BAWAG GROUP AG
QUALITATIVE DISCLOSURE REPORT ACCORDING TO REGULATION (EU) NO. 575/2013 (“CRR”)
2020

CONTENTS

QUALITATIVE DISCLOSURE

Qualitative disclosure

LIST OF TABLES

LIST OF ABBREVIATIONS

ALM	Asset Liability Management
AML	Anti Money Laundering
AS	Application Scoring
BP	Basis Point
BPV	Basis Point Value
BS	Behavioral Scoring
BWG	Bankwesengesetz (Austrian Banking Act)
CAC	Credit Approval Committee
CCF	Credit Conversion Factor
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CHAID	Chi-square Automatic Interaction Detectors
CHF	Swiss Franc
CLO	Collateralized Loan Obligation
CMM	Capital Management Meeting
CRD	Capital Requirements Directive
CRO	Chief Risk Officer
CRR	Capital Requirement Regulation
CSA	Credit Support Annex
CET1	Common Equity Tier 1
DH	Division Head
EAD	Exposure at Default
EBA	European Banking Authority
ECB	European Central Bank
ECL	Expected Credit Loss
EEA	European Economic Area
ERM	Enterprise Risk Meeting
ESG	Environment Social Governance
FACE	Free Available Cash Equivalent
FMA	Financial Market Authority
FTP	Funds Transfer Pricing
FVPL	Fair Value through Profit or Loss
FVOCI	Fair Value through Other Comprehensive Income
FX	Foreign Exchange
GBP	British Pound
GDP	Gross Domestic Product
HQLA	High-Quality Liquid Assets
IAS	International Accounting Standards
ICS	Internal Control System
ICT	Information and Communications Technology
ICAAP	Internal Capital Adequacy Assessment Process
ID	Identity Document
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process
IRB	Internal Ratings Based Approach
ISDA	International Swap and Derivatives Association
ISTC	ICAAP & Stress Test Committee
KRI	Key Risk Indicator
KSHK	Kreditsicherheitenkatalog (Credit Collateral Catalogue)
KSV	Kreditschutzverband

KYC	Know your Customer
LAS	Liquidity Adequacy Statement
LCR	Liquidity Coverage Requirement
LGD	Loss Given Default
LTIP	Long Term Incentive Program
LTV	Loan-to-Value
NFR&ESGC	Non-Financial Risk & Environment Social Governance Committee
NII	Net Interest Income
NPL	Non-performing loans
PD	Probability of Default
PIP	Product Implementation Process
P&L	Profit and Loss
PSC	Portfolio Steering Committee
RAP	Risk Adjusted Pricing
RBC	Risk Bearing Capacity
RCC	Risk and Credit Committee
RCSA	Risk Control Self-Assessment
RMBS	Residential Mortgage Backed Securities
ROC	Receiver Operating Characteristic
RWA	Risk Weighted Assets
SALCO	Strategic Asset and Liability Committee
SEQ	Sicherheitenerlösquotient (Collateral Return Rate)
SICR	Significant Increase in Credit Risk
SME	Small and Medium Enterprises
S&P	Standard & Poor’s
TM	Treasury & Markets
TMA	Asset Liability Management
TPU	Temporary Partial Use
UGB	Unternehmensgesetzbuch (Austrian Commercial Code)
USD	US-Dollar
VaR	Value-at-Risk
WAL	Weighted Average Life
WAM	Weighted Average Maturity
WGG	Austrian Non-profit Housing Act

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Review of risk management systems according to Article 435 (1) point (e) CRR	Consolidated Annual Report IFRS 2020
Figures and information according to Article 435 (1) point (f) CRR	Consolidated Annual Report IFRS 2020
Information according to Article 41 FMA circular letter on accounting issues in connection with derivatives for controlling interest rates	BAWAG P.S.K. Annual Financial Report according to Section 124 Stock Exchange Act 2018
Details on accounting and valuation methods according to Article 447 point (a) CRR	Consolidated Annual Report IFRS 2020

GENERAL PRINCIPLES

According to Article 13 of Regulation (EU) No 575/2013 (hereinafter abbreviated to “CRR”), this Disclosure Report is published on BAWAG Group AG level. BAWAG Group AG is a financial holding company in form of a corporation. Its main business purpose is the management of the company’s assets (BAWAG P.S.K. with its subsidiaries). From a risk perspective, the main bank-wide steering processes are performed by its subsidiary, BAWAG P.S.K. AG. These processes are disclosed in this report.

