB) determinations expanded by an economic perspective.

The control system pertinent to the overall bank management process (Internal Capital Adequacy Assessment Process) is the one set forth in IFRS whose values are applied to capital allocation/limitation.

A confidence level of 99.9 per cent is applied to the calculations (based on the A target rating to which the BAWAG P.S.K. Group is aspiring in the medium term). The confidence level indicates the probability of potential losses not exceeding the quantified risk.

Limits are determined for all limit categories (and control portfolios) as part of a defined risk strategy. Compliance with them is monitored monthly in accordance with the defined monitoring processes. Escalation occurs immediately if defined warning levels are reached or limits are exceeded. The associated processes are triggered.

2.2. Capital allocation and limitation at total Bank level

Article 5, line 1 OffV; Article 6, line 1 OffV

The processes for limitation and capital allocation run parallel to planning and budgeting at least once a year, or more often if required. First, the established premises such as confidence level and capital buffer (risk appetite) are updated. Control portfolios are defined for credit risk and are geared to the customer segments or organisational responsibilities. The subsidiaries of the BAWAG P.S.K. Group are also included in the control portfolios. Sub-limits are also defined for market price risks (trading book, interest rate risk in the banking book, other market price risks).

The definition of capital allocation/limitation in Article 39a of the Austrian Banking Act assumes the following premises and information:

- ▶ The strategy the management has set for the next five years is depicted in the medium-term plan.
- ▶ Premises determined by the Managing Board: confidence level, holding period, capital buffer, control units.
- ▶ Planning and budgeting process and any changes in risk value/balance sheet items determined by virtue of this process.
- ▶ Existing limit setting systems (e.g. in connection with market price risks).
- ▶ Limitation for the control units analogous to the quantification methods defined for the individual risk categories.

The capital allocation as a major component of overall bank risk management and limitation of the risk categories is approved by the Managing Board and is acknowledged by the Supervisory Board.

2.3. Bank wide risk management

Article 2, line 2 OffV

The full Managing Board determines the business strategy for the Group and the individual business segments as part of its risk management responsibilities and defines target values for the key risk ratios. The Managing Board then derives from this business strategy the risk strategy for the Bank and sets the risk tolerance for the current planning period. Finally, the Managing Board takes fundamental decisions with regard to the processes to be used to identify, measure, control and monitor risks.

The Chief Risk Officer (CRO) is a member of the Managing Board and assumes responsibility as the risk manager for the entire Group. All risk management entities report to the CRO. He regularly informs the full Managing Board about the risk situation at the Bank. As required by the supervisory authority, this organisational structure separates the front-office and back-office units, particularly risk management, at all levels of the Bank including the Managing Board level.

The **Enterprise Risk Meeting (ERM)** is a monthly risk meeting of all members of the Managing Board and is chaired by the CEO. It performs the following tasks for the BAWAG P.S.K. Group based on the Austrian Banking Act (Articles 39 and 39a – ICAAP), the specifications of the Supervisory Board and internal regulations:

- ▶ Delegates competence for limit setting to the committees for credit and risk in the Group
- ▶ Approves the risk strategy, defines risk acceptance and, if needed, gives recommendations to the Supervisory Board on changes and adjustments
- ▶ Approves the capital allocation in the framework of the Bank's ICAAP
- ▶ Approves new transactions and products recommended by committees of the Managing Board
- ▶ Reviews material findings made in the supervisory audits and orders actions to be taken to remedy shortcomings
- ▶ Deals with actions taken by the Credit Policy Committee
- ▶ Deals with and approves goals for risk-based margin setting
- ▶ Deals with audit findings from Internal Auditing as well as Compliance findings and the steps/plans for remedying shortcomings
- ▶ Deals with the monthly Group Risk Report

The Enterprise Risk Meeting has further responsibilities and powers in connection with stress tests, with which it must deal as needed but at least every six months:

- ▶ Has a legal review conducted of the requirements of stress tests – by internal and external auditors, risk units, Managing Board and Supervisory Board
- ▶ Identifies risk factors
- ▶ Defines and reviews stress test scenarios
- ▶ Interprets the results and discusses risk measures

In addition to ERM, the following further committees at Managing Board level deal with risk management:

Credit Approval Committee (CAC): Approval of loan applications with the authorities defined in the Competence and Power Regulation (KPO).

Credit Policy Committee (CPC): The main tasks of this committee are to examine the appropriateness of credit risk management, examine and approve credit risk strategies for all business segments, review and approve concentration risks related to sectors and geographic regions (countries), examine and approve the approval standards for all business segments and to examine and approve guidelines and processes.

Strategic Asset and Liability Management Committee (SALCO): This committee performs these main tasks among others:

- ▶ Determines the replication methods
- ▶ Determines the capital costs
- ▶ Determines individual liquidity costs for products and terms
- ▶ Decides on the investment of liabilities bearing no interest
- ▶ Decides on the (long-term) financing of assets bearing no interest
- ▶ Decides on the strategic interest position and market risk limit for the banking book

Proactive risk management is a major goal of the BAWAG P.S.K. Group and is among the core tasks of risk activities. Efforts must be made to ensure that the Bank takes on risks that are not excessively high (but rather reasonable and measurable) yet the business model must also definitely be supported along with the planned business growth defined in it.

To perform its tasks, the risk management organisation comprises the following organisationally independent units (main levels or divisions):

- ▶ Commercial and Institutional Risk
- ▶ Credit Risk Retail and SME
- ▶ Market Risk
- ▶ Risk Reporting (until December 2012, Strategic Risk in 2013)

3. CREDIT RISK⁴

3.1. Objectives and principles of credit risk management

Article 2, lines 1, 2, 3, 4 OffV

3.1.1. Strategies and procedures

Commercial credit

Credit is processed and decided upon according to extensive work instructions and decision-making powers set forth in the authority table.

The following points are considered for the extension of credit:

- ▶ All individual customers and customers in a customer group or a corporate group are rated at least annually.
- ▶ The analysis of creditworthiness is based on current business documents. Planning calculations of the company and other information ensure a meaningful analysis for the rating and decision.
- ▶ The assessment of a customer's creditworthiness and credit capability is based on ratings that must systematically cover all information made available from the relationship manager. The final rating confirmation is done by the responsible organisational risk division. The credit decision is taken solely according to the Competence and Power Regulation.
- ▶ The Bank strives to collect suitable collateral to minimise the credit risk and values it using a standardised valuation based on the Group collateral catalogue. In the event of any net exposure, correspondingly higher collateral must be provided if the rating shows any signs of worsening.
- ▶ Finance for complex business models (e.g. leveraged finance) or in new countries or regions is based on a thorough analysis and description of the associated (credit) risks. The (credit) risk units must be involved with appropriate expert opinions, as set forth in the product implementation process. New business segments must also be compatible with the general treatment of credit risk in terms of classification and basic rules in order to ensure consistency.
- ▶ Any decision that could change the risk position of BAWAG P.S.K. in a customer relationship requires approval from the competent authorised person. Each application requires a positive front-office recommendation (from the customer advisor) before being submitted to the back office.
- ▶ If key ratios are defined in a credit relationship as auxiliary conditions (known as covenants), they must be spelled out in the credit application and approved. Compliance with the key ratios relevant at the contractually fixed dates must be checked by the competent risk unit within the organisational structure.
- ▶ The exposure per customer and group of affiliated customers is not allowed to exceed certain RWA magnitudes as determined by the specifications in the risk strategy.

4) According to Article 2 OffV, the representational document includes in the following the risk types pursuant to Article 39 (2b) BWG.

Retail and Small Business Customers

Risk from new business is managed using clear, strict underwriting guidelines. Decisions at the point of sale are mostly made on the basis of automated scoring systems that issue recommendations, or the decision is made by the risk division. Special attention is paid in this portfolio to process compliance and the assurance of data quality. A central monitoring process ensures on-going quality assurance.

The credit risk in retail business is measured monthly using the following methods:

- ▶ Portfolio trends in terms of risk class distribution
- ▶ Portfolio trends in terms of overdue/late payments
- ▶ Portfolio trends for defaulted credit facilities
- ▶ Portfolio trends in terms of losses
- ▶ Scorecard performance
 - Approval rate
 - Manual scoring for decision cancellations

The findings of the analysis are reported periodically to the Enterprise Risk Meeting.

Independent of this process, risk-relevant data from standardised assessments at regional level between market managers (sales directors) and risk management units (Risk Centres) are discussed and documented in monthly committee meetings. The recorded results are summarised and also discussed and analysed monthly in central committees.

This process ensures a regular and standard flow of information whilst also enabling the Bank to respond directly to changes in risk parameters and market conditions.

3.1.2. Risk measurement systems

The (external) credit risk measurement for regulatory purposes is based on the Basel II standardised approach whereas the internal control system uses internally implemented IRB models for its results.

In addition, country, currency and industry concentration risks are included in the review of the credit risk.

3.1.3. Reporting systems

The full Managing Board of BAWAG P.S.K. is informed monthly about all risks of the BAWAG P.S.K. Group at the Enterprise Risk Meeting based on the comprehensive, monthly Group Risk Report.

In addition, the full Managing Board is informed immediately of any material change in the risk situation of BAWAG P.S.K.

3.1.4. Risk hedging and mitigation

Collateral is recognised and valued in accordance with the credit collateral catalogue that is valid throughout the Group (“KSHK”). The KSHK together with the collateral checklist serves as the basis for cataloguing collateral according to internal risk criteria at BAWAG P.S.K. The KSHK also determines the amount to be set for the market value and lending value (internal value) and whether the collateral may or may not be applied to reduce risk under the regulations of the current Austrian Banking Act. If new collateral not yet defined in the KSHK is taken in, the organisational unit Credit Risk Retail and SME must check whether this new collateral is eligible for recognition and select the valuation method for the market value and the limits for the lending value.

The lending value is the value at which the collateral is internally estimated at BAWAG P.S.K. in terms of reducing exposure. The lending value incorporates values empirically obtained from saleability, duration of realisation or discounts based on risks specific to the rating or country. In the case of real estate with prior liens, these liens are also considered in figuring the lending value. The lending value is set for daily credit business and is generally far below the current market value. The lending values in general and the discount rates per risk category in particular are subject to periodic review.

The market value is the value of the collateral usually attainable from selling the asset in a fair business transaction. The market value is determined using a valuation process that takes into account future marketability and is geared to standardised valuation processes (e.g. for real estate: income approach, cost approach, sales comparison approach, etc.). Speculative aspects are not considered in the calculation of the market value.

3.2. Counterparty default risk arising from derivatives, repurchase transactions, securities and commodities lending transactions, margin lending transactions and long settlement transactions

3.2.1. Risk hedging and mitigation

Article 6, line 2 OffV

BAWAG P.S.K. can demand the appropriation of collateral or take other steps to mitigate risk based on bilateral agreements (repurchase agreements, lending transactions, ISDA netting agreements, credit support annexes, etc.). From the standpoint of BAWAG P.S.K., credit risk only exists in cases in which the net market value is positive (replacement risk). As this risk depends largely on fluctuations in market risk parameters (exchange rates, interest rate movements, stock prices, etc.), regular recalculation of this risk is indispensable as is an appropriate adjustment in the collateral.

The types of collateral generally allowed include cash in several (major) currencies found in a set list (usually EUR, USD, GBP) and securities from issuers with very good ratings (government bonds of several European countries and the United States).

If securities are provided as collateral, a discount based on the remaining term is additionally applied. The collateral amounts are adjusted to the current risk situation (market valuation of the counterparty's transactions), or the intrinsic value of the collateral is checked at contractually agreed times. This check takes into account exchange rate fluctuations for collateral denominated in a foreign currency as well as the market value of securities. The customary intervals for valuation in the market are daily, weekly or monthly. For the majority of contracts, BAWAG P.S.K. provides for daily valuation.

The possibility of realising the deposited collateral in the event of the partner's bankruptcy and its further use (e.g. rehypothecation or passing along of the collateral as security for another contracting party) is ensured by the legal opinions drawn up on behalf of ISDA for the given jurisdiction of the individual contracting parties.

The only collateral BAWAG P.S.K. accepts for derivative business is financial collateral in the form of cash deposits in EUR and USD. This type of security therefore does not result in any reserves being formed nor is hedging required for the financial collateral taken in, as (with exception of USD) its value does not change due to price changes.

3.2.2. Correlation risks

Article 6, line 3 OffV

According to the Basel Committee, there are two types of correlation risk, general and specific. A general correlation risk exists if there is a high correlation between the counterparty's probability of default and risk factors in the general market risk. A specific correlation risk exists if there is a high correlation between the counterparty's probability of default and the replacement value of current transactions being conducted with that counterparty due to the nature of these transactions.

BAWAG P.S.K. takes account of the general correlation risk by conservatively assuming a correlation of 1 between credit and market risk when calculating the total bank risk in Pillar 2 (ICAAP). Assumptions on general and specific risk correlations also go into defining the total bank stress test and are thus indirectly quantified and reported. The stress tests are conducted every six months and undergo constant further development as part of a defined process.

Possible correlation risks are also taken into account in connection with deliberations on the collateral portfolio at BAWAG P.S.K. Any specific correlation risks are countered by combining the granting of limits to a counterparty or obligor group of counterparties and the setting of internal limits (exposure determination). For derivative business, only financial collateral in the form of cash deposits is allowed. This practice is also intended to help avoid specific correlation risks. In determining the limit and limit structure during the rating check, the Bank considers the counterparty's rating and a possible worsening of this rating. These factors are not part of the determination of exposure.

In the case of counterparties with whom a comparatively large volume of derivative business is conducted, collateral agreements are also signed. They stipulate that positive market values are regularly compensated solely in the form of cash deposits.

With respect to repos and securities finance, additional risks are largely eliminated in the corresponding agreements (repo annex, tri-party agreement) by setting restrictive criteria on acceptable types of securities, issuers, rating classes and haircuts. In repos trade, margin calls are periodically executed to compensate for the market value.

Performance risk is a special case of counterparty risk. It always arises when a payment is to be rendered upon the finalisation of transactions but there is not yet a corresponding counter-performance for that payment. The amount owed determines the size of the risk. This risk is added to the settlement limits, which are also defined at counterparty level. Payment netting agreements are concluded to minimise this risk. Also, these transactions are increasingly handled through clearing houses (continuous linked settlement ["CLS"]) and corresponding CLS agreements are concluded for them.

3.2.3. Rating downgrade and its impact on collateral

Article 6, line 4 OffV

Contractual clauses on dependencies between the collateral provided and the rating assigned by BAWAG P.S.K. exist only in a few isolated cases in connection with risk mitigation agreements from derivative transactions. In some of these agreements, this provision affects what are known as the “independent amount”, the “threshold amount” and the “minimum transfer amount”.

Based on existing agreements and as matters stand today, a downgrade of the rating issued by BAWAG P.S.K. would not have any material effect on the additional amount to be provided.

3.2.4. Measures for exposure value

Article 6, line 6 OffV

BAWAG P.S.K. enters into derivative transactions and repos in its trading activities and to manage assets and liabilities. Derivative financial transactions are conducted in the form of interest rate and currency swaps, forward exchange dealing, interest rate and foreign exchange options, forward rate agreements, interest rate futures and credit derivatives. Credit derivatives are used to a small extent for trading purposes and for hedging parts of the securities portfolio. Repo business is dominated by genuine repos and reverse repos.

BAWAG P.S.K. was not engaged in any securities lending and commodity lending outside the Group or in any margin lending transactions and long settlement transactions on 31 December 2012.

The fair value is applied in the valuation of derivatives and repos. It is determined from publicly quoted prices. If there is no quoted price available, the fair value is determined using accepted valuation methods. The fair value represents the potential replacement cost.

BAWAG P.S.K. has opted to use the market valuation method as defined in supervisory law. The counterparty risk thus consists of the potential replacement cost (positive market value) plus the add-on as a risk surcharge. This approach takes account of the possibility that the market value of an instrument can change from the start of a transaction due to market price fluctuations over time. A positive market value from the standpoint of the Bank is an economic exposure in relation to the counterparty, which would be lost in part or altogether in the event of default. The market value thus also represents the additional cost that would be necessary to place a comparable transaction in the market at the time of default, which is why it is referred to as the replacement value. To take account of potential future market price fluctuations as well, an add-on is also determined. Its amount varies depending on the instrument and the remaining term and is calculated from a fixed percentage factor added to the nominal value of the transaction. In calculating the internal exposure (limit add-on), BAWAG P.S.K. is guided by the procedure stipulated for determining capital adequacy.

3.2.5. Estimation of the scaling factor

Article 6, line 9 OffV

BAWAG P.S.K. does not use own estimates for determining the scaling factor.

3.3. Credit risk mitigation

3.3.1. Policies and processes for netting

Article 17, line 1 OffV

BAWAG P.S.K. has made use of off-balance-sheet netting since 31 December 2008. Netting pertains exclusively to derivative instruments with counterparties for whom corresponding netting agreements exist. BAWAG P.S.K. enters into derivative agreements solely with counterparties that have also signed a corresponding master agreement entitling the Bank to undertake netting. Netting is applied to the entire derivative business at the Bank. The pertinent netting agreements are legally valid and legally enforceable in all relevant jurisdictions in the event that the counterparty becomes insolvent or goes bankrupt.

3.3.2. Types of collateral and collateral valuation and management

Article 17, lines 2, 3 OffV

The following guidelines must be followed for collateral valuation and management:

- ▶ The Bank reserves the right to accept or reject collateral or to assign collateral the value deemed necessary and reasonable in order to protect Bank interests.
- ▶ The Group collateral list defines for the entire Group what combinations of goods (characteristics of the economic good/asset) and collateral (to which the Bank has title) are deemed basically acceptable and what value (market value, nominal value, etc.) to apply. It also indicates what discounts from the calculated value apply and under what circumstances this collateral can be applied to reduce capital requirements. This document is revised as warranted but at least once a year.
- ▶ The accompanying documents stipulate the process steps required to evaluate take-in and put into effect the collateral and to manage and realise it. Transaction-related exceptions to discounts set down in the collateral list must be approved by the organisational division Credit Risk Retail and SME.
- ▶ All collateral must have a market value that is easy to determine or an internally calculated value and the Bank must be in a position to represent its interests in the collateral.
- ▶ Collateral must meet the general legal requirements, in particular the minimum recognition requirements and the policies as set down by the Credit Policy Committee (CPC).

The compliance of the collateral with the legal criteria and the policies is determined during the credit application process in the front office and checked by the risk departments.

Generally, the value of collateral is checked during annual prolongation or the annual risk check or as warranted (e.g. increase, default).

The table below provides a summary of the key types of collateral, their estimated values, and the frequency of valuation:

Types of collateral and collateral valuation and management

Type of collateral	Estimated values	Frequency of valuation
Financial collateral	Market value according to current GEOS price data (with volatility adjustments taken into account)	Automatic daily valuation except for deposits at other banks
Residential real estate	Market value	Automatic compliance check with maximum interval of three years; evaluation with regard to expiring valuations; updating of relevant data in a valuation tool based on statistical data
Commercial real estate	Market value	A new valuation is conducted by a commercial risk department at least every three years for loans > EUR 3 million and at least every five years for loans < EUR 3 million; once a year, the risk units additionally check whether any material changes have occurred
Other physical collateral	Market value (no estimate for regulatory purposes)	At least once a year
Pledging or assignment of life insurance policies	Repurchase value	Automatic updating of repurchase value (through the insurance platform); for all other insurance companies when data is not transmitted via the platform: customer must be obligated to submit the insurance confirmation annually
Guarantees	Guaranteed amount (nominal value) less possible currency risks (volatility adjustment)	Monthly reconciliation of liability amount with the balance – depending on scope of liability
Co-obligations	Outstanding balance unless a restriction applies (no estimate for regulatory purposes)	On-going

Table 2

Real estate valuation is centralised to ensure a standard valuation approach throughout the Group. Residential real estate is assessed automatically using a valuation tool. The value of commercial real estate is assessed by an independent expert at the current market value, at the maximum. The values of real estate serving as collateral must be monitored periodically. For commercial real estate, the necessary information must be obtained at least annually and if necessary the market values must be updated. The values of residential real estate are monitored at intervals of at least every three years using statistical methods and adapted as required (e.g. in response to changes in the market).

3.3.3. Guarantors/counterparties for credit derivatives

Article 17, line 4 OffV

The main types of guarantor eligible for regulatory credit risk mitigation are domestic and foreign banks, the federal government, state governments, local governments and sovereigns. Credit derivatives are concluded exclusively and to a small extent with major international banks with a rating of AA or A.

3.3.4. Risk concentrations in risk mitigation

Article 17, line 5 OffV

A concentration risk exists if a significant percentage of collateral items Group-wide (at portfolio level) are concentrated in a small number of collateral categories, instruments, sectors or special protection providers (e.g. collateral providers). Certain reporting and monitoring activities are conducted at consolidated level for all types of physical collateral and guarantees for credit risk as well as market risk.

In the context of the consideration of the total collateral portfolio, concentration risks in connection with real estate collateral and guarantees have been identified and the following measures have been initiated: Warning thresholds have been defined at portfolio level for all collateral with intrinsic value and at individual level for the largest providers or issuers of collateral (with the rating taken into account in cases involving guarantees). This procedure is performed monthly and is submitted to the heads of the credit risk units. The largest providers of collateral are presented quarterly in the Group Risk Report. Moreover, for real estate collateral, a monthly examination is made according to country, region and town, type of real estate and lending value.

3.4. Value adjustments and provisions

3.4.1. Definition of “past due” and “impaired”

Article 7, paragraph 1, line 1 OffV

Definition of “past due”

As with the definition in the Solvency Regulation, overdrafts start being past due on the day on which the debtor exceeds a limit of which he is aware, is notified of a lower limit than the one of which he is availing himself, or avails himself of a credit that has not been approved. Credit card debt starts being past due on the earliest due date.⁵ Also, a receivable is deemed past due if a payment otherwise agreed is not rendered.

Definition of “impaired”

Positions are classified as impaired if the associated borrowers can be assumed unable to perform their outstanding payment obligations. BAWAG P.S.K. recognises appropriate provisions for this purpose.

5) Article 46 (1) SolvaV

3.4.2. Approaches and methods for determining provisions and reserves

Article 7, paragraph 1, line 2 OffV

Credit business risks are addressed by establishing credit risk provisions. They consist of provisions for credit transactions on the balance sheet and reserves for credit transactions off the balance sheet.

The main components are described below.

- ▶ Specific provisions (also known as loan loss provisions) are created for all exposures for which a reduction in value has already been ascertained. The Workout Group and Legal Collection are responsible for individually determining these provisions based on the credit risk range estimated for expected return flows of payments and collateral return.
- ▶ Provisions recognised automatically by the Bank risk engine in the event of unpaid instalment payments, current account overdrafts lasting more than 90 days and accounts handed over to the Workout Group and Legal Collection for active collection.
- ▶ Portfolio provisions according to IAS 39 AG 89 for losses in the Group credit portfolio that were incurred but not yet reported on the reporting date. For this portfolio-based provision (IFRS portfolio provision), it is assumed that losses have been incurred but not yet reported for a certain percentage of accounts not recognised as defaulted on the reporting date. To calculate this provision, the receivables are grouped into homogeneous portfolios with comparable risk characteristics. The quantification is based on the expected loss taking into account the loss identification period. This period, in turn, is determined individually for each customer segment on the basis of the average time until the next expected payment. A periodic check is conducted to determine whether the incurred but not reported losses are in a logical ratio to the losses that actually occurred.
- ▶ Structured credits, off-balance-sheet transactions, and items already in default are not considered in the determination of the portfolio value adjustment.
- ▶ Provisions for potential coverage gap for redemption carrier loans.

Information regarding the level of provisions and any changes in them can be found in the quantitative section of the Disclosure Report and in the annual report.

4. MARKET RISK

4.1. Objectives and principles of the management of market risk

Article 2, lines 1, 2, 3, 4 OffV

Strategies and procedures

Until autumn 2012, activities in the trading book focused primarily on own trading, i.e. buying and selling in defined markets and in defined product classes. The objective was primarily to carry out proprietary trading activities in highly liquid monetary and capital market instruments in the money market, fixed income and FX segment. All spot products and associated derivatives were traded within their risk class (interest rate, FX). In the autumn of 2012, the Bank decided to extensively reduce active proprietary trading and reduced trading book limits significantly.

Investments in securitisations (structured credits) are based on a buy-and-hold strategy. Each individual investment is approved within the scope of a global investment strategy by the responsible front-office and back-office unit based on a sound analysis. Only actions that mitigate risk, i.e. reduce and diversify existing credit risks, are taken based on current market trends in this asset class.

All transactions for which an active market exists and the market price is available are valued at the market price. Valuation models were applied to determine the fair value for several classes of structured credit transactions, as a fully active market does not exist for these transactions. These transactions involve securitised corporate exposures (index-sensitive corporate CDOs), CDOs with exposure in US mortgage loans (ABS CDOs with subprime exposure) and CLOs as well as US RMBSs. The valuation models were calibrated at the market prices of comparable transactions (liquid indices such as ABX, iTraxx, CDX, CLO Trading Runs).

The risks are monitored using a limit system. The Market Risk (MR) division measures availment of market risk limits and also orders counter-measures if the market risk limit is exceeded (VaR, vega, gamma, worst case, BPV, volume limits).

The objectives of the limit system were defined as follows:

- ▶ To create a risk-oriented limit system that consistently and methodically covers all positions in the trading and banking book that are sensitive to market risk and all risk factors using standard risk ratios.
- ▶ To ensure the controllability of market risk using clear-cut, non-ambiguous risk ratios and to set limits for these ratios in a proactive limit system.
- ▶ To integrate risk measurement, limit setting and the monitoring of limit utilisation systematically for all positions in the trading and banking book sensitive to market risk at individual and aggregate level in order to improve the basis for making decisions on risk policy and risk diversification.
- ▶ To integrate the market risk limits into budget planning and to take account of calculated risk bearing capability and, thereafter, of risk appetite in the scope of the overall ICAAP Bank control system.

Additional risk restrictions can be put in place for a period ranging from temporary to indefinite in response to the market situation for the actual controlling of risks in current business in the trading and banking books.

Trading book limits

Overnight limits apply to trading positions at the end of the trading day, whereas intraday limits are restricted to the maximum outstanding risk position during the day and are 1.5 times as large as the overnight limits.

A further distinction is made in

- ▶ Sensitivity and volume ratios
- ▶ Worst case limit (maximum loss with executed crisis tests)
- ▶ VaR limits (limit check in relation to Managing Board overnight)
- ▶ Gamma limit (for options in the interest rate segment and FX)
- ▶ Vega limit (for options in the FX segment)
- ▶ Annual loss limit (dynamic limit)

Total Bank limits

There are basis-point value limits at enterprise level in the interest rate segment that are divided by maturity range and total. There is a limit for each of the maturity ranges 0–1Y, 1–2Y, 2–3Y, 3–4Y, 4–5Y, 5–6Y, 6–7Y, 7–8Y, 8–9Y, 9–10Y and >10Y. The total of all basis-point values is also limited for the individual maturity ranges. Additional limits are also set within the described maturity ranges and overall for the sub-portfolios calculated at fair value. There is a limit for securities relevant for the AFS portfolio as well.

All limits are monitored and reported in Market Risk.

Reporting systems**Trading book reports**

The VaR, its limit utilisation, the basis-point values and gamma in the interest range are reported daily to the Managing Board and the competent trading units, as are the sensitivities of delta, gamma and vega and the currency holdings in the foreign exchange unit.

Along with the daily reports, interest rate, FX, volatility and credit-spread shifts are figured weekly and reported to the corresponding trading unit.

An ALCO Report containing all material market risk factors is produced monthly and submitted to the Strategic-ALCO. In addition, monthly shifts (interest rate, FX, volatility, credit spread) are figured for the respective trading units and reports are sent to the supervisory authority.

Furthermore, stress and crisis tests are conducted quarterly and reported to the Austrian National Bank and the Financial Market Authority.

If an outlier occurs in the daily VaR calculation, it is reported to the Austrian National Bank and Financial Market Authority within five business days along with the reasons for it.

Banking book reports

Limit compliance is checked daily in Financial Markets for the FX risk, option risk (gamma value) and BPV and reported to the Managing Board.

Compliance with the basis-point value limits (enterprise and maturity range limits as well as limit relevant to AFS and P/L) is monitored monthly at institution and Group level. Furthermore, stress tests and scenario analyses are also conducted. Intended future actions are included in all reports as needed. A net-interest-income simulation (NII simulation) is also done monthly for BAWAG P.S.K., with associated stress tests also being carried out.

The basis-point value calculation and the NII simulation are both reported to the Strategic ALCO or as part of the Group Risk Report to the Enterprise Risk Meeting. The VaR is calculated monthly for the entire Bank (enterprise) and for all banking subsidiaries.

The equity exposure risk (which is immaterial at BAWAG P.S.K.) is calculated monthly. It is included in the risk bearing capability calculation and reported quarterly to the Austrian National Bank. Furthermore, interest rate risk statistics at individual institution and Group level are compiled and reported to the Austrian National Bank each quarter.

Exceedance of the limit in the trading book⁶

If the VaR limits defined in the Risk Management Manual for individual trading groups are exceeded, trading management can take over the overdraft in the scope of its VaR limit (trading management in its function as limit buffer). If this buffer is utilised to an extent exceeding 10 per cent of the limit set for the given trading group (or floor for EUR 200 thousand if the limit is less than EUR 2 million), Market Risk informs the Managing Board member responsible for market risk in writing.

If trading management can no longer cover the exceeding of the limit or if this step is not desired, Market Risk sends a written message to this effect to the Chief Risk Officer (CRO). If the CRO is absent, the message is passed on to the Managing Board member responsible for trading. In collaboration with trading management, the corresponding risk position is closed immediately. If no Managing Board member is present, Market Risk is authorised to have trading management close out the position that caused the limit to be exceeded.

In the event of an exceedance of all other market risk limits (delta/gamma/vega/volume/intraday/worst-case limit), trading management and the competent group head must be informed by Market Risk immediately in writing (by e-mail) and the corresponding counter-measures taken by the affected group and monitored by Market Risk.

If the worst-case limit is exceeded, a risk-mitigating limit order must also be placed in the market in order to reduce the potential loss and the risk position in the event the worst case actually materialises.

If the loss sustained by a trading desk exceeds 30 per cent of the defined annual loss limit (warning level), a written message is sent immediately to the Managing Board members responsible for market risk and for the trading book, respectively.

The VaR limit is then duly adjusted at the end of the month. If the annual loss limit is exceeded by 60 per cent or 90 per cent within one month, Market Risk immediately adjusts the VaR limit. If the annual loss limit for the entire trading book exceeds 95 per cent, the limit is adjusted daily.

Exceedance of the limit for the total bank/banking book

If the market risk limit set by the ALCO or the full Managing Board is exceeded, MR sends a written message immediately to the Managing Board members responsible for the given division and to the Managing Board member responsible for market risk. In the event of exceedance in the banking book, a message is also sent to the head of the division and the competent group heads. Counter-measures are initiated. If the market risk limit is exceeded by more than 25 per cent, MR must also notify the CEO of this in writing.

Risk hedging and mitigation

If a market risk limit is exceeded, the position causing this must be closed out immediately. Alternatively, an adequate counter-position providing adequate risk mitigation can be entered into under certain circumstances (hedge).

6) The trading management was eliminated as of 31 December 2012 and with it that body's function as a buffer.

4.2. Internal models for market risk limitation

Article 11, line 1, lit a, b, c OffV

Characteristics and mode of operation

The BAWAG P.S.K. Group has used an internal market risk model since 1998 for calculating its minimum capital requirements in the trading book. A variance-covariance approach is applied for making daily forecasts of the maximum expected loss for the next day (value-at-risk) for all interest rate and FX positions in the trading book within the defined confidence level. The following parameters apply:

- ▶ Variance-covariance approach
- ▶ Historical time series of 250 days, equally weighted
- ▶ 99 per cent confidence level
- ▶ Holding period of one day for internal risk control and ten days for the calculation of the minimum capital requirement
- ▶ Use of correlations within and between the risk categories (equities, interest rate, FX)

The non-linear market risk is evaluated in two steps. The gamma risk is incorporated in the VaR calculation as a Taylor series (derivation of the market risk factors incorporated to the second order). The vega risk is calculated using an analytical approach in the internal vega model (99 per cent confidence level, one-day or ten-day holding period).

In addition, a Monte Carlo simulation is conducted, particularly to compare the non-linear results (options). Daily back-testing is carried out to measure the quality of the forecast loss figures (VaR).

In VaR analyses, the limits for the underlying methods must also be kept in mind. Factors limiting the VaR method include:

- ▶ When historical data are used as a basis for estimating future market trends, all potential events may not be covered, in particular, extreme movements in the market.
- ▶ The assumption that changes in the risk factors are based on a normal distribution could prove to be untrue, which would lead to an underestimation of the risk.
- ▶ The use of a one-day or ten-day holding period assumes that all positions can be closed out or hedged in the corresponding period. This assumption does not fully capture the market risk during illiquid periods when trading positions cannot be closed out or hedged.
- ▶ When a confidence level of 99 per cent is used, losses that could occur above this level are neither taken into account nor duly recognised.
- ▶ The value-at-risk calculations are based on the end-of-the-day positions in the trading book.

Given the limits in the value-at-risk method, Market Risk additionally applies sensitivity limits and stress tests (worst case limits) as well as a Monte Carlo simulation.

As of 31 December 2011, the law requires that a stressed VaR be calculated in addition to the VaR. As of 31 December 2011, this stressed VaR must be taken into account for the minimum capital requirements. The calculation method is analogous to the VaR using the variance-covariance approach for a one-day or a ten-day holding period. Volatilities and correlations are calculated for a continuous 12-month stress period. It is assured that this period will represent a substantial stress for the portfolio of BAWAG P.S.K.

Stress and crisis tests

The value-at-risk approach provides a quantitative measure for market risks in the trading book under normal market conditions. An estimate is made of the possible future loss that will not be exceeded over a defined period and with a defined confidence level under normal market conditions. Losses in connection with unexpected extreme market developments are assessed by additionally carrying out crisis and stress tests. In the course of these types of stress tests, the trading book is subjected to stresses from scenarios simulating extreme market conditions not covered by the confidence interval.