SCOPE OF CONSOLIDATION AND CONSOLIDATION METHODS

Article 436 points (a), (b) sublit (i-iv) CRR

Owing to diverging regulations in the International Financial Reporting Standards (“IFRS”) and the CRR, there are two different sets of consolidation guidelines, one for accounting and one for regulatory purposes which also lead to two different scopes of consolidation. The following paragraphs present the scopes of consolidation and explain changes that occurred in 2020.

Consolidation for accounting purposes

In accordance with IFRS 10, the scope of consolidation includes BAWAG Group AG and all material subsidiaries owned directly and indirectly.

The group´s share in total assets and profit or loss of the subsidiary are the criteria for materiality.

The consolidated financial statements as of 31 December 2020 contained 60 fully consolidated companies and two companies that are accounted for using the equity method. The book value of associated equity interests including banks not consolidated at equity amounted to € 1 million as of 31 December 2020.

Controlled companies with a book value of € 18 million were not consolidated because of their negligible effect on the assets, financial and earnings position of the group. Proportionate total assets (higher than € 30 million) and profit or loss (higher than € 3 million) of the subsidiary are the criteria for inclusion. Subsidiaries with a negligible effect on the assets, financial and earnings position of the group are not included in the consolidation.

By decision of 20 February 2020, the merger of easybank AG and Pa-Zweiundsechzigste WT Beteiligungsverwaltungs GmbH with BAWAG P.S.K. AG was approved by the ECB. The merger was entered in the Austrian commercial register on 28 March 2020.

In the third quarter 2020, IMMO-BANK Aktiengesellschaft as the transferring company was merged with BAWAG P.S.K. Wohnbaubank Aktiengesellschaft as the absorbing company. Due to the merger, IMMO-BANK Aktiengesellschaft was eliminated from the scope of consolidation.

By resolution dated 29 October 2020, the Annual General Meeting of BAWAG P.S.K. AG approved the cross-border merger of SÜDWESTBANK Aktiengesellschaft as the transferring company with BAWAG P.S.K. AG as the acquiring company in accordance with the provisions of the joint merger plan dated 24 September 2020. The cross-border merger was carried out in accordance with the German Transformation Act and the Austrian EU Merger Act and has been filed with the Commercial Register Court. The merger was registered on 26 February 2021.

Consolidation for regulatory purposes

The scope of consolidation in accordance with the CRR includes BAWAG Group AG as the highest financial holding company, and all material subsidiaries owned directly and indirectly.

Consolidation for regulatory purposes is carried out in accordance with Article 18 and 19 CRR, with the financial statements of the individual companies and the consolidated financial statements being prepared in accordance with the principles of the IFRS (International Financial Reporting Standards).

The criteria used to determine the scope of consolidation are total assets and off-balance sheet items. The scope of consolidation for regulatory purposes is different to the scope of consolidation for accounting purposes.

As of 31 December 2020, the scope of consolidation for regulatory purposes included 49 fully consolidated companies, three companies were proportionally consolidated and 15 companies that were accounted for using the equity method.

In addition to the information in Consolidation for accounting purposes: Due to the change in the CRR (Article 18 (7) CRR2) regarding the methods of regulatory consolidation that came into effect at the end of December 2020, subsidiaries or participations , which are an undertaking other than an institution, a financial institution or an ancillary service undertaking must be at-equity consolidated. This affects BAWAG P.S.K. Versicherung AG and different real estate companies, which were at-equity consolidated for the first time as of 31 December 2020.