A distinction is made between time-based and event-based stress tests. In the process, one assumes statistical methods (different correlations, higher confidence level, etc.) and extreme movements by market risk factors (equity prices and index prices, interest rates, exchange rates, volatilities, credit spreads) and illiquidity in the markets and applies them to the valuation. Stress test results are perforce limited by number and by the fact that not all scenarios can be foreseen and simulated. Stress tests are therefore constantly checked and improved to ensure the material risks are captured and possible extreme market changes are depicted.

Back-testing

The quality of the forecast loss figures (VaR) is measured in daily back-testing (hypothetical back-testing). To this end, the exposures in the trading book from day x are subject to valuation at market prices from day x and day (x+1) and the actual trading result is calculated from the difference. In addition, back-testing is done on the basis of the actual daily P&L changes. In the process, the VaR is compared to the loss or profit that actually occurred on the next day. If a negative back-test result exceeds the VaR, it is referred to as an "outlier". As the number of outliers increases, so too does the multiplier determined by the Austrian Federal Ministry of Finance for calculating minimum capital requirements.

Basically, back-testing must take into account not only the change in market value in the narrower sense, but also the change in volatility.

The change in volatility is implicitly taken into account for products traded on exchanges using stock market prices. For OTC products where the volatility feed occurs daily, the change in volatilities must be incorporated into the calculation of market value.

No outliers occurred at BAWAG P.S.K. in the period under review. This fact confirms the quality of the model and means that the best possible multiplier of 3 set by the Austrian Ministry of Finance can be retained for calculating capital adequacy.

Scope of application of the models used

Article 11, line 2 OffV

By virtue of the decision made by the Austrian Ministry of Finance on 27 December 1999, BAWAG P.S.K. was granted permission to use a model in accordance with Article 21e Austrian Banking Act for the calculation of the minimum capital requirements for

- ▶ the general position risk in debt instruments,
- ▶ the general position risk in equity instruments and
- ▶ foreign exchange positions in the trading book.

Article 11, line 3 OffV

Marking to market

The positions in the trading book are marked to market based on market prices provided by Reuters. For instruments with an official close-out price, this price is used; otherwise, the arithmetic mean is calculated from the ask price and bid price.

Trading book positions undergo valuation as part of the calculation of daily results by the trading groups using Kondor+ and OPUS within Financial Markets. These results are adjusted for consistency in a reconciliation procedure using the valuation and position data in PMS. The trading results reported by the front office are reconciled with the back-office figures at least monthly.

Marking to model

Positions in the trading book for which there are no listed market prices are evaluated mark to model. Only recognised models customary in the banking industry are used. No self-developed models are applied. The market parameters utilised for valuation are provided by Reuters.

For linear derivatives such as IRS, CRS, FX forwards and FRA, the present value is determined by discounting the replicating cash flows. Plain vanilla OTC options in the trading book undergo valuation using recognised option price models (Black Scholes method or Garman-Kohlhagen). Interest rate derivatives that are more complex are calculated using Hull White models. A key prerequisite for mark-to-model valuation is to ensure a fluid and automated feed of market parameters by a recognised data provider subject to constant monitoring by Market Risk.

Independent price verification

Prices are independently verified using a two-man rule (front office and back office), independent setting of risk parameters for the trading systems by the risk unit and subsequent reconciliation of valuation with accounting. Furthermore, this area is annually audited internally by Internal Auditing and externally by the external auditor.

All trading book positions also undergo valuation daily by a system independent of the front office with a separate market data feed as part of the daily VaR calculation. The results (market values and sensitivities) are compared with those from the front-office systems. This constitutes independent price verification.

Taking into account of valuation adjustments

In its trading book, BAWAG P.S.K. only conducts trades in liquid positions that allow state-of-the-art marking-to-market valuation.

In addition, OTC positions undergo valuation with models customary in the market, whereby model risks for models developed in house are avoided and prices in line with the market are applied in the valuation. In addition, BAWAG P.S.K. does not have a market maker function with its total trading book position due to its size.

The valuation adjustments for the trading book are calculated monthly. They take account of the closing costs for the open position (bid/ask spreads) and model reserves based on volatility smiles. A volatility smile signifies the dependence of the volatility of option transactions on their strike price. This aspect is not considered in valuations carried out in FO and PMS with ATM (at-the-money) volatilities.

Creditworthiness is taken into account for OTC derivatives when calculating valuation adjustments. Creditworthiness is seen as immaterial for business partners with whom an agreement has been made regarding cash collateral. The net derivative exposure per counterparty is calculated for all business partners that have no collateral agreement if a netting agreement has been entered into with them. For all material net exposures from derivative transactions, a valuation adjustment is calculated for the credit risk. The customer rating and available credit spreads are taken into account in the calculation.

The structure of trading book positions is evaluated on an on-going basis to determine whether existing valuation processes and methods are suitable for correctly presenting the trading book in the internal model.

For all material net liabilities from OTC derivative transactions, a valuation adjustment is also calculated for the Bank's own credit risk.

The specific position risk is not part of the internal model, so no information can currently be given in accordance with Article 11 line 1 lit d OffV, Article 11 line 4 lit c, d OffV and Article 11 line 5 OffV.

The quantitative section of the Disclosure Report contains information according to Article 11 line 4 lit a, b OffV and Article 11 line 6 OffV.

4.3. Interest rate risk from positions not held in the trading book

Measurement of interest rate risk

Article 14, line 1 OffV

The method currently used for the banking book controls all interest-bearing instruments through sensitivity analysis using the basis-point value and value-at-risk, all currency instruments using volume limits for open positions, and the non-linear option components in several books using gamma values.

To limit the interest rate risk, a maximum available basis point value (BPV) is defined for individual credit institutions which are relevant to the interest rate risk and in the scope of consolidation in accordance with the Austrian Banking Act. The BPV is also sub-divided into maturity ranges and limited once again at this level. Positions affecting the profit and loss account and equity are also subjected to separate limits. Volume limits per currency are applied to reduce the foreign currency risk of the customer bank; the foreign currency risk in the Treasury banking book is limited by a low overall limit. In general, however, BAWAG P.S.K. follows the strategy of avoiding foreign currency risk in the banking book.

The interest rate risk in the banking book is measured at least monthly. A static analysis of interest rate risk is currently conducted for BAWAG P.S.K. subsidiary banks and other financial institutions relevant to interest rate risk.

Types of interest rate risk examined:

- ▶ Present value perspective: Account is taken of risks resulting from changes in the market value of transactions accompanied by a parallel shift in interest rate curves (currencies: EUR, USD, JPY, CHF, GBP and CAD). Changed interest rate curves are also simulated for the main currencies in the monthly stress tests.
- ▶ Income perspective: Risks that may cause an unexpected decline in the interest margin (interest margin risk; impact of possible interest rate scenarios).

In addition to and as part of the ICAAP process, the VaR is also reported monthly for the control group of relevance economically and quarterly for the control group of relevance for the profit and loss account pursuant to UGB or IFRS.

Assumptions regarding fixed interest rates

Article 14, line 2 OffV

For positions without a defined fixed interest rate, the Bank makes replication assumptions based on mathematical models. These models, in turn, are based on a holistic view of interest rate and liquidity risk and consist of the following four components:

- ▶ Future-oriented interest rate scenarios derived from an interest rate model
- ▶ Volume scenarios based on analyses of historical customer behaviour as a function of the interest rate trend
- ▶ Forecasts of customer conditions as a function of market data
- ▶ Stochastic optimisation model for ideal roll-over investments

Back-testing and the adjustment of replication assumptions are carried out at least annually prior to the planning process.

Scenario analysis

Article 14, line 3 OffV

A static and a dynamic analysis is currently carried out for BAWAG P.S.K. (internal risk report).

Interest rate gaps, key rate durations, average interest rates and changes in market values for various scenarios are calculated for each defined portfolio as part of the static analysis. The various scenarios and risk parameters below are analysed to determine their impact on the economic value of the position:

- ▶ Parallel shifts in the interest rate curves (+/-25 bp, +/-50 bp, +/-110 bp, +/-145 bp, +/-200 bp)
- ▶ Interest rate forecasts or crisis scenarios by Strategy & Development
- ▶ Worst case scenario (derived from historical series)
- ▶ Other scenarios as required

In the dynamic simulation of interest income, the different scenarios below are investigated along with their impact on net interest income:

- ▶ Forward rates
- ▶ Interest rate forecasts or crisis scenarios by Strategy & Development
- ▶ Parallel shift in main currencies (at forward rates): +/-110 bp
- ▶ Non-parallel shift for EUR (gradual over six months; at stable rates): 1 month +/-140 bp to 5 years +/-40 bp
- ▶ Inflation scenario (gradual over twelve months; at stable rates): 1 month +400 bp to 5 years +240 bp

5. OPERATIONAL RISK

Article 2, lines 1, 2, 3, 4; Article 12, line 1 OffV

5.1. Strategy and procedure

The BAWAG P.S.K. Group defines operational risk as “the risk of losses due to inadequate or failed internal processes, people and systems or due to external events”. This definition of operational risks includes legal risks. The company management is responsible for risk management as it pertains to strategic risks or risks to the Bank’s reputation.

The strategic policies regarding the management of operational risks seek to minimise these risks by taking suitable action. This action includes:

- ▶ Determining comprehensive principles by which the BAWAG P.S.K. Group can control its operational risks
- ▶ Assigning responsibility and authority for the development of standards and processes to identify, assess, measure, monitor and check operational risks and to produce reports on operational risks
- ▶ Abiding by a strategic orientation for the Group that complies with regulatory requirements and measures the danger from operational risks
- ▶ Support from Management in efficiently controlling the operational risks in the Bank and promoting a corporate culture that encourages understanding and recognition of operational risks and that gives priority to risk management
- ▶ Periodically determining material operational risks and initiating process improvements
- ▶ Minimising losses from operational risks

The rules for dealing with operational risks are set down in the “Operational Risk Management Guideline” and in the pertinent manuals and standards. In the Operational Risk Management Guideline, the Managing Board of BAWAG P.S.K. determines principles for the management of operational risks that are valid throughout the Group. These activities are coordinated by a central operational risk unit in order to ensure a common approach throughout the Group. The management of operational risks is handled locally in the individual business segments in the respective Group units by the division heads or managing directors and their operational risk agents.

5.2. Risk measurement systems

Since 1 July 2011, the Group has calculated the regulatory minimum capital requirements using the standardised approach pursuant to Articles 185ff. It is therefore not subject to disclosure obligations in accordance with Article 12 line 2 and line 3 or Article 18 OffV.

Loss database

Events, losses, profits, payments and near-losses resulting from operational risks in the business segments and areas are collected continuously as part of an institutionalised loss reporting system to provide a database for the management of operational risk (decentralised recording in loss database).

Subsequent central analysis allows concentrations of losses to be identified early and further losses to be prevented.

Definitions:

- ▶ **Operational risk events**
An operational risk event is an incident occurring during a business process that has an effect other than the one expected owing to inadequate or failed internal processes, people or systems or owing to external events or circumstances. An operational risk event can, but does not have to, lead to an economic or financial effect for the company.
- ▶ **Losses from operational risks**
Losses from operational risks result from operational risk events with a negative financial impact on the company. The analysis of these losses provides important evidence that can be used to identify the operational risks and to take steps to avoid future losses. Depending on the nature of the events and the time at which they occur, the events may reflect the existing or historical environment of the checks.
- ▶ **Profit from operational risks**
Profit from operational risks results from operational risk events with a positive financial impact on the company. Even if profit results from an operational risk event, the event itself is an indication of a process weakness that could result in a loss the next time it occurs. These events therefore provide valuable clues to Risk Management.
- ▶ **Payments**
Payments refer to the reduction of a loss (e.g. by means of insurance). Operational risk payments are divided into insurance payments and other payments.

Insurance

Insurance policies are an important way of reducing loss. Even if the act of taking out an insurance policy cannot prevent a possible operational risk event, it can at least reduce the financial effect of that event.

Other payments

Other payments refer to payments by third parties that reduce the loss for the company. Examples are damage claim payments, penalty payments, recourse payments and refunds.

► Near-losses

Near-losses are risk events that ultimately do not result in an actual loss. Near-losses refer to mistakes, system failures or process accidents that could have a negative financial effect for the company but that do not occur thanks to favourable circumstances. The identification of near-losses can open up possibilities for improving system structures and processes and thus reducing the extent of loss that occurs. A near-loss is an event signalling that a system or process weakness can result in losses in the future if not remedied.

Risk control self-assessments

Annual risk control self-assessments per business unit (division/subsidiary)

Additional information is collected through Risk Control Self-Assessments (RCSAs). Within a standard framework, all business divisions and subsidiaries annually identify and assess their material operational risks. Further, they evaluate the effectiveness of the control activities in the interest of the internal control system (IKS) and, if needed, also define any necessary control activities or steps. These efforts include evaluating individual control activities and estimating the probability and extent of losses from the various individual risks. A link to the Business Continuity Plan (BCP) is also established during the RCSAs.

Individual focal points are examined and assessed each year based on internal and external needs.

Actions are agreed for the material operational risks that come to light in the RCSAs. Their implementation is subject to continuous subsequent monitoring. An intranet application enables all divisions in the BAWAG P.S.K. Group to make decentralised enquiries about the agreed actions and to process and report the completion of these actions in a decentralised way.

Ad-hoc risk control self-assessments

If processes change or other pertinent events occur, the central operational risk unit can convene an ad hoc working group comprising risk specialists and experts in the field to determine possible risk potential. This step is particularly important in cases involving inter-divisional operational risks extending beyond the RCSA process.

Outsourcing risk control self-assessment

An outsourcing risk control self-assessment has been mandatory for outsourcing projects since 13 October 2011. The object of this risk control self-assessment is to identify and assess any operational risks associated with outsourcing projects. The outsourcing RCSA must be performed before an agreement is drawn up/signed and before it is approved so the risk assessment findings can be incorporated.

Outsourcing specifications that are more precise have been summarised in an outsourcing policy since 29 October 2012. Along with the operational risks, the policy covers the assessment of other risks such as strategic risks, legal risks, regulatory risks and risks from collaborating with business partners.

Operational risk assessment of new business segments or products

New products have been launched according to the revised product implementation process since June 2012. The Operational Risk department is entitled to vote in this process and serves as the internal control system.

5.3. Reporting systems

Reports are produced periodically on material operational risks and on the actions needed to prevent similar future risks. These documents enable the Managing Board and the division heads/managing directors to manage operational risks and minimise possible losses arising from those risks.

- ▶ Every month, the Enterprise Risk Meeting receives a summary of recorded losses and the results of the risk control self-assessments as part of the Risk Report.
- ▶ The divisions and the subsidiaries receive quarterly summaries of the recorded losses.
- ▶ The results from the annual and ad hoc risk control self-assessments are conveyed in a separate RCSA report to the pertinent division heads/managing directors, to the competent Managing Board member, the Chief Risk Officer, and Internal Auditing.
- ▶ The results from the outsourcing risk control self-assessments are reported to the CEO, CRO and responsible Managing Board member and to the pertinent division heads and to the heads of Legal Compliance and Internal Auditing.
- ▶ An overview of all pending actions for reducing the operational risk (as set forth in the RCSA) is reported quarterly to the responsible Managing Board member for each area of responsibility.
- ▶ Any carrying out of product implementations is reported quarterly in the Enterprise Risk Meeting.

5.4. Risk hedging and mitigation

The BAWAG P.S.K. Group has laid the basis for operational risk mitigation with its segmented organisational structure, clear rules on competencies and responsibilities, and work instructions. In addition, consistent guidelines on corporate authorisation levels help to achieve the goal of a controlled risk situation, as does having an internal control system (IKS) that adequately captures risk. The IKS does so, for example, by means of the two-man rule, separation of functions, access checks, limited authorisations, automation-assisted plausibility checks and system tests.