The following table shows an overview of the companies, which are treated differently in the scope of consolidation for accounting and for regulatory purposes:

Table 1: Divergent consolidation basis

	IFRS	CRR
BAWAG Leasing & fleet s.r.o. Prague	FVPL	F
BAWAG Leasing s.r.o. Bratislava	FVPL	F
Bonnie RE UK 1 B.V.	F	E
Fides Leasing GmbH	FVOCI	P
Gara RPK Grundstücksverwaltungsgesellschaft m.b.H.	FVPL	F
HFE alpha Handels-GmbH	FVOCI	P
Kommunalleasing GmbH	FVOCI	P
LSREF3 Tiger Aberdeen S.à r.l.	F	E
LSREF3 Tiger Falkirk I S.à r.l.	F	E
LSREF3 Tiger Gloucester S.à r.l.	F	E
LSREF3 Tiger Romford S.à r.l.	F	E
LSREF3 Tiger Southampton S.à r.l.	F	E
Promontoria Holding 136 B.V.	F	E
PT Immobilienleasing GmbH	FVOCI	F
SWBI Darmstadt 1 GmbH	F	E
SWBI Mainz 1 GmbH	F	E
SWBI München 1 GmbH	F	E
SWBI Stuttgart 1 GmbH	F	E
SWBI Stuttgart 2 GmbH	F	E
SWBI Stuttgart 3 GmbH	F	E

F …….. Fully Consolidated
P …….. Proportionally Consolidated
E …….. Equity Consolidated
FVOCI .. Equity Instruments At Fair Value Through Other Comprehensive Income
FVPL …. Equity Instruments At Fair Value Through Profit or Loss

Significant subsidiaries in terms of Article 43 CRR were not deducted from CET1, as they did not exceed the defined threshold of Article 48 CRR. For significant positions in instruments of supplementary capital an obligation for deduction exists (Article 66 CRR).

According to Article 36 (1) point (h) institutions shall deduct the applicable amount of direct, indirect and synthetic holdings by the institution of CET 1 instruments of financial sector entities where the institution does not have a significant investment in those entities.

Non-significant subsidiaries in terms of Article 46 CRR were deducted from CET 1 in the amount of € 1 million and from Additional Tier 1 in the amount of € 2 million, as they did exceed the defined threshold of Article 46 CRR.

As all subsidiaries subject to banking regulation laws are included in the scope of consolidation or all relevant book values are deducted from own funds in case the threshold is exceeded, there is no shortfall in own funds in terms CRR, Part 8, Title II, Article 436 point (d).

IMPEDIMENTS TO THE TRANSFER OF OWN FUNDS

Article 436 point (c) CRR

There are currently no restrictions or other significant impediments to the transfer of own funds or regulatory equity within BAWAG Group.

TOTAL SHORTFALL IN OWN FUNDS OF ALL SUBSIDIARIES NOT INCLUDED IN THE SCOPE OF CONSOLIDATION

Article 436 point (d) CRR

No shortfalls in own funds are known among subsidiaries that are not consolidated but deducted from own funds.

USAGE OF ARTICLES 7 AND 9 CRR

Article 436 point (e) CRR

There are no issues for the usage of Articles 7 and 9 CRR in BAWAG Group.

RISK MANAGEMENT

GROUP-WIDE RISK MANAGEMENT

Article 435 (1) point (b) CRR
Article 435 (2) point (a) – (e) CRR
Article 435 (1) point (e) – (f) CRR

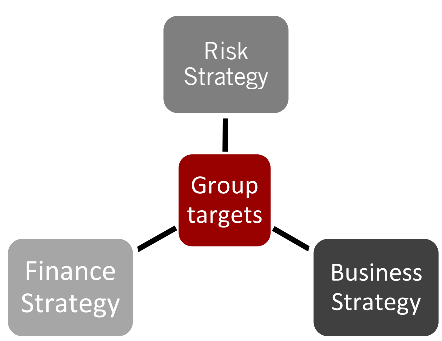
Risk management decisions are taken at various places within BAWAG Group on daily basis. The systematic orientation of risk decisions at the company's targets requires the development of a common fundamental understanding concerning the risk-related issues, the specification of strategic and operational objectives in the individual business units as well as a comprehensive process of continuous risk management covering all risk areas.

The guidelines regarding the risk management are laid down in framework of risk management documents. The Risk Governance contains the basic position in terms of risk principles, a classification of risk types as well as the organization of the risk management. The Risk Strategy (derived from the specifications defined in the business strategy) considers the risk appetite statement, details about the ICAAP-Framework (economic and normative perspective), the target risk profile in term of capital allocation and the structure limits to manage concentration risk. The management of the individual risk types is part of specific risk guidelines.