6. LIQUIDITY RISK

Article 2, lines 1, 2, 3, 4 OffV

6.1. Strategies, processes and management

The Group ALM Liquidity (ACAL) and the S-ALCO (Strategic Asset Liability Committee) handle liquidity management throughout the Group. Market Risk Management independently monitors risks. The principles and goals below serve as the point of departure for liquidity management:

Principles of liquidity control

- ▶ Liquidity management is a central core competence of the Bank
- ▶ Liquidity is a scarce resource at the Bank and must therefore be controlled
- ▶ Liquidity has a price that fluctuates with supply and demand
- ▶ ALM, a department answerable to the CFO, bears the main responsibility for liquidity management
- ▶ ALM does not pursue its own profitability goals in the process
- ▶ Liquidity is basically subject to central control – it is compulsory, except if it is determined differently by the liquidity management of BAWAG P.S.K. in individual cases, that the subsidiaries obtain financing from or deposit any excess liquidity with BAWAG P.S.K. in the scope of their governance
- ▶ ALM monitors liquidity risk in cooperation with Market Risk
- ▶ Control activities are geared primarily to liquidity cover, secondarily to liquidity structure and tertiarily to liquidity costs
- ▶ Organisationally, ALM manages liquidity independently of the business areas, but the effects of liquidity actions are analysed and taken into account at the level of the business areas
- ▶ Income, accounting and RWA effects are considered in the process, as are the ramifications for collateral, regulatory key ratios, maturity structure and the franchise value
- ▶ Liquidity control is done indirectly with internal clearing prices for customer business and indirectly with needs-based transaction pricing for large-volume wholesale funding
- ▶ The price of liquidity is determined centrally using defined methods. ALM serves as a counterparty for all business areas with respect to obtaining and extending liquidity
- ▶ Liquidity control takes account of possible negative effects from risks to the Bank's reputation

Goals

The central goals of liquidity control are as follows:

- ▶ Ensure sufficient liquidity even in a stress case
- ▶ Meet short- and medium-term liquidity needs and ensure long-term funding for the Bank based on planning and forecast calculations for each currency
- ▶ Develop and maintain the strategic refinancing structure of the Bank
- ▶ Maintain sources of financing on the capital market and in customer business even in periods with a minimal need for obtaining refunding
- ▶ Reduce the concentration risk as regards the maturities profile and through diversification of funding sources
- ▶ Optimise the maturity structure and funding costs
- ▶ Maintain a sufficiently large liquidity buffer at the lowest possible costs
- ▶ Comply with all internal and external key ratios and limits for liquidity
- ▶ Invest excess liquidity based on planning and forecast calculations
- ▶ Objectively offset liquidity costs for liquidity control
- ▶ Take into account strategic elements for the procurement of funds such as the franchise value for customer deposits and customer relationships

Organisational structure

The full Managing Board determines the business strategy of the Group and the individual business areas and defines target values for the central key ratios. It is therefore responsible for the liquidity strategy of the Bank and defines the level of risk tolerance for the planning period.

The Chief Financial Officer (CFO), as a member of the Managing Board, performs the function of liquidity manager for the Group as a whole. Asset Liability Management (ALM) is answerable to the CFO and incorporates liquidity management in the organisational unit ALM – Liquidity. The CFO monitors the activity of the organisational units and regularly informs the full Managing Board about the liquidity situation at the Bank. ALM – Liquidity bears the central specialised responsibilities for liquidity management in the BAWAG P.S.K. Group.

Controlling, also answerable to the CFO, is responsible for operational accounting of the liquidity costs and premiums in the profit centre account and for the methods used in the FTP system.

Market Risk (MR), a unit answerable to the CRO, monitors compliance with the defined limits and liquidity buffers.

Commercial Customers Corporate & Markets Business Development (BD) was responsible for the management of collateral. In February 2013, this function was taken over by the staff department ALM & Capital Management (AC).

Financial Markets (FM) is responsible for the operational execution of money market transactions.

Liquidity management is subdivided into four task areas: operational, tactical and strategic liquidity management and liquidity buffer management. As regards liquidity risk categories, a distinction is made between dispositive, structural and market liquidity risks. Basic methods for liquidity pricing are described and the powers and scope of decision-making for the ALM (ACA) department and the ALCO are laid down. The most important key ratios and reports for control purposes are also described. Among the key ratios are FACE (free available cash equivalent), which is internally defined at the Bank, and LCR (liquidity coverage ratio), a ratio introduced by Basel III. The liquidity buffer is divided into a short-term and medium-term portion that can be liquidated.

6.2. Risk measurement systems

The liquidity risk is calculated by rolling out the cash flows from existing and planned transactions. These cash flows are calculated from business data drawn from the central data warehouse of the Bank. Based on the transaction data for customer business (loans, deposits, securities, etc.), the cash flows from interest and repayment of principal are rolled out in the cash flow generator. They are then imported into the ALM system, where they are reported in aggregated form according to defined criteria (e.g. product type, customer category, and behaviour with respect to the repayment of principal). If a transaction has no contractual term, appropriate capital commitment assumptions are made and reviewed annually.

The total of asset and liability cash flows determines the gap in the static balance of cash flows, i.e. new business is not assumed. A second analysis then includes the new business assumptions from the business forecast, which the business areas formulate monthly, and the cash flows are rolled out again. The assumptions on new business contain expectations for products on the asset side (lending, investments) and on the liability side (deposits, own issues, money market). No gaps should occur in the roll-out of cash flows because by definition, liquidity planning closes these gaps. In a third analysis, stress tests are then conducted in the Bank balance sheet by making certain assumptions regarding volume changes in certain stress situations. These stress tests are based on the existing balance sheet structure and assume that transactions drawing to an end will be replaced under the same conditions (terms, volumes but with different circumstances). With this constant balance sheet, the volume assumptions for individual products are entered in the ALM system in accordance with the given stress scenarios.

The stress scenarios are distinguished as follows:

- ▶ Idiosyncratic stress
- ▶ Systemic stress
- ▶ Macroeconomic stress
- ▶ Mixed stress scenario

The stress tests also take account of counterbalancing capacity, i.e. unencumbered liquidity buffers. It is assumed that these buffers can be converted into genuine liquidity in a short time either in a sale, in repurchase agreements or through refinancing from the central bank.

The time-to-wall is measured in these stress tests and then juxtaposed with the risk limits approved by the Managing Board. The stipulated risk limits must be adhered to in the stress tests with account taken of the counterbalancing capacity; otherwise, ALM must suggest or initiate countermeasures.

6.3. Reporting systems

The liquidity status is presented and reported in standardised, regular reports. These reports, in turn, are divided into the following categories:

- ▶ Operational liquidity status
- ▶ Tactical liquidity status
- ▶ Structural liquidity status

The reports on the operational liquidity status basically provide a concrete forecast of liquidity for the next several days so that the operational ALM can immediately indicate a need for liquidity or a surplus of liquidity. This status is then adjusted by conducting short-term interbank transactions or by compensating account balances.

The reports on the tactical liquidity status are used to estimate business developments on the assets or liabilities side of the balance sheet and to present them monthly to the S-ALCO. These reports depict developments in economic and regulatory liquidity statically and dynamically, pointing out potential gaps. The corresponding limits and compliance with them are measured in these reports for economic and regulatory liquidity. ALM is responsible for closing unplanned tactical gaps (in a time horizon of 12 months) by taking farsighted actions.

The reports on the structural liquidity status are produced as part of total Bank planning. In the process, ALM coordinates the planning of overall funding, which comprises theoretical scenarios, business shifts and planned assumptions for new business. ALM draws on these factors to develop the funding plan, whose purpose is to close the structural funding gaps arising from planning. The funding plan has a time horizon of five years.

6.4. Risk hedging and mitigation

Risks are hedged and mitigated by means of on-going checks of the current and forecast liquidity status from an economic, regulatory and also strictly cash standpoint. Plans are constantly adjusted based on current developments in the business areas and the market and on a re-evaluation of the counterbalancing capacity.

A liquidity emergency plan for the actual stress case was drawn up and is periodically updated.

The purpose of the liquidity risk strategy is not only to hedge and mitigate risks. It is also used for rendering risks measurable, for raising awareness of risks and for actively controlling risks (in terms of a conscious decision to take a liquidity risk). In this same context, the Bank continuously tests market liquidity for individual balance sheet items and constantly sustains the ability of the market to absorb products on the liability side (and the potential refinancing costs associated with them). It also prepares forecasts of the volume of collateral material for securitised refinancing (and reconciles it with the business plan).

7. CONCENTRATION RISKS

Article 2, lines 1, 2, 3, 4 OffV

The general framework for the management of concentration risks is based on estimates made by senior management at BAWAG P.S.K. coupled with specifications and recommendations made by national and international institutions engaged in bank regulation.

The Risk Management Organisation at the BAWAG P.S.K. Group manages, limits, and controls concentration risks and reports them periodically to the full Managing Board.

In connection with risk concentrations, BAWAG P.S.K. treats certain types of credit risks as material types of risk, namely credit risks arising from large exposures in individual customer segments or from large total exposures in certain industries, countries or foreign currencies and whose loss potential could endanger the core business at the Bank or lastingly impact its risk profile.

Corresponding limits are defined at the level of individual borrowers and groups of affiliated customers and for industries, countries and currencies. All limits are monitored promptly within a narrow time frame corresponding to the estimated risk potential.

The actual limit utilisation and the professional risk estimate are reported to the responsible committees and the Managing Board on a regular basis. If limits are exceeded or warning thresholds are met, Risk Management joins with the Managing Board to take suitable action to mitigate and reduce the risk.

Appropriate warning thresholds subject to periodic monitoring and corresponding reporting processes are defined to avoid losses in connection with concentrations of collateral that could endanger the economic stability of the Bank or cause a major change in the risk profile of the Bank.

In market risk, all material risk factors are depicted in scenario analyses and stress tests using VaR models in order to analyse and monitor market concentration risks. Generally disadvantageous assumptions are made regarding correlations between these risk factors based on the risk profile of the Bank. This approach is taken for reasons of caution. Special attention is paid in this process to potential liquidity risks resulting from financial instruments with incongruous maturities.

In connection with concentrations of operational risks, BAWAG P.S.K. focuses not only on activities with a long business history but also especially on adequate assessments of new lines of business.

Active monitoring of funding requirements and broad diversification of funding sources are precautions against potential liquidity problems from risk concentrations in the investment and funding structure.

8. RISK OF MONEY LAUNDERING AND TERRORIST FINANCING

Article 2, lines 1, 2, 3, 4 OffV

8.1. Strategies, processes and management

As required under the law, there is an analysis of total bank risk on the basis of which specific money laundering risks can be derived. Customer relationships and domestic and foreign transactions are monitored with specific screening and transaction software in accordance with this risk analysis (where customers are divided into risk categories). Further, specific transaction and country screening is used to take account of the High Risk Country Regulation issued by the FMA and the sanction guidelines relevant to us. Bank employees receive training (self-learning programs or classroom training) to sensitise them to specific constellations suspected of involving money laundering. Pertinent directives (summarised in a separate manual) and technical mandatory fields ensure compliance with pertinent regulations to prevent money laundering under the Banking Act and under Regulation (EC) 1781/2006 (full transmission of customer data for a money transfer).

8.2. Structure and organisation of relevant risk management functions

The law requires a person be appointed to deal with money laundering matters. This person at the Bank performs these duties at the Compliance Office and has the staff indicated below to support him in performing his duties. The Compliance Office is organisationally part of Legal Compliance yet takes its decisions independently of the head of Legal Compliance and reports to the full Managing Board and the Audit and Compliance Committee on a quarterly basis. Furthermore, the annual report has to be acknowledged by the Supervisory Board. The Organisational Manual of the Bank outlines the duties and responsibilities of the Compliance Office.

8.3. Risk hedging and mitigation

Comprehensive guidelines are summarised in the Money Laundering Manual and a control system is in place for the setup of accounts and the major transactions where mandatory identification apply. Further, additional mandatory IT fields have been created to ensure that the required data is obtained and recorded in the system for account setup and for specific transactions (e.g. verification of origin for transactions of EUR 15,000 and more, transactions requiring an ID to be shown). In addition to the total bank risk analysis that undergoes regular evaluation, the Bank also conducts constant analysis to evaluate reported cases suspected of involving money laundering and to determine whether new patterns of behaviour require the software to be adjusted or other actions to be taken.

9. RESIDUAL RISK FROM CREDIT RISK MITIGATION

Article 2, lines 1, 2, 3, 4 OffV

9.1. Strategies, processes and management

At BAWAG P.S.K., all risks not already covered in other sections on risk are referred to as residual risks:

- ▶ Concentration risks for collateral
- ▶ Legal risk of realisation (change in the legal situation, etc.)
- ▶ Other risks – changes affecting security and exceeding usual fluctuations and changes

Transparent risk assessment for concentrations of collateral is ensured by means of appropriately defined processes and continuous monitoring of collateral at portfolio level and guarantor level. These activities also give management a sufficient information base for adequately controlling collateral concentration risks.

The Bank covers legal risks and other risks by applying correspondingly conservative valuation approaches and collateral lending values as well as with the stress test.

9.2. Structure and organisation of relevant risk management functions

These risks are constantly monitored within the risk organisation and regularly reported upon to the Managing Board.

9.3. Risk hedging and mitigation

BAWAG P.S.K. takes various steps to address and ensure compliance with the requirements pertaining to residual risk from credit risk mitigation.

- ▶ The market value and lending value are assessed and estimated at BAWAG P.S.K. in the course of collateral valuation. Details on the valuation procedure are given in the credit collateral catalogue (KSHK) of BAWAG P.S.K.
- ▶ Stress tests involving the stressing of the LGDs are conducted to analyse the fluctuations in collateral market values and lending values and their ramifications for the risk bearing capability of BAWAG P.S.K. Details on these stress tests can be found in the stress test plan of BAWAG P.S.K.
- ▶ The residual security concentration risk is covered in the monitoring plan entitled “Concentrations of Collateral”.

10. MACROECONOMIC RISKS

Article 2, lines 1, 2, 3, 4 OffV

10.1. Strategies, processes and management

(Macro-)economic risks refer to the risks arising from disadvantageous changes in the development of the economies in which the BAWAG P.S.K. Group conducts business.

The possible effects of (macro-)economic risks are diverse. Disadvantageous macroeconomic developments could mean any of the following for BAWAG P.S.K.: a negative change in market prices, an increased number of credit defaults, lower demand for products, negative trends in the value of participations, declining savings rates (liquidity tensions), etc. Risk is identified during stress testing conducted to determine the type and scope of the required stress tests as well as the macroeconomic scenarios and the associated risk parameters. Stress tests are generally conducted every six months on the reference dates 30 June and 31 December and are the responsibility of the individual specialised units of the risk organisation in the BAWAG P.S.K. Group.

10.2. Risk measurement, risk reporting system and risk hedging or mitigation

The macroeconomic risks are quantified for all material risks based on the specified stress tests and the stress parameters associated with them.

Preliminary control of macroeconomic risks is done during total bank risk control and planning activities. Planning is completed with a defined economic environment indicated.

Subsequent risk control is completed in connection with total bank risk control and the reporting of stress test findings as well as during the determination of any necessary actions. Possible actions for subsequent control range from diversification and the reduction of risk positions to an increase in risk coverage capacity. Actions can also be of an organisational nature, for instance an in-depth analysis of risk drivers or also the inclusion of additional aspects in the stress tests. The actions are approved by the decision-makers and carried out by the responsible organisational units.

The stress test report is submitted every six months to the Managing Board for approval.

11. PARTICIPATIONS NOT INCLUDED IN THE TRADING BOOK

11.1. Objectives and principles for the management of participations

Article 2, lines 1, 2, 3, 4 OffV

11.1.1. Strategies and procedures

Participation risk includes potential losses from own equity provided, from risks caused by the assumption of liability (e.g. comfort letters) or from profit and loss transfer agreements (assumption of losses).

Under the **participation strategy** approved by the Managing Board, BAWAG P.S.K. and its Group undertakings carry participations in the following categories:

- ▶ **Majority participations in the financial services sector** that are considered part of the core business of the BAWAG P.S.K. Group and that therefore address additional groups of customers or enlarge the product range and that must satisfy minimum return requirements at least in the medium term. These minimum return requirements can be met by contributions to the Bank's commission result from dividends or service contributions.
- ▶ **Minority participations in the financial services sector** of strategic significance for enlarging the product range within the financial services sector. These equity exposures are measured based on direct return.
- ▶ **Auxiliary undertakings of the BAWAG P.S.K. Group** that perform services for the BAWAG P.S.K. Group in outsourced legal entities. Auxiliary undertakings are generally active in the IT sector or in payments. The participation portfolio carries auxiliary undertakings both as majority participations and as minority participations (usually collaborations with other credit institutions).
- ▶ **Own funds generation:** These participations are held mainly due to the generation of own funds associated with them and are also measured on that basis. A return can only be depicted in individual cases.
- ▶ **Other participations**

BAWAG P.S.K. generally pursues the goal of achieving appropriate and lasting profitability, taking any risk mitigation into account. Any major change in the participation portfolio therefore requires the approval of the Managing Board of BAWAG P.S.K. following a request from the Strategic Participation Management and M&A department (a unit in Accounting/Participations) and an expert opinion from the risk unit Commercial and Institutional Risk.

11.1.2. Risk measurement systems

Requests from the Strategic Participation Management and M&A department regarding a change in a participation are forwarded to the Managing Board for a decision after a separate expert opinion on the associated risk is drawn up by Commercial and Institutional Risk.

For material operational participations, Controlling conducts a standardised analysis of target versus actual company figures during the year, with monthly reports to Participations and to the full Managing Board.

All participations are rated at least once a year based on the BAWAG P.S.K. rating standards. The confirmed rating is issued by Commercial and Institutional Risk. Credit-financed participations are handled by Workout in the restructuring phase.

An impairment test for participations must be carried out annually and checked by the Commercial and Institutional Risk division. The purpose of the impairment test is to determine the recoverability of the participations and to identify hidden reserves in the participation portfolio. Impairments are taken into account immediately in accounting after being approved by the full Managing Board.

11.1.3. Reporting systems

Risk controlling for participations is completed in the form of quarterly reports to the Managing Board. The risk types credit risk, market risk, operational risk, tax risk, country risk and participation risk are recorded for each material participation held directly or indirectly. EUR 3 million is the threshold for being considered material.