The Management 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 ratios. The Management Board then derives from this business strategy the Risk Strategy and sets the risk appetite for the current planning period. Finally, the Management Board takes fundamental decisions with respect to the processes to be applied to identify, measure, control and monitor risks.

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

In addition, the Management Board is informed within the Enterprise Risk Management (ERM) Committee about all risks within the Group on a monthly basis. With regard to the ERM Committee the provided Group Risk Report builds the information basis in which various key risk indicators are reported, analyzed and their development commented. Furthermore, any significant change in the risk situation must be immediately reported to the entire Management Board. The external stakeholders are semi-annually (in form of the annual report and half year report) informed about the risk situation. The reports and presentations are published on BAWAG Group's website.



BAWAG Group has implemented a clear risk strategy, which is fully aligned with the Group’s overall business strategy. The Managing Board defines and approves the overall risk appetite and risk strategy on an annual basis. By defining the risk strategy, the overall risk appetite serves as a constraint and represents the Group's intention to use a defined extent of the available internal capital for risks under consideration of regulatory and economic capital availability, the liquidity position and the profitability expectations. The risk strategy breaks the overall risk appetite down into more detailed business appetite metrics and limits.

The Risk Strategy is defined by the division Risk Controlling and is stating the Risk Appetite and defining the Target Risk Profile based on the results of the Risk Self-Assessment and Risk Planning Guidelines; in particular for Credit Risk the volume by segment defined in the budget are taken in consideration with the year-end credit risk capital density and are used for estimating the credit risk figures and the limits for the year as well as the allocation within the business segments; for the country and industry limit allocation is reviewed more on case by case by expert judgement, following the indication of the Risk Planning Guidelines as well as the capital density of the specific country and industry, the macroeconomic country development and the industry risk perception; all the components of the Risk Bearing Capacity are forecasted for the year, based on the capital planning; moreover all the limits indications provided in the Risk Self-assessment are already assessed in order to be consistent with the respective Risk Appetite targets and limits and are considered for the capital allocation.

The Risk Appetite Statement provides a compact overview about the targets and limits set in term of Capital, Liquidity and Portfolio Quality metrics for the year 2020.

	YE 2020	Target[1)]	Limit[1)]
CET1 ratio	13.98%	≥ 13%	> 10.187%[2)]
Tier 1 ratio	16.34%	> 14%-14.5%	> 11.687%[2)]
Total Capital ratio	19.60%	> 16%-16.5%	> 13.687%[2)]
ICAAP limits utilization	64.4%	n.d.	< 95%
LCR	231%	> 120%	> 110%
FACE	€ 4.8bn	n.d.	> € 1.5bn
Leverage ratio	6.1%	n.d.	> 3%
NPL ratio	1.5%	< 3%	< 3.5%

1) Target and Limit were approved within the Risk Strategy 2020 and were valid for the whole year 2020. Any adaptations within the year 2020 were due to the regulatory requirement.
2) excluding Pillar 2 Guidance buffer of 1% according to SREP.

Other important figures and information according to Article 435 (1) point (f) CRR which provide a comprehensive overview about the risk management can be found in the annual report.

The Risk Strategy and the Risk Governance are updated on an annual basis, approved by the Management Board, submitted to the Risk and Credit Committee of the Supervisory Board for discussion and, in a final step, approved by the Supervisory Board. The Group Risk Report is represented to and discussed within the Risk and Credit Committee on a quarterly basis.

Pro-active risk management is a major target of BAWAG Group and is among the core tasks of the risk organization. Efforts must be made to ensure that BAWAG Group 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. Basically, BAWAG Group follows a low risk strategy, which means that risks are managed conservatively.

Moreover, all rating and scoring systems are subject to an annual validation process in which the adequacy and the performance of the systems is monitored. If further measures are required, appropriate analyses will be initiated and, if necessary, adjustments will be implemented and communicated to the Management Board.

Due to the variety of monitoring processes, ongoing reporting activities and the immediate introduction of countermeasures in the case of significant deviations from the target risk profile defined in the Risk Strategy, it is ensured that the risk management processes and systems are appropriate.

Risk management organization as of 31.12.2020

The Chief Risk Officer (CRO) is responsible for the Risk Control function and for monitoring the risk management framework across the entire Group.

To perform its tasks, the risk management organization comprises the following independent units (main level or divisions) as of 31 December 2020:

- Chief Data & Risk Control Office
  - Strategic Risk Management
  - Risk Controlling
  - Group Data Warehouse
- Commercial Risk Management
- Retail Risk Management
- Credit Risk Strategy & Analytics

The Chief Data & Risk Control Officer role was introduced in the organization in 2019, directly reporting to CRO. This role is coordinating the risk control divisions of Strategic Risk Management and Risk Controlling as well as the data division Group Data Warehouse.

The Retail Risk Management function is responsible for managing credit risk for Retail & SME customers while Commercial Risk Management is responsible for non-retail risk within the group.

Furthermore, the risk division Credit Risk Strategy & Analytics is responsible for designing, developing, and maintaining credit decision strategies to ensure new originations are within approved risk appetite and policy. Monitoring of the risk profile and performance of new originations with special emphasis on ratings, LTV, and exposure buckets are one of the key competences.

The above risk management divisions are directly subordinated to the Chief Risk Officer (CRO) and periodically referred to the following committees at Management Board level:

The **Enterprise Risk Meeting (ERM)** is a monthly risk meeting of all members of the Management Board and is chaired by the CEO. It takes fundamental risk decisions, such as:

- approves the Risk Strategy and determines the risk appetite, and, if needed, gives recommendations to the Supervisory Board on changes and modifications
- approves the capital allocation in the framework of the ICAAP
- delegates competence for credit risk limit setting to the Portfolio Steering Committee (PSC) at profit sub-segment level (level 3) and for specific countries and industries within each sub-segment (level4)
- approves capital re-allocation in level 3 and level 4 above € 40mn upon explicit recommendation by the PSC
- delegates competence for market risk limits for the Group to the S-ALCO
- reviews and approves underwriting guidelines for all business units
- reviews significant findings resulting from regulatory examination and initiates action for remedy
- discusses the monthly Group Risk Report
- discusses the monthly Capital Report
- reviews and approves use of rating models, scorecards, cut-offs as well as development or changes of risk parameters
- reviews and approves results or rating- and scoring models validation and the resulting actions
- reviews and approves or recommends (according to regulatory requirements) credit policies
- approves the results and potential countermeasures of the stress test exercises, as recommended by the Stress Test Committee.

Credit Approval Committee (CAC): Approves loan applications within the power defined in the Competence and Power Regulation of the CAC.

Strategic Asset and Liability Management Committee (SALCO): This committee is the decision-making body on all market and liquidity risk related topics. The SALCO allocates the respective risk limits and serves as escalation body for exceeding individual limits or regulatory requirements. Furthermore, all relevant Market- and Liquidity Risk reports as well as ALM and Treasury reports are presented to the board via this committee.

Non-Financial Risk & ESG Committee (NFR&ESGC): The committee is established for discussion and approval of bank-wide NFR Risk Assessment (as part of Group Risk strategy) for topics such as AML, Fraud, Data Protection, ICT Risks, Conduct, Outsourcing, BWG Compliance, Business Continuity and changes in regulatory requirements as well as ESG related topics.

On level of Supervisory Board various committees are established. The most essential one from a risk perspective is the **Risk and Credit Committee (RCC)**, which also deals with the Group Risk Report. Four meetings were held in 2020.

Under the current valid version of the Rules of Procedure of the Supervisory Board dated 13 December 2019, the RCC has the following responsibilities:

- approves the granting of loans and credit (as well as other forms of financing) to individual borrowers or groups of associated customers within the meaning of Article 392 CRR (exposures that equal 10% or more of the Bank's eligible own funds)
- reports annually to the Supervisory Board on large exposures approved by the Risk and Credit Committee
- decides on transactions with the Bank's affiliated parties within the meaning of Article 28 BWG
- approves material credit policies and advises the Management Board regarding fundamental issues of credit and risk policy
- advises the Supervisory Board on the current and future risk appetite and Risk Strategy and monitors the implementation
- regularly monitors the effectiveness and efficiency of the risk management system and compliance with legal and regulatory provisions.

BAWAG Group applies a Group-wide Fit and Proper Policy. It sets forth the procedure for selecting members of the management body and for reviewing actual knowledge, skills and experience. In addition, aspects of personal reliability, internationality and age structure of the members are to be taken into account.