11.1.4. Risk hedging and mitigation

The treatment of risks arising from participations is governed in the Participation Risk Strategy, the Participation Risk Manual and the work manual "Risk Controlling for Participations".

The **Participation Risk Strategy**, a sub-risk strategy of the BAWAG P.S.K. Group, determines the medium-term projects pertaining to material risky participations.

The **Participation Risk Manual** describes the organisation, processes for the current management of participation risk and methods for risk measurement and risk mitigation for participations.

A risk controlling report on participations must be submitted quarterly to the Managing Board. The **Work Manual for Risk Controlling** presents the processes, responsibilities and methods stipulated for risk controlling.

In addition, the Participation Controlling Department monitors the financial results of all material operational participations on an on-going basis and monitors the performance of all other participations in the overall portfolio annually.

11.1.5. Structure and organisation of relevant risk management functions

The risk management function for participations is integrated in International Transactions and Participations, a department that answers to the credit risk unit Commercial and Institutional Risk. This unit reports to the Chief Risk Officer (CRO) of the Bank. The participation risk strategy, work manuals, expert opinions on risk associated with equity capital actions and value determinations during impairment tests are submitted to the Managing Board to be decided on.

11.2. Accounting and valuation methods

Article 13, line 2 OffV

UGB

The valuation of participations is based on acquisition costs unless persistent losses or a lack of earning power necessitate a write-down.

IFRS

Non-consolidated participations are assigned to the category "Financial assets available for sale". The valuation is based on the market value. If the market value cannot be reliably determined, the valuation is based on acquisition costs. Extraordinary write-downs are not subsequently written up again according to IAS 39.

Notes item 1 in the annual report contains details on accounting and valuation methods.

12. SECURITISATIONS

12.1. Securitisation activities and functions in the securitisation process

Article 15, lines 1, 4, 5, 7, 9, 14, lit a, c, d and f, 16, 17 OffV

BAWAG P.S.K. itself has not yet conducted any securitisations and has thus far acted solely as an investor in structured securitisation. The extent and structure of the portfolio is described in the quantitative section of this publication and in the annual report. Beyond that, BAWAG P.S.K. plays no role in any securitisation transactions. All securitisation positions are contained in the banking book.

12.2. Risks from securitisations and resecuritisations

Article 15, lines 2, 3, 6 OffV

The securitisation portfolio of BAWAG P.S.K. essentially contains securitised exposures with risks of defaults of corporates (European and US investment grade companies; European and US high-yield companies through CLOs), residential mortgage backed securities (European and US RMBS and ABS-CDOs with RMBS exposure) and securitised commercial real estate (Europe and United States). The investments are subject not only to credit risk but also to market risk because of the increase in the risk premiums on securitisation transactions observed in the market after the outbreak of the financial crisis in 2007.

The securitisation positions held by BAWAG P.S.K. are largely senior tranches with adequate subordination. Appropriate value adjustments have already been made for the transactions with only slight subordination.

The resecuritisation items mainly comprise ABS-CDOs, and securitisations holding a pool of (credit) exposures as well as occasional securitisations in the portfolio (e.g. CLOs with individual CLO tranches in the portfolio). Resecuritisation positions (with the exception of CLOs) pose a larger (binary) credit risk due to their greater structural leverage and generally also exhibit greater fluctuations in market price and lower liquidity.

BAWAG P.S.K. uses valuation models to determine the market value for a large part of the portfolio. Models are also used to determine the economic value of the transactions. Models for calculating sensitivities, stress tests, etc. were developed based on the valuation models. All models are applied to the exposures underlying the transactions, i.e. for securitisations they are applied to the pool of exposures, and for resecuritisations they are applied to exposures within the individual underlying securitisations.

12.3. Approaches to the calculation of risk-weighted exposure amounts

Article 15, line 8 OffV

Risk-weighted exposure amounts for securitisation and resecuritisation positions are calculated under the standardised approach according to the provisions of SolvaV Article 161.

Positions with no external rating from Moody's, Standard & Poor's or Fitch are assigned a risk weight of 1250 per cent. If the underlying assets are known at all times, an average risk weight is applied and multiplied by a concentration coefficient.

12.4. Accounting policies for securitisations

Article 15, line 10, lit a, b and d through f OffV

This requirement only concerns originators of securitisations and is thus irrelevant for BAWAG P.S.K. until further notice.

Article 15, line 10, lit c OffV

The valuation models (refer also to section 12.2, last paragraph) were calibrated at the market prices of comparable transactions (liquid indices such as ABX, iTraxx, CDX, CLO Trading Runs).

12.5. Eligible external rating agencies used for securitisations

Article 15, line 11 OffV

In its investment deliberations, BAWAG P.S.K. utilises the estimated ratings of Moody's, Standard & Poor's and Fitch regardless of the category of securitised exposure. If several ratings are available, the relevant risk weight for the capital requirements is determined as indicated in Article 31 SolvaV.

12.6. Internal assessment approach

Article 15, line 12 OffV

BAWAG P.S.K. has no disclosure obligations in accordance with Article 15 line 12 OffV because it does not apply the internal assessment approach.

13. RATING SYSTEMS AND RATING PROCESSES

13.1. External ratings

Article 8, lines 1, 2, 3, 4 OffV

The weighted exposure amounts are calculated for regulatory purposes for the entire loan portfolio of BAWAG P.S.K. using the standardised credit-risk approach set forth in Article 22a Austrian Banking Act. It is generally geared solely to ratings from Moody's. An exception is only made for securitisation positions. For these items, ratings from Standard & Poor's and from Fitch are also applied.

13.2. Internal rating systems

Article 16, paragraph 1, line 2, lit a OffV

13.2.1. Customer segmentation and overview of the internal rating systems

The Bank employs internal rating and scoring systems for its own risk management and the internally implemented IRB approach. Customers are assigned an exposure category and the stipulated rating procedure based on a process called segmentation. The first step in segmentation occurs automatically in advance of actual calculations based on the following parameters:

- ▶ ÖNACE segment
- ▶ Country containing the principle place of business
- ▶ Operating revenues of the customer or corporate group
- ▶ Exposure amount of the corporate group for the BAWAG P.S.K. Group
- ▶ Special finance code Y/N

The relevant rating and scoring process is determined based on the indicated criteria and, in retail business, also on the selected product. Individual provisions of the Austrian Solvency Regulation are taken into account when required capital is calculated in the risk engine, at which time the exposure class or its sub-category is finally set.

The table below summarises the significant rating and scoring models for the customer segment Banks and Commercial and Retail Customers. Beyond that, rating systems applied in accordance with the standardised approach are also used for customer groups.

Overview of rating and scoring systems

	Rating system	Stat. model/ expert model	BAWAG P.S.K.	easybank	Other ⁷
Corporates	Standard Commercial (Austria)	Stat. model	x	x	x
	Commercial Foreign (not Austria)	Stat. model	x	x	x
	Holding Companies	Stat. model	x	x	x
	Private Real Estate	Stat. model	x	x	x
	Construction of Non-profit Housing	Expert model	x		x
	Special Financing	Expert model	x		x
Banks	Banks	Stat. model	x	x	x
Retail	AS ⁸ – Current Accounts	Stat. model	x	x	x
	AS – Standard Loans	Stat. model	x	x	x
	AS – Mortgage Loans	Stat. model	x	x	x
	AS – Co-branded Credit Cards	Stat. model	x	x	x
	AS – Small Business Retail	Stat. model	x	x	x
	BS ⁹ – Credit Private and Small Business	Stat. model	x	x	x
	BS – Current Accounts	Stat. model	x	x	x
	BS – Accounts	Stat. model	x	x	x
	BS – Credit Cards	Stat. model	x	x	x
BS – Accounts Small Business	Stat. model	x	x	x	

Table 3

The rating and scoring systems are subject to annual validation processes. If major deviations exist, subsequent analyses are initiated during the year and may result in corresponding adjustments.

7) Other institutions in the BAWAG P.S.K. Group

8) AS stands for application scoring

9) BS stands for behavioural scoring

13.2.2. Relationship between internal and external ratings

Ratings from Moody's are employed at BAWAG P.S.K. to calculate the minimum capital requirements for regulatory purposes. For securitisations, the ratings from Moody's, Standard & Poor's and Fitch are incorporated in the calculation of risk-weighted exposures.

The results of the internal rating procedures are depicted using a master scale. The table below shows the relationship between the internal rating notches and the external ratings used by external rating agencies.

Rating notches and classes

All segments Rating notch	External rating agencies		
	Moody's	S&P	Fitch
1.1	Aaa*	AAA*	AAA*
1.2	Aaa*, Aa1	AAA*, AA+	AAA*, AA+
1.3	Aa2	AA	AA
2.1	Aa3	AA-	AA-
2.2	A1	A+	A+
2.3			
3.1	A2	A	A
3.2			
3.3	A3	A-	A-
4.1	Baa1	BBB+	BBB+
4.2	Baa2	BBB	BBB
4.3	Baa3	BBB-	BBB-
5.1	Ba1	BB+	BB+
5.2	Ba2	BB	BB
5.3	Ba3	BB-	BB-
5.4	B1	B+	B+
6.1	B2	B	B
6.2	B3		
6.3	Caa1	B-	B-
6.4	Caa2		
7	Caa3	CCC+, CCC, CCC-, CC, C	CCC, CC, C
8.1–8.8	Ca, C	R, SD, D	RD, D

*) Aaa and AAA correspond to Class 1.1 for sovereigns and to Class 1.2 for all other segments.

Table 4

The internal rating processes for the exposure classes also take into account external ratings under certain conditions (e.g. information that is more current or more comprehensive).

13.3. Rating systems and processes in the retail segment

Article 16, paragraph 1, line 3, lit d OffV

Article 16, paragraph 2, line 1 OffV

13.3.1. Retail customers

Retail customers are defined as natural persons whose income does not derive primarily from self-employment. The main exposure categories in the retail customer segment are private loans, overdrafts on salary accounts and credit card products.

Whenever a new product that can be recorded as a debit is opened or customer or product information changes, retail customers are subject to

- ▶ application scoring
- to determine their rating and after a product relationship lasts six months (at the earliest), they are subject to automatic
- ▶ monthly behavioural scoring.

Application scoring

The application scoring is based on the product involved and on the different scorecards for the product categories:

- ▶ loans for which real estate was provided as collateral,
- ▶ current accounts,
- ▶ non-collateralised standard loan facilities and
- ▶ qualified revolving retail exposures (credit cards).

The scorecards take into account customer characteristics (e.g. age, occupation), application and product characteristics (e.g. amount of credit extended) and external data on any incidences of payment problems.

Loans can be approved only for customers in risk classes up to 6.2. Beyond the determination of risk class, scoring gives a recommendation on what decision to make (accept/green; reject for now/yellow; reject/red) based on the regulations specifying the essential criteria in the credit extension guidelines (total credit exposure, affordability, security, etc.).

These recommendations are binding for the authorised employees in sales. Only authorised staff in the risk centres are allowed to overrule the categories “reject for now” and “reject”.

Another application scoring procedure can be carried out during the term of any product where warranted, particularly if essential new information has come up that indicates a (positive or negative) change in the customer’s current risk class.

Application scoring for mortgage loans

The automatic rating procedure incorporates no collateral characteristics beyond the customer’s personal data (e.g. economic environment, employment status, household account) and credit application information (e.g. amount of loan). These characteristics are checked for compliance with credit extension guidelines in keeping with the rules for decision making.

Application scoring for co-branded credit cards

For credit cards for current account holders at the Bank, the risk class of the current account is the decisive factor.

Some credit cards are issued jointly with organisations or companies outside the financial sector and served within the BAWAG P.S.K. Group by easybank. These co-branded credit cards are assigned a product-based risk class and a “decision recommendation”.

Application scoring for consumer loans

For standard loans, the Bank determines a risk class based on the customer’s personal data (e.g. economic environment, employment status) and the credit application data (e.g. amount, term, purpose). Decision-making rules are used to check the specifications in the credit extension guidelines as regards total exposure and affordability taking into account security reserves, etc.

Application scoring for current accounts

For current accounts, the customer’s personal data (e.g. age, education and external information) are used to form a risk class.

The credit line is extended automatically in accepted risk classes.

Behavioural scoring

A distinction by product group is made in behavioural scoring. Payment accounts (e.g. salary accounts) are divided into three different scorecards. Credit products are grouped in a single scorecard. Payment behaviour and product specifics are incorporated in all scorecards to calculate a behavioural scoring risk class.

After six months (at the earliest), each product with a potential debit balance is checked at the end of the month and a behavioural score is determined. This score is based mostly on internal account movements: e.g. account behaviour (accounts and loans/overdrafts), duration of the customer relationship, payment behaviour, number of loans taken out, but also external information such as entries in warning lists.

Forming the customer risk class

Every month, the Bank conducts an aggregation to create a customer risk class from the different procedures for application scoring and behavioural scoring for the individual products. This is done at least once at the end of the month – if behavioural scoring is taken into account – or is calculated when a transaction is first commenced. The aggregation to the customer risk class is based on an internal weighting of the risk classes for the customer’s products.

13.3.2. Small and medium-sized enterprises

The Retail category takes in all enterprises with operating revenues of less than EUR 50 million and an exposure (for the entire customer group) of less than EUR 1 million in the BAWAG P.S.K. Group. If these enterprises cannot be assigned a special rating based on business purpose (see Rating systems and processes at companies and institutions), the scoring procedure for small and medium-sized enterprises is applied.

In the Retail/Small Business segment, further sub-segments geared to the type of accounting (cash-based, lump-sum and accrual accounting) and the operating revenues are formed to take into account the different information bases and the procedural requirements. The exposures consist mainly of overdrafts in payment accounts as well as operating loans and medium- and longer-term investment loans.

As with retail customers, both application and behavioural scoring processes are used here.

Application scoring

An application scoring risk class is determined based on quantitative information (customer's financial data) and qualitative characteristics (soft facts, account behaviour) as well as additional items of external and internal information (e.g. warning list, Kreditschutzverband von 1870 [KSV]).

The Bank has internally developed models based on key figures for enterprises with cash-based accounting, lump-sum accounting and small companies using accrual accounting. The statistically validated RiskCalc Austria™ model from Moody's KMV is used for the financial rating for businesses that use accrual accounting and that have more than EUR 0.5 million in operating revenue. Information from the commercial customer portfolio of BAWAG P.S.K. was instrumental in the development of that model.

The Retail/Small Business rating systems for application scoring have been used in their initial versions since 2006. In 2007, the RiskCalc Austria™ financial rating model was replaced with a revised version (3.1). The small business scoring systems for enterprises with cash-based accounting, lump-sum accounting and small companies using accrual accounting with operating revenues less than EUR 0.5 million were adapted in the autumn of 2009 and in 2011 as part of master scale adaptations.

RiskCalc Austria 3.1 was revised in the second half of 2010 and replaced with the version 3.2 as scheduled in February 2011.

Application scoring must be done for each new application, in connection with the annual prolongation process or as warranted (when a change occurs in essential information relevant to the rating) and regularly repeated in connection with accounting, operating revenues, exposure and the behavioural score of the customer. The application scoring results in a customer rating based on risk class and descriptive reasons associated with that risk class.

In addition, a recommendation is given on what decision to make (accept/green; reject for now/yellow; reject/red) for special customer groups to enable differentiated treatment of the customers.

Behavioural scoring

Behavioural scoring essentially involves an evaluation of the customer's account behaviour. Other variables such as the duration of the customer relationship and external information are also considered in the score.

Behavioural scoring is independent of the retail segment Private or Small Business, however. It is geared to product behaviour.

Forming the customer risk class

Every month, the Bank conducts an aggregation to create a customer risk class from application scoring and behavioural scoring for the individual products. The aggregation to the customer risk class is based on an internal weighting of the risk classes for the customer's products.

13.4. Rating systems and processes at companies and institutions as well as participation positions and sovereigns

Article 16, paragraph 1, line 3, lit b OffV (for institutions)

Article 16, paragraph 1, line 3, lit c OffV (for companies)

Article 16, paragraph 2, line 1 OffV

The rating systems must be applied to companies and institutions that avail themselves of an exposure at the BAWAG P.S.K. Group. This exposure is mainly attributable to overdrafts on payment accounts, operating facilities and medium- and longer-term investment loans or to corporate securities in the Bank's own portfolio and Treasury products.

The rating process for companies basically calls for the customer advisor to solicit information relevant to the rating and conduct a qualitative evaluation of the customer (rating based on soft facts) in the central corporate data system. The customers' financial data is also centrally recorded and evaluated (hard-fact rating) in this database (separated from the lending process). Based on these qualitative and quantitative input factors, a risk class is calculated automatically for the customer and checked by risk analysts (back office; two-man rule). It is altered if needed and confirmed in the system. The risk class must likewise be approved by the employee responsible for it. The customer's rating must be updated at least once a year or as needed (new application, deterioration of creditworthiness, etc.), also during the year. This rating is subsequently used for calculating the regulatory minimum capital requirements, for reporting, for setting terms and conditions, and for controlling risks.