The Nomination and Remuneration Committee has defined a target quota for the underrepresented gender of 33% until 2027 which applies to the Supervisory Board and the Senior Leadership Team (including the Management Board).

The strategy for reaching this goal was further developed and defined together with BAWAG P.S.K. Women's Initiative and Human Resources. The focus is on promoting female employees within the Women's Promotion Program, internal and external mentoring programs for female leaders and experts, gender-specific workshops for all female employees and appointing females as Supervisory Board and Management Board members of subsidiaries.

Women's Promotion Plan

The Women's Promotion Plan, which has been in force since 2012, serves as a binding framework for promoting equality and ensuring equal opportunities for women and men in the company. The plan is based on four principles and concrete measures:

- Raising Awareness
- Equal career opportunities
- Financial equality
- Promoting a better work-life balance for employees

BAWAG Group Women's Mentoring Program

External and internal women's mentoring programs alternate annually.

The external women's mentoring program is aimed at female employees with longer management experience who would like to benefit from external top managers from the business world as mentees and broaden their horizons. The internal women's mentoring program is suitable for all female colleagues who would like to develop themselves further, have already gained their first leadership experience or would like to develop in this direction.

The goal of the Women's Mentoring Program is to give female employees the opportunity to deal intensively with the topic of "women and careers", to have an intensive personal exchange with their mentors and to build a network within the company. In this program, top executives of the BAWAG Group are available to the female mentors to share their experience in joint discussions and to provide advice to the mentees. During the mentoring year, the mentees are offered professional and personality-building content in workshops, networking events and extensive further training as part of the BAWAG Group Business Academy. Participants can talk to internal experts on the topics of finance, risk and retail, as well as to exchange ideas with members of the BAWAG Group's Managing Board in a personal setting during business talks.

Since 2013, BAWAG P.S.K. is committed to the compatibility of work and family as part of a structured auditing process and received the certification as a family-friendly company. End of 2020, BAWAG P.S.K. successfully re-certified the "*berufundfamilie*" certificate. As a response to the Corona crisis and the associated new forms of collaboration, the *berufundfamilie* audit is also offering the option "Home Office / Mobile Working". As part of the process, BAWAG P.S.K. also sought this additional certification for the first time.

Disclosure of the number of management and supervisory functions held by BAWAG P.S.K. Management and Supervisory Board members pursuant to EBA/GL/2016/11 and Article 435 (2a) CRR as of 31 December 2020:

Table 2: Functions held by members Management Board and Supervisory Board

Name	Function in BAWAG P.S.K.	Number of Management Board functions	Number of Supervisory Board functions
Egbert Fleischer	Chairperson Supervisory Board	0	3
Frederick Haddad	Member Supervisory Board	7	2
Kim Fennebresque	Member Supervisory Board	0	5
Adam Rosmarin	Member Supervisory Board	1	2
Anas Abuzaakouk	Management Board, CEO	2	0
David O´Leary	Member Management Board	2	0
Andrew Wise	Member Management Board	2	0
Enver Sirucic	Member Management Board	3	2
Sat Shah	Member Management Board	2	3

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP) AND GROUP-WIDE STRESS TEST

Article 435 (1) point (a) CRR
Article 438 point (a) CRR
Article 439 point (a) CRR

The Internal Capital Adequacy Assessment Process (ICAAP) is part of the regulations known as Pillar II. The ICAAP-related processes and methods established at BAWAG Group ensure that the existing risk coverage capacity in terms of capital is adequate to cover the relevant risks that may arise.

According to the ICAAP Guides, issued on November 2018 by the European Central Bank, BAWAG Group has implemented both Normative and Economic perspectives for the Group steering.

The risk self-assessment (RSA), which is conducted on an annual basis, provides an overview of BAWAG Group's risk situation using quantitative and qualitative evaluation methods, i.e. all potential risks arising in connection with the implementation of the business strategy are evaluated with respect to their relevance, materiality and their impact on BAWAG Group. All material and non-material risks are considered under the economic perspective, while the normative perspective encompasses Pillar I risks (credit risk, market risk, operational risk) and all other material risks.

BAWAG Group's economic perspective compares the quantified risks with the risk-bearing capacity. The risk bearing capacity