13.4.1. Standard commercial

This area of application pertains to companies with their registered office in Austria which use accrual accounting and which cannot be assigned a special rating procedure because of their business purpose (e.g. holding companies, real estate companies, etc.). These companies must also have a group exposure under Basel II equal to or greater than EUR 1 million or consolidated operating revenue equal to or greater than EUR 50 million.

The customer's risk class is calculated from a combination of a financial rating from the statistically validated RiskCalc Austria™ model and an evaluation of qualitative characteristics (e.g. management, organisation, market/sector, general factors, account management). The risk analyst can overrule¹⁰ or override¹¹ a confirmed customer rating if needed. The major reasons for this step are downgrades based on an outdated balance sheet, or warning signals (e.g. outstanding taxes, warning list entries) and consideration of a group influence, ratings of a rating sponsor (e.g. dominant shareholder, personal partner with unlimited liability) or, under certain circumstances, consideration of external ratings.

The RiskCalc Austria™ financial rating model used since 2004 and developed with Moody's KMV was replaced in the summer of 2007 with a first revised version (3.1) that takes sector affiliation into greater account, among other aspects. Discriminatory power was noticeably improved by incorporating a credit cycle adjustment factor that is updated monthly. It is based on sectoral economic data and stock exchange price trends and adds a dynamic component for determining the probability of default. Further development of the RiskCalc Austria™ model V3.2 proceeded and the revised model went into use in February 2011 as planned.

10) Overruling refers to a deviation of the confirmed rating from the automatically calculated rating in predefined cases with defined effects, i.e. according to defined rules (e.g. outdated annual financial statements of the customer, various warning signals, and group influence).

11) An override refers to a variable deviation from the automatic rating outcome based on a subjective assessment with a review made by a risk analyst and with a corresponding decision by an authorised employee.

13.4.2. Foreign commercial

Foreign commercial customers, i.e. non-Austrian companies, were removed as a subsegment from the process for standard commercial customers in February 2011. Since February 2011, the Bank has been assessing these customers using a separate method developed in house. The Bank developed its own statistics-based hard-fact rating model for this purpose. The soft-fact rating and the process structure correspond to the process for standard commercial customers.

13.4.3. Holding companies

This area of application extends to companies that hold permanent stakes in legally autonomous companies. It was expanded in the summer of 2011 with the addition of Group financial vehicle belonging to the group holding risk-relevant Group-related assets.

The rating system for holding companies combines a hard-fact rating and a soft-fact rating as well as a segment-specific “rating in the group”. Risk analysts can alter the calculated rating with an overruling or override if need be.

The process was revised and implemented in the summer of 2011. The revision includes an adaptation of the statistical rating component, namely the hard-fact rating for the holding company (key ratios and weights), and a change in the soft-fact rating based on an expert system. In addition, the “rating in the group” has gained substantial significance in the process structure as a third component. This results from a confirmed rating assessment of the group or of associated companies relevant to the holding company (rating process in accordance with the group’s segmentation). It is the most heavily weighted component in the rating algorithm and also serves as a rating ceiling. Conceptually, the basic underlying idea is that the holding company cannot have a better rating than the group that generates the income.

13.4.4. Real estate companies

This area of application covers companies with accrual accounting that can be designated as real estate agents/investors based on their business activities.

The rating system is generally structured like the standard commercial process. It combines hard-fact and soft-fact ratings, which can be altered with an overruling/override if need be. In May 2011, the rating components financial rating and soft-fact rating were revised on the basis of statistics.

13.4.5. Non-profit housing

This area of application extends to non-profit building associations as defined in Article 1 Austrian Non-profit Housing Act (WGG).

The risk class for this customer segment is based on a financial rating with key ratios developed specifically by experts. The rating can be adjusted using upgrades and downgrades (defined qualitative parameters such as vacancies, property condition, owners, account management, etc.) and, if need be, by means of an overruling/override.

13.4.6. Special financing

Special financing is treated according to the standardised approach based on the exposure class Companies in Article 11 SolvaV.

13.4.7. Banks (institutions)

This area of application applies to banks (except special lending institutions) in the portfolio of the BAWAG P.S.K. Group. Exposure to banks arises mainly from payment transactions and other handling transactions, from money market liquidity placements, investments in banks and Treasury business.

A bank has to be assigned a risk class before accounts can be opened and limits granted.

The financial rating is based on key figures derived from the balance sheet and the profit and loss account. Before the final rating can be recorded, the analyst still has the option of upgrading or downgrading the rating based on qualitative factors (e.g. risk management, competitiveness) and support factors (e.g. support from the parent company). The rating calculated in this way has an upward ceiling in that it may be no better than the rating of the country in which the bank has its registered office. The final confirmed rating is then assigned a certain probability of default based on the BAWAG P.S.K. master scale.

13.4.8. Participation items

Article 16, paragraph 1, line 3, lit e OffV

For participations of the BAWAG P.S.K. Group, the same rating procedures are used as for external borrowers, namely the processes for corporates and banks. Capital requirements are determined by the simple risk weight method in accordance with Article 77 paragraph 3 Austrian Solvency Regulation.

13.4.9. Central governments and central banks

Article 16, paragraph 3, line 3, lit a OffV

The standardised approach is employed for central governments and central banks with no geographic assessment, i.e. the procedure is geared to the existence or non-existence of an external rating for the given government. If a rating is available from Moody's¹², the risk weight is assigned to the six rating notches as follows:

Rating notch	1	2	3	4	5	6
	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	B+ to B-	Below B-
Risk weighting	0%	20%	50%	100%	100%	150%

If no external rating is available, exposures to central governments and central banks are assigned a risk weight of 100 per cent.

12) Only ratings from Moody's are allowed.

13.5. Use of internal estimates

Article 16, paragraph 1, line 2, lit b OffV

The risk parameters in the rating systems are integral parts of the Bank control system within the scope of credit portfolio modelling and of price calculation that adequately captures risk (with standard risk costs taken into account during pre-calculation in the RAP tool).

13.6. Control mechanism for rating systems

Article 16, paragraph 1, line 2, lit d OffV

Most important are the validation processes of rating and scoring systems, which are performed at least once a year. They are conducted by a central risk management office for all rating models used throughout the Bank and comprise the following activities:

Description of the validation methods

Validation method	Description
Method 1	Verification of the documentation for the rating and scoring systems
Method 2	Verification of the quality of the database being used for validation
Method 3	Verification of the correct use of the rating and scoring systems as part of a use test
Method 4.1	Distribution analysis to identify clusters of customers in individual risk classes
Method 4.2	Comparison of internal ratings with external ratings (benchmarking)
Method 4.3	Identification of clustering of high exposures in individual risk classes
Method 4.4	Verification by the risk manager of the frequency of overrulings/overrides in the automatically generated rating classes
Method 4.5	Verification of clusters of defaults in individual rating or scoring systems Observation proceeds over extended periods of time and economic cycles; validation is based on the currently available database and is further developed on an on-going basis.
Method 5.1	Testing of rating and scoring systems for calibration using Brier score
Method 5.2	Testing of individual risk classes to determine correlation between the forecast PD and the observed PD using standard normal tests and binomial distribution tests; also a comparison of the mean forecast PD and the mean observed PD
Method 6	Testing of the discriminatory power of the rating and scoring systems using ROC and Gini coefficient
Method 7.1	Stability analyses of discriminatory power over time
Method 7.2	Migration matrices for the observation of changes in the risk structure

Table 5

The results achieved using the described methods are presented in a traffic signal system. If there are results of statistical significance and major deviations from established values exist, subsequent analyses are initiated during the year and may result in corresponding adjustments.

Credit Risk Retail and SME is the organisational unit responsible for validating the rating systems used in the Bank Group, it reports directly to the CRO.

Above and beyond that, the following figures are prepared monthly as part of standardised monitoring reports:

- ▶ Distribution of the customers and exposures across the Basel II segments, an internal subdivision of the exposure classes
- ▶ Distribution of the risk classes across the Basel II segments and their degree of up-datedness
- ▶ Risk classes based on overrulings
- ▶ Distribution of the risk classes and the individual risk factors per rating and scoring system

If defined limits are exceeded or fallen short of, the causes are analysed in depth and counter-measures are initiated as needed.

13.7. Estimation and validation of the risk parameters

Article 16, paragraph 1, line 8; Article 16, paragraph 2, line 2 OffV

13.7.1. Probability of default

The probability of default (PD) is the estimated probability that a borrower will default within the next twelve months. The occurrence of one of the events listed below is deemed a default event throughout the Group. The definition of default corresponds to the regulatory reference definition (“90 days past due” and “imminent default of payment”) as set forth in Article 22b paragraph 5 line 2 Austrian Banking Act in connection with Article 46 paragraphs 1 and 2 Austrian Solvency Regulation:

Description of the reference definitions for default

Reference definition for default	Description
90 days past due	A material liability of the borrower is more than 90 days past due.
Imminent default of payment	In response to the rating, the parties agreed to a reorganisation interest rate/exemption from interest, restructuring of the obligation (e.g. change in term, change in schedule for repayment of principal) or the like.
	In response to the rating, the Bank removed claims against the borrower from the Bank balance sheet.
	Legal case without allocation of a specific provision (e.g. due to full securitisation)
	The borrower filed a bankruptcy petition.
	A specific provision is formed due to the rating (automatically or manually).

Table 6

At present, BAWAG P.S.K. mainly uses generic PD estimation models. The models are calibrated based on long-term average rates of default and a sufficiently conservative surcharge. The calibration is based on a statistical model.

The PD estimation is validated annually using qualitative and quantitative methods. The qualitative methods focus on data quality and use and on the quality of the documentation for the estimation process. Discriminatory power is measured in the quantitative area. Furthermore, a binomial test is used for calibration and to check the discrepancy between the forecast PD and the PD actually observed. The stability of the estimation models is also observed over extended periods of time.

13.7.2. Loss given default

Loss given default (LGD) is defined as economic loss as a percentage of the outstanding exposure at default (EAD). The economic loss comprises the outstanding EAD less recoveries from the realisation of collateral and other non-collateral proceeds.

Internal Bank estimates are carried out only for the retail portfolio (Private and Small Business). The LGD estimate is based on a two-step process. First, the collateral return rate (SEQ) is determined per collateral pool. Then the outstanding exposure less collateral return (EAD*) is determined. For the non-collateralised portion of the exposure, a non-collateralised LGD is estimated using a CHAID-class decision-tree process applying criteria with a high degree of discriminatory power. In a final step, the two components SEQ and non-collateralised LGD are then merged to arrive at the final estimated LGD. The generated values of the individual pools are calibrated at a conservative level using an upward surcharge based on the standard deviation and the number of data sets and taking into account any downturn effects that may be observed. All data available were used for model development as long as the data were of sufficient quality and sufficiently representative.

The annual validation of the estimated LGD comprises analyses of the deviation between observed values and estimated values, plausibility checks, as well as descriptive statistics and tests for the individual LGD pools.

A re-estimation was done to take into account the higher values observed in previous periods with respect to LGD. The increased values could not be assigned clearly to individual factors, however.

13.7.3. Credit conversion factor

The credit conversion factor (CCF) is the expected utilisation in per cent of a line of credit existing but not yet drawn at the time of estimation until such time as a default event occurs. In other words, the CCF is used for estimating EAD from currently unutilised limits.

Internal Bank estimates are carried out only for the retail portfolio (Private and Small Business). The CCF estimate is based on a CHAID-class decision-tree process using criteria with a high degree of discriminatory power. The generated values of the individual pools are calibrated at a conservative level using an upward surcharge based on the standard deviation and the number of data sets and taking into account any downturn effects that may be observed. All data available were used for model development as long as the data were of sufficient quality and were sufficiently representative.

The annual validation of the estimated CCF comprises analyses of the deviation between observed values and estimated values, plausibility checks, as well as descriptive statistics and tests for the individual CCF pools.

Adaptations in the collection process and organisational changes have necessitated model adjustments for the CCF.

14. REMUNERATION POLICY DISCLOSURE

Article 15a, paragraph 2, lines 1, 2, 3, 4, 5 OffV

BAWAG P.S.K. has a Remuneration Committee, which is set up as a Supervisory Board committee. This Remuneration Committee approves the remuneration policy, monitors its implementation and submits regular reports on its activities to the full Supervisory Board. The committee consists of the chairman of the Supervisory Board, who also chairs it, and two further Supervisory Board members.

The Remuneration Committee passed a remuneration guideline for BAWAG P.S.K. that takes into account the principles of the EU's CRD III Directive, the CEBS guideline and the act amending the Austrian Banking Act in this regard. Deloitte and Wolf Theiss Rechtsanwälte were involved as external consultants in determining the remuneration guideline.

For employees whose activities have a material influence on the Bank's risk profile, the remuneration guideline stipulates a remuneration policy compatible with effective risk management. It is designed to align the personal objectives of the employees with the long-term interests of the Bank and to ensure an appropriate balance between fixed and variable remuneration components. It also takes into account the legal regulations stipulating that the policy must be applied to the management and to risk purchasers, to employees with controlling duties, as well as to employees who are in the same wage category as the management and the risk purchasers and whose activities have a material influence on the risk profile.

In deciding on any bonus distribution, the Remuneration Committee will take into account the market situation and market trends, the appropriateness of bonus payments, the risk trends and the strengthening of the equity base.

The annual budget for variable remuneration components is based on the degree to which the Bank achieves the budgeted results and is determined by the Remuneration Committee.

The remuneration guideline took the mandatory basic conditions into account as follows:

- ▶ To ensure risk adequacy, the variable remuneration must not provide an incentive to enter into inappropriate risks.
- ▶ To ensure sustainability, success is determined based on a longer-term assessment. Therefore, 70 per cent of the bonus is reserved up to five years on the one hand. On the other hand, as the Bank has no negotiable shares, a phantom scheme was implemented that is also linked to the Bank's business success. As a result, generally 30 per cent of the total bonus is paid in the first year. The payment of reserved portions of the bonus in the following years is subject to the Bank's profitability.
- ▶ The appropriateness and market adequacy of remuneration is ensured, applying a balanced relationship between fixed and variable components.
- ▶ The variable remuneration is determined on the basis of the individual's success (in quantitative and qualitative terms) as well as on the success of the respective organisational unit and the Bank.

QUANTITATIVE DISCLOSURE

1. SCOPE OF CONSOLIDATION AND ACCOUNTING STANDARDS

Section 1.1 of the qualitative part of the disclosure report describes the respective accounting standards and the scope of consolidation on which the annual financial statements of BAWAG P.S.K. Group are based and on which the regulatory standards in section V of the Austrian Banking Act (referred to below as BWG) are based. These differences arise from differing objectives of the regulations in question and result in different values for some items.

The quantitative part of this disclosure report applies the same differentiation. For example, the information on own funds and the own funds requirements as well as the detailed breakdown of exposures in accordance with Article 7 of the Disclosure Regulation (referred to below as OffV) were prepared according to the regulatory principles and the BWG, while the notes on the figures in the annual financial statements are based on IFRS. In cases of doubt, the regulations that were applied are stated with the respective table.

2. OWN FUNDS

Article 4 OffV

Own funds and their components

in millions of Euros	31.12.2012
Subscribed capital	800
thereof paid-in capital	250
thereof participation capital	550
Reserves including profits and losses carried forward	1,178
Difference	9
Minority interests	546
thereof hybrid capital	142
Intangible assets	-85
Deductions pursuant to Article 23, paragraph 13, line 3 and line 4 (excluding 4a) BWG	-39
Core capital (Tier I)	2,409
Eligible subordinated liabilities	405
Revaluation reserves	20
Country-specific, higher-quality supplementary own funds items	24
Deductions pursuant to Article 23, paragraph 13, line 3 and line 4 (excluding line 4a) BWG	-39
Additional own funds (Tier II) including deductions	410
Total eligible own funds	2,819
Redesignated subordinated capital (Tier III)	16
Total own funds	2,835

Table 1

The core capital on 31 December 2012 amounted to EUR 2,448 million. Of this total, EUR 800 million are paid-in capital (thereof EUR 550 million participation capital) while EUR 1,648 million are reserves. Minority interests of EUR 546 million contain EUR 142 million in hybrid equity instruments pursuant to Article 103n, line 3 BWG, whose key features are presented in the table below.

Key features of equity items pursuant to Article 103n, line 3 BWG

Issuer	Title of issue	Issue date	ISIN	Interest
BAWAG Capital Finance (Jersey)	Perpetual Non-cumulative Non-voting Fixed/Floating Rate Preference Shares	31.10.2000	XS0119643897	8.765% p.a. up to 31.10.2010; thereafter 3 M EUR-IBOR + 4.7% p.a.
BAWAG Capital Finance (Jersey) II	Perpetual Non-cumulative Non-voting Fixed Rate Preference Shares	27.06.2002	DE0008600966	7.125% p.a.

Table 2

Core capital net of deduction items reported in Table 1 amounts to EUR 2,409 million. Long-term subordinated capital totals EUR 375 million and accounts for the overwhelming share of eligible supplemental capital, which totals EUR 410 million net of deduction items.

Regarding the buyback of hybrid instruments please see the section “Events after the Reporting Date” in the Group management report.

BAWAG P.S.K. has floated three hybrid capital issues in total (BCF, BCF II, BCF III). In financial year 2012, BAWAG P.S.K. purchased part of the preference shares issued by BCF and BCF II as part of its buyback of hybrid instruments. All of the preference shares in BCF III were also purchased from the sole investor. After this, these preference shares were sold to BCF, BCF II and BCF III. This transaction eliminated the nominal value of these preference shares. There was no extraordinary income from the buyback recognised in the consolidated annual financial statements. The buyback resulted in extraordinary income in the amount of EUR 110 million in the Bank’s financial statements according to local GAAP. These issues are included as part of the Tier I capital for the calculation of the group own funds according to Basel II.

Further information on this can be found in the section “Notes to the Income Statement” in the annual report for BAWAG P.S.K. as an individual institution and in Note 17 in the consolidated annual financial statements.

3. CAPITAL REQUIREMENTS

3.1. Capital requirements for each exposure class

Article 5, lines 2, 3 OffV

All risk-weighted exposure amounts are calculated using the standardised approach to credit risk.

Capital requirements by exposure class

in millions of Euros	31.12.2012
Standardised approach – total	1,503
Standardised approach – exposure classes	1,398
Exposures to central governments or central banks	7
Exposures to regional governments	–
Exposures to public-sector entities, administrative bodies and non-commercial undertakings	18
Exposures to institutions	124
Exposures to corporates	691
Retail exposures	164
Exposures secured by real estate	279
Past-due exposures	62
High-risk items	4
Exposures in the form of covered bonds	16
Exposures in the form of shares in investment funds	2
Other items	31
Standardised approach – securitisation positions	105
thereof resecuritisation items	70

Table 3

Capital requirements by exposure class

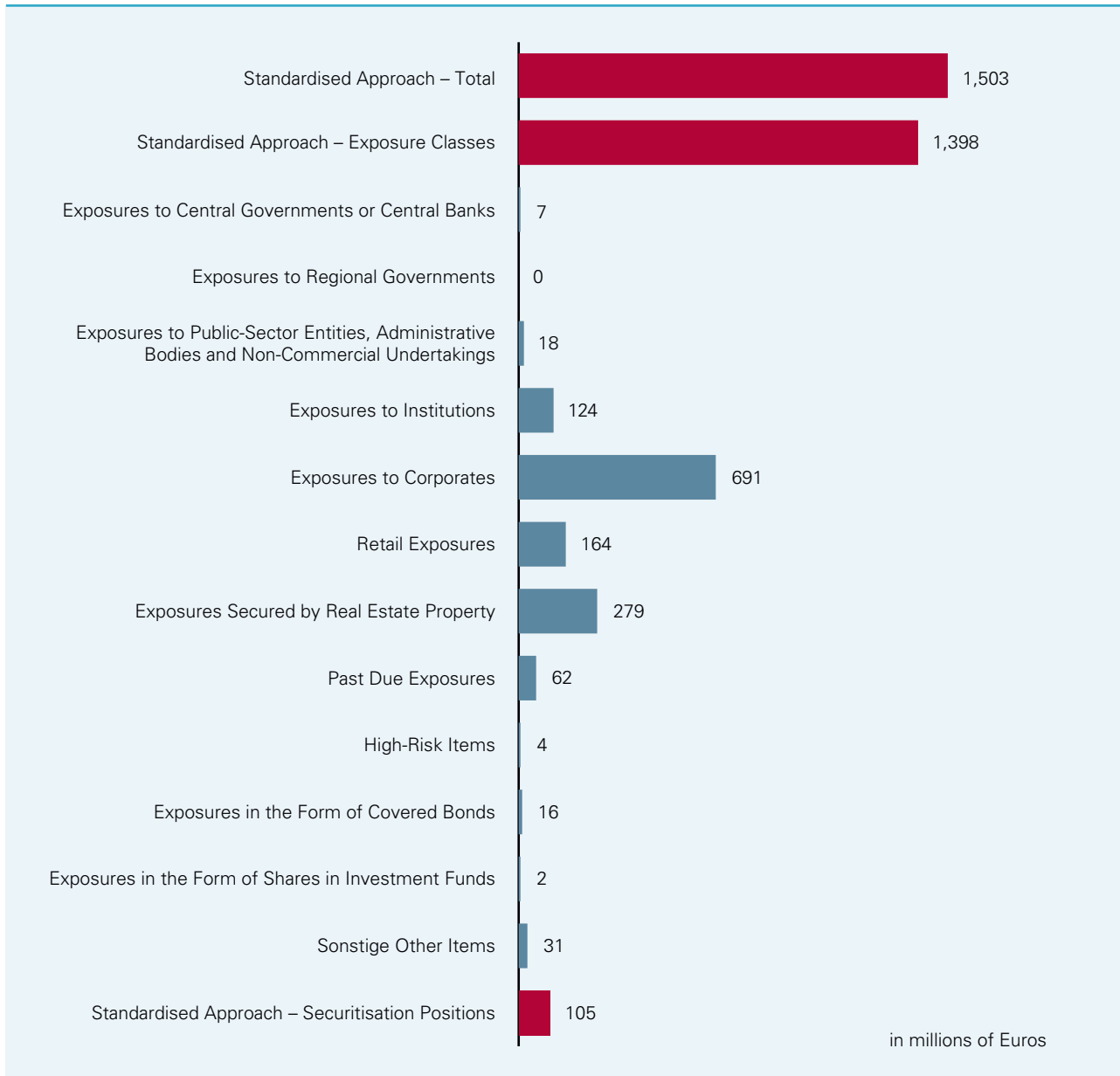


Figure 1

3.2. Capital requirements for commodities risk, foreign exchange risk and risk types in the trading book

Article 5, line 4 OffV, Article 10 OffV

Capital requirements for risk types in the trading book, commodities risk and foreign exchange risk

in millions of Euros	31.12.2012
Position risk in debt instruments and equity instruments, foreign exchange risk and commodities risk	–
thereof debt instruments in the trading book	–
thereof equity instruments in the trading book	–
thereof foreign exchange risk	–
thereof commodities risk	–
Position risk in debt instruments and equity instruments, foreign exchange risk and commodities risk (internal model)	16
Market risk	16

Table 4

3.3. Capital requirements to cover operational risk

Article 5, line 5 OffV

The capital requirement according to the standardised approach totals EUR 130 million.

4. COUNTERPARTY DEFAULT RISK ARISING FROM DERIVATIVES, REPURCHASE TRANSACTIONS, SECURITIES AND COMMODITIES LENDING TRANSACTIONS, MARGIN LENDING TRANSACTIONS AND LONG-TERM SETTLEMENT TRANSACTIONS

Article 6, lines 5, 7, 8 OffV

BAWAG P.S.K. has no commodity-borrowing transactions, margin lending transactions or transactions involving long-term settlement. Netting is utilised at BAWAG P.S.K in the banking book and trading book. The positive fair values are offset against the negative fair values for each counterparty. Further, any cash collateral held at BAWAG P.S.K is credited to reduce the applicable fair values.

As contracts with a central counterparty are not subject to any counterparty risk, the information in the following table is confined to OTC derivatives and repos. The positive reacquisition values for derivative counterparty default risk positions and for repos totaled EUR 2,760 million on 31 December 2012.

Fair values for all derivatives and repos

in millions of Euros	31.12.2012
Total of applicable positive fair values for all derivatives and repos	
Derivatives	2,029
Repos	731
Positive fair values for all derivatives and repos	2,760
Credit exposures resulting from transactions mentioned above prior to netting – presentation of the full credit exposure (positive fair value and add-on)	
Positive fair value for all derivatives and repos	2,760
Add-on	957
Total off-balance-sheet credit exposures	3,717
Details on off-balance-sheet exposure amount	
Interest derivatives	1,773
Foreign exchange derivatives	219
Credit derivatives	17
Other items	20
Repos	731
The amount of collateral held for transactions pursuant to Article 6 OffV	
Financial collateral in the form of cash deposits	434

in millions of Euros	31.12.2012
Credit exposures from derivatives after netting	
Netting at BAWAG P.S.K. is done in the banking book and the trading book. The applicable negative fair value is subtracted for each counterparty from the positive fair value and any cash collateral is credited.	
Total credit exposures (off balance sheet)	3,717
Reduction due to netting	-1,169
Total credit exposure from derivatives after netting	2,548
Credited cash collateral	-432
Total credit exposure from derivatives after netting	2,116

Table 5

CDSs and micro hedges serve as hedges for part of the Bank's securities portfolio.

Nominal values of CDS for hedging of securities

in millions of Euros	31.12.2012
Nominal values of CDS for hedging securities	969

Table 6

The credit derivatives are used as a hedge for part of the securities portfolio totalling EUR 335 million. In addition, there are synthetic securities positions from a CDS protection sell amounting to EUR 645 million.

Nominal values of hedged securities

in millions of Euros	31.12.2012
Nominal values of hedged securities	980

Table 7

Nominal values of derivatives, broken down by product group and by collateral acquired and collateral sold

Unilateral derivatives are recorded either under buy or under sell. Bilateral derivatives (IRS, CRS, currency swaps or forwards) are recorded both under buy and under sell. Credit derivatives the Bank uses to hedge its own credit portfolio are presented in the banking book as buy positions.

in millions of Euros	Nominal values banking book		Nominal values trading book	
	buy	sell	buy	sell
Interest rate contracts	49,506	49,458	13,647	14,214
FX derivatives	9,655	8,683	8,112	7,616
Index and equity contracts	187	187	–	–
Credit derivatives	969	1,164	–	–
Others	177	177		

Table 8

5. CREDIT RISK AND DILUTION RISK

5.1. Total amount of exposures after accounting offsets and average amount of the exposures broken down by exposure class

Article 7, paragraph 1, line 3 OffV

Exposure values by exposure class (according to UGB/BWG)

in millions of Euros	31.12.2012 Exposure value	Average 2012
Exposures to central governments or central banks	3,311	3,067
Exposures to regional governments	3,403	3,422
Exposures to public-sector entities, administrative bodies and non-commercial undertakings	2,068	1,856
Exposures to multilateral development banks	53	52
Exposures to institutions	6,068	5,942
Exposures to corporates	9,277	9,398
Retail exposures	2,744	2,770
Exposures secured by real estate	7,108	7,066
Past-due exposures	1,449	1,428
High-risk items	31	30
Exposures in the form of covered bonds	812	775
Exposures in the form of shares in investment funds	40	40
Other items	1,014	1,031
Securitisation positions	1,218	1,209
Total	38,596	38,086

Table 9

5.2. Breakdown of exposures by country group

Article 7, paragraph 1, line 4 OffV

Exposure values by country group (according to UGB/BWG)

in millions of Euros	31.12.2012 Exposure value	Share in %
Austria	24,404	63.2%
Western Europe	9,539	24.7%
Central and Eastern Europe	1,430	3.7%
North America	1,428	3.7%
Asia/Pacific	287	0.7%
Others	1,508	3.9%
Total	38,596	100.0%

Table 10

Exposure values by country group (according to UGB/BWG)

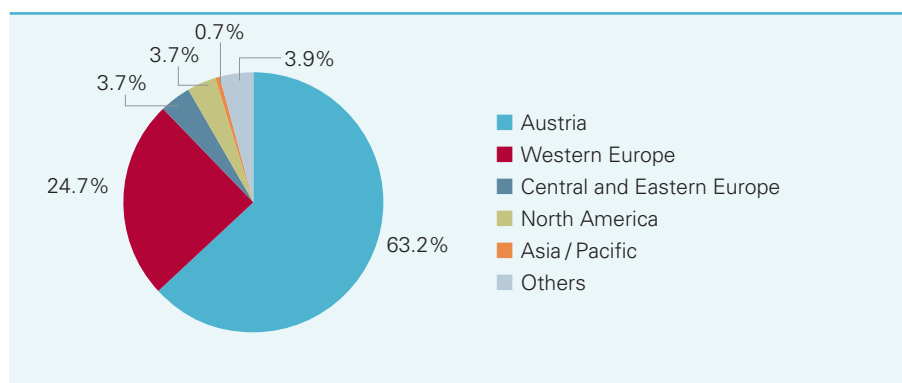


Figure 2

5.3. Breakdown of exposures by industry

Article 7, paragraph 1, line 5 OffV

Exposure values by industry (according to UGB/BWG)

in millions of Euros	31.12.2012 Exposure value	Share in %
Banks	9,625	24.9%
Agriculture and forestry	75	0.2%
Insurance and other financial institutions	3,953	10.2%
Trade	1,378	3.6%
Subsidised housing	1,542	4.0%
Services	2,005	5.2%
Real estate	2,936	7.6%
Other corporates	11,088	28.7%
Private households	5,994	15.5%
Total	38,596	100.0%

Table 11

Exposure values by industry (according to UGB/BWG)

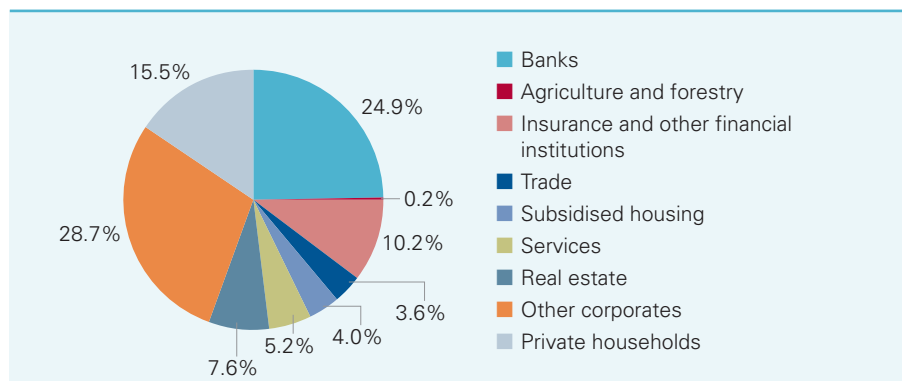


Figure 3

5.4. Breakdown of exposures by maturity

Article 7, paragraph 1, line 6 OffV

Exposure values by residual maturity (according to UGB/BWG)

in millions of Euros	31.12.2012 Exposure value	Share in %
Up to 3 months	9,191	23.8%
3 months to 1 year	1,509	3.9%
1 to 5 years	9,928	25.7%
Over 5 years	17,968	46.6%
Total	38,596	100.0%

Table 12

Exposure values by residual maturity (according to UGB/BWG)

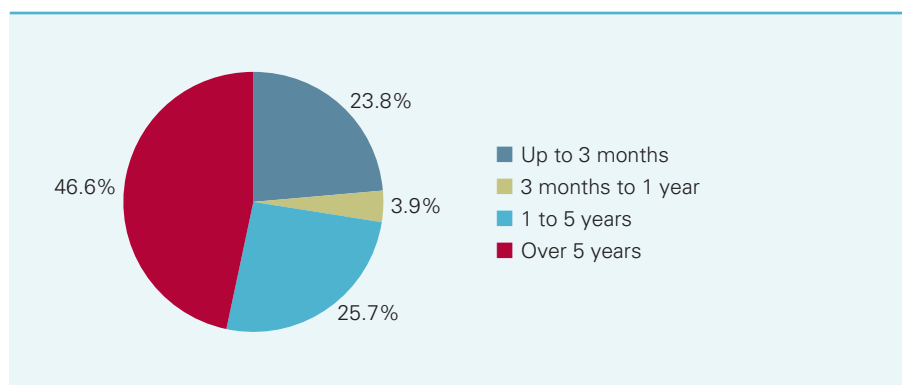


Figure 4

5.5. Breakdown of exposure values and loan loss provisions by industry for exposures with increased default risk

Article 7, line 1, lit a, b, c OffV

Exposure values by risk category and industry (according to UGB/BWG)

in millions of Euros	Risk category	31.12.2012 Exposure value	Share in %
Banks	impaired	39	2.3%
	past due	15	0.9%
Agriculture and forestry	impaired	4	0.2%
	past due	1	0.1%
Insurance and other financial institutions	impaired	67	4.0%
	past due	12	0.7%
Trade	impaired	74	4.4%
	past due	24	1.4%
Subsidised housing	impaired	4	0.2%
	past due	–	–
Services	impaired	84	5.0%
	past due	14	0.8%
Real estate	impaired	44	2.6%
	past due	23	1.4%
Other corporates	impaired	532	31.4%
	past due	51	3.0%
Private households	impaired	586	34.6%
	past due	119	7.0%
Total		1,693	100.0%

Table 13

Loan loss provisions by risk category and industry (according to UGB/BWG)

in millions of Euros	Risk category	31.12.201 Loan loss provision	Share in %
Banks	impaired	17	2.8%
	past due	–	–
Agriculture and forestry	impaired	2	0.3%
	past due	–	–
Insurance and other financial institutions	impaired	49	8.1%
	past due	–	–
Trade	impaired	48	7.9%
	past due	–	–
Subsidised housing	impaired	–	–
	past due	–	–
Services	impaired	59	9.7%
	past due	–	–
Real estate	impaired	17	2.8%
	past due	–	–
Other corporates	impaired	133	21.9%
	past due	–	–
Private households	impaired	283	46.5%
	past due	–	–
Total		608	100.0%
Reconciliation loan loss provision according to IFRS		27	
Total according to IFRS		635	

Table 14

5.6. Net charges for loan loss provisions for impaired exposures by significant economic sectors

Article 7, paragraph 1, line 7, lit c OffV

Net charges for loan loss provisions for impaired exposures by significant economic sectors¹⁾ (according to IFRS)

in millions of Euros	31.12.2012
Exposures to central governments	–
Exposures to credit institutions	–
Exposures to corporates	48
Exposures to retail	36
Exposures to other customers	–
Total	84

Table 15

1) Including expenses for losses incurred but not yet recognised in accordance with IAS 39 AG 89.

5.7. Breakdown of exposure values and loan loss provisions by country group for exposures with increased default risk

Article 7, paragraph 1, line 8 OffV

Exposure values by risk category and country group (according to UGB/BWG)

in millions of Euros	Risk category	31.12.2012 Exposure value	Share in %
Austria	impaired	1,203	71.1%
	past due	226	13.3%
Western Europe	impaired	107	6.3%
	past due	19	1.1%
Central and Eastern Europe	impaired	122	7.2%
	past due	8	0.5%
North America	impaired	–	–
	past due	4	0.2%
Asia/Pacific	impaired	1	0.1%
	past due	2	0.1%
Others	impaired	1	0.1%
	past due	–	–
Total		1,693	100.0%

Table 16

Loan loss provisions by risk category and country group (according to UGB/BWG)

in millions of Euros	Risk category	31.12.2012 Loan loss provision	Share in %
Austria	impaired	502	82.6%
	past due	–	–
Western Europe	impaired	50	8.2%
	past due	–	–
Central and Eastern Europe	impaired	56	9.2%
	past due	–	–
Total according to UGB/BWG		608	100.0%
Reconciliation loan loss provision according to IFRS		27	
Total according to IFRS		635	

Table 17

5.8. Loan loss provisions for impaired exposures

Article 7, paragraph 1, line 9, lit a, b, c, d, e OffV

Loan loss provisions for impaired exposures (according to IFRS)

in millions of Euros	Individual and collective impairment	Loan loss provisions for incurred but not reported losses	Total
Balance as of 1.1.2012	657	36	693
Additions			
Provisions created through profit or loss	139	–	139
Disposals			
Used as intended	-111	–	-111
Provisions released through profit or loss	-50	-5	-55
Reclassifications	–	–	–
Balance as of 31.12.2012	635	31	666

Table 18

5.9. Write-downs and recoveries on loans previously written off

Article 7, paragraph 3 OffV

Write-downs and recoveries on loans previously written off (according to IFRS)

in millions of Euros	31.12.2012
Direct write-downs	-34
Recoveries on loans previously written off	3
Total	-31

Table 19

6. STANDARDISED APPROACH TO CREDIT RISK

Article 8, line 5, lit a, b OffV

Exposure values¹⁾ before and after credit risk mitigation per credit quality and exposure values deducted from regulatory capital

in millions of Euros	31.12.2012										Total
	0%	10%	20%	35%	50%	70%	75%	100%	150%	Other risk weights	
Exposures to central governments or central banks											
Gross exposure	4,062		222		70				21		4,375
Exposure after CRM	4,114		222		85				1		4,422
Exposures to regional governments											
Gross exposure	3,747		18								3,765
Exposure after CRM	5,033		18								5,051
Exposures to public-sector entities, administrative bodies and non-commercial undertakings											
Gross exposure			3,277								3,277
Exposure after CRM			1,145								1,145
Exposures to multilateral development banks											
Gross exposure	50		3								53
Exposure after CRM	50		3								53
Exposures to institutions											
Gross exposure	117		6,878		52				320		7,367
Exposure after CRM	101		6,054		53				310		6,518
Exposures to corporates											
Gross exposure	46		34		423				12,190	151	12,844
Exposure after CRM	44		20		688	12			8,070	139	8,973
Retail exposures											
Gross exposure	4							6,086			6,090
Exposure after CRM	4					165		2,586			2,755
Exposures secured by real estate											
Gross exposure				4,409	1,277		879	809			7,374
Exposure after CRM				4,370	1,241	221	633	705			7,170
Past-due exposures											
Gross exposure					25				1,226	224	1,495
Exposure after CRM					25	10			486	182	703

1) Exposure values contain balance-sheet and off-balance-sheet elements, as credit risk mitigation techniques are also applied to gross exposures.

in millions of Euros	31.12.2012										Total	
	0%	10%	20%	35%	50%	70%	75%	100%	150%	Other risk weights		
High-risk items												
Gross exposure									31			31
Exposure after CRM									31			31
Exposures in the form of covered bonds												
Gross exposure		481			331							812
Exposure after CRM		312			331							643
Exposures in the form of shares in investment funds												
Gross exposure								25		15		40
Exposure after CRM								25		15		40
Other items												
Gross exposure	626							388				1,014
Exposure after CRM	626							388				1,014
<i>Of which other items deducted from equity:</i>												
Gross exposure	164											164
Exposure after CRM	164											164

Table 20

7. INTERNAL MODELS FOR LIMITATION OF MARKET RISK

Article 11, line 4, lit a, b OffV, Article 11, line 6 OffV

Value-at-risk in the trading book (99 per cent, one-day holding period)

Risk class	Minimum	Maximum	Average	31.12.2012
FX risk	-0.08	-2.00	-0.94	-0.09
Interest rate risk	-0.27	-1.44	-0.62	-0.34
Total (without correlations)	-0.38	-2.71	-1.56	-0.43
Total (with correlations)	-0.31	-2.11	-1.23	-0.38
Diversification	n/a	n/a	-0.33	-0.04
Total sVaR (with correlations)	-0.54	-2.41	-1.48	-0.64

Table 21

The reliability of the model and its ability to yield meaningful information is checked in daily backtesting by juxtaposing the hypothetically achieved profits and losses of two consecutive trading days with the VaR of the first day. If a negative finding from backtesting should be lower than the VaR, it is called an outlier.

There were no outliers at BAWAG P.S.K. in the period under review. This confirms the quality of the model and means that the best possible multiplier of 3 set by the Austrian Ministry of Finance can be retained for calculating capital adequacy. It has remained unchanged since the model was first used in 1998.

The daily VaR (99 per cent, one-day holding period) values are compared with the backtesting results (delta) for the reporting period in the following chart:

Value-at-risk in the trading book (99 per cent, one-day holding period)

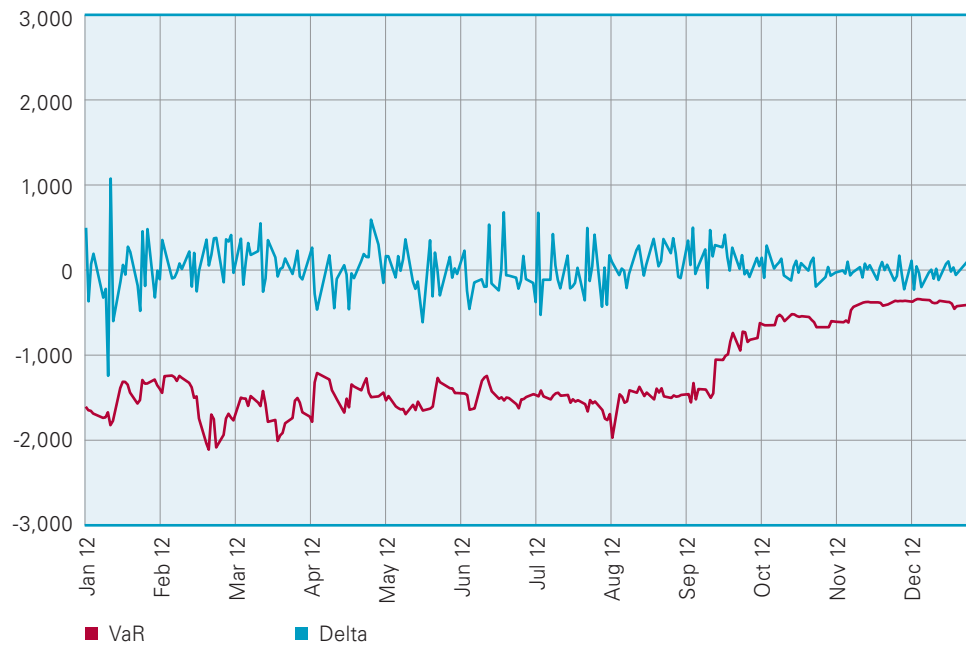


Figure 5

The decline in VaR in the last quarter of 2012 is directly related to the decision of the Managing Board to reduce own trading substantially and the reduction in the trading book associated with that decision.

8. PARTICIPATIONS NOT HELD IN THE TRADING BOOK

8.1. Participations based on their objectives

Article 13, line 1 OffV

A differentiation is made according to the following criteria:

Participations belonging to the **core business** of BAWAG P.S.K.: These are majority and minority interests intended to be held over the long term within the financial services sector.

Participations performing **auxiliary tasks** for the BAWAG P.S.K. Group: e.g. in payment transactions or IT.

Other participations: These primarily cover participations in private equity financing, credit guarantees and real estate as well as legally mandatory participation in deposit insurance.

Participations based on their objectives

in millions of Euros	Book value 31.12.2012
Equity interests belonging to core business	70
Equity interests performing auxiliary tasks for the BAWAG P.S.K. Group	1
Other equity holdings	72
Total shares in non-consolidated companies	143

Table 22

8.2. Participations categorised by kind of company

Article 13, lines 3, 4, OffV

Participations categorised by kind of company and line item

in millions of Euros	Book value ¹⁾ 31.12.2012
Shares categorised as “available-for-sale assets”	123
Shares in credit institutions	36
Subsidiaries	–
Associates	21
Other shares	15
Shares in other companies	87
Subsidiaries	23
Associates	42
Other shares	22
Shares accounted for using the equity method	20
Associates	20
Total shares in non-consolidated companies	143

Table 23

Breakdown of securities (according to UGB/BWG)

in millions of Euros	Not listed	Listed			BAWAG P.S.K. Group total 2012
		Total	Loans and receivables	Other valuation	
Bonds and other fixed-income securities	2,036	7,620	463	7,157	9,656
Shares and variable-income securities	7	71	–	71	78
Shares in associates and other shares	100	–	–	–	100
Shares in non-consolidated subsidiaries	23	–	–	–	23
Total securities	2,166	7,691	463	7,228	9,857

Table 24

1) The book value was used as an approximation of the fair value because a market value cannot be determined reliably for the most part.

8.3. Cumulative profit or loss from the sale of participations

Article 13, lines 5, 6 OffV

Cumulative profit or loss from the sale of participations

The cumulative profit or loss from the sale of participations in the Group amounts to EUR 1 million.

Revaluation reserve

Additional own funds contain a revaluation reserve of EUR 20 million.

9. INTEREST RISK FROM NON TRADING BOOK POSITIONS

Article 14, line 3 OffV

PvBP as of 31.12.2012 per currency

in thousands of Euros	< 1 Y	1 Y-3 Y	3 Y-5 Y	5 Y-7 Y	7 Y-10 Y	> 10 Y	Total
EUR	-35	104	265	-10	26	276	625
USD	-2	-20	-21	14	-11	-28	-68
CHF	4	-9	-8	-9	-15	-34	-70
JPY	4	-2	1	1	2	4	10
Other currencies	-	3	-	6	3	-23	-11
Total	-29	76	237	2	6	194	485

Table 25

10. SECURITISATIONS

Article 15, line 13 OffV, Article 15, line 14, lit e OffV, Article 15, line 15, lit a, b OffV

BAWAG P.S.K. has not yet securitised any exposures. It acts solely as an investor. Exposure from securitisation and resecuritisation items on the reporting date 31 December 2012 amounted to EUR 1,217 million (2011: EUR 1,441 million)

Exposure values and capital requirements for securitisation items by risk weighting

in millions of Euros	Risk weighting	31.12.2012		31.12.2011	
		Exposure value	Capital requirement	Exposure value	Capital requirement
Securitisation	20%	784	12	794	13
	50%	111	4	72	3
	93%	5	–	–	–
	100%	45	4	76	6
	104%	–	–	4	–
	126%	–	–	30	3
	140%	13	1	–	–
	161%	28	4	–	–
	182%	4	1	–	–
	249%	–	–	15	3
	350%	2	1	30	8
	475%	20	8	–	–
	479%	–	–	20	8
	1,250%	–	–	1	1
		1,012	35	1,042	45
Resecuritisation	40%	70	2	88	3
	100%	50	4	57	5
	225%	2	–	16	3
	246%	–	–	152	30
	650%	41	22	43	22
	1,250%	42	42	42	42
		205	70	399	105
Total		1,217	105	1,441	150

Table 26

The changes in the capital adequacy requirements in the exposure class “Securitisations” are largely attributable to downgrades and upgrades of individual tranches and to the restructuring of Pilatus, a structure originally treated as a securitisation that no longer meets the regulatory requirements of a securitisation following restructuring. The resulting change in exposure class leads to a reduction in capital adequacy requirements of EUR 30 million.

The risk report in the annual report contains quantitative information regarding Article 15, line 14, lit b OffV.

11. REMUNERATION POLICY AND PRACTICES

11.1. Information regarding remuneration by business segment

Article 15a, paragraph 1, line 6 OffV

The following summary of quantitative information regarding remuneration in financial year 2012 shows a breakdown by business segments and refers to employees whose activities have a material influence on the Bank's risk profile.

in millions of Euros	Retail Banking	Corporates	International Business	Financial Markets	Corporate Center/ALM
Number of beneficiaries	12	10	20	10	26
Total pay for financial year 2012	3.7	2.5	6.2	1.8	9.0
Of which variable component for financial year 2012	0.8	0.4	1.5	0.5	1.5

Table 27

11.2. Information about remuneration by top management and employees

Article 15a, paragraph 1, line 7, lit a through d OffV

The following summary of quantitative information regarding remuneration in financial year 2012 shows a breakdown by top management and employees whose activities have a material influence on the Bank's risk profile.

in millions of Euros	Fixed remuneration for financial year 2012	Variable remuneration for financial year 2012	Total remuneration for financial year 2012	Number of beneficiaries
Higher level management	11.8	2.6	14.4	40
Employees whose activities have a material influence on the Bank's risk profile	6.7	2.0	8.7	38
Total	18.5	4.6	23.1	78

Table 28

in millions of Euros	Variable remuneration			Total for financial year 2012 ³⁾
	Cash	Deferred cash ¹⁾	Phantom scheme ²⁾	
Higher level management	0.9	1.1	0.6	2.6
Employees whose activities have a material influence on the Bank's risk profile	0.7	0.8	0.5	2.0
Total	1.6	1.9	1.1	4.6

Table 29

in millions of Euros	Deferred remuneration	
	Earned portions	Portions not yet earned
Higher level management	2.3	4.6
Employees whose activities have a material influence on the Bank's risk profile	0.3	1.7
Total	2.7	6.4

Table 30

in millions of Euros	Deferred remuneration		
	Granted for financial year 2012	Paid out for financial year 2012	Reduced for financial year 2012 due to performance adjustments
Higher level management	1.7	–	–
Employees whose activities have a material influence on the Bank's risk profile	1.3	–	–
Total	3.0	–	–

Table 31

Article 15a, paragraph 1, line 7, lit e, f OffV

As this pertains to fewer than three people, the information is not being disclosed for data privacy reasons and pursuant to Article 241, paragraph 4 UGB.

1) Dependent on the Bank's profitability in the next five years

2) Dependent on the Bank's profitability in 2013

3) Deferred variable remuneration for 2012 amounts to 70 per cent

11.3. Information about remuneration for managing directors

Article 15a, paragraph 2 OffV

in millions of Euros	Fixed remuneration for financial year 2012	Variable remuneration for financial year 2012	Total remuneration for financial year 2012	Number of beneficiaries
Managing directors	4.5	–	4.5	6

Table 32

in millions of Euros	Deferred remuneration	
	Earned portions	Portions not yet earned
Managing directors	1.6	2.0

Table 33

No new payments were made in the Group in financial year 2012 for hiring bonuses. As this pertains to fewer than three people, information about severance payments is not being disclosed for data privacy reasons and pursuant to Article 241, paragraph 4 UGB.

12. CREDIT RISK MITIGATION BY EXPOSURE CLASS

Article 17, lines 6, 7 OffV

Exposure values covered by eligible financial collateral and other real collateral

in millions of Euros	Financial collateral	Other collateral
Exposures to central governments or central banks	3	
Exposures to institutions	1,212	
Exposures to corporates	233	12
Retail exposures	58	165
Exposures secured by real estate	42	5,923
Past-due exposures	6	10
Total	1,554	6,110

Table 34

Exposure values covered by personnel collateral

in millions of Euros	Guarantees	Credit derivatives	Other forms of credit risk mitigation	Total
Exposures to central governments or central banks	53			53
Exposures to public-sector entities, administrative bodies and non-commercial undertakings	1,001			1,001
Exposures to institutions	211			211
Exposures to corporates	1,347	564		1,911
Retail exposures	11			11
Exposures secured by real estate	16		1	17
Past-due exposures	27			27
Exposures in the form of covered bonds	169			169
Exposures in the form of securitisation positions		11		11
Total	2,835	575	1	3,411

Table 35

Owner and publisher

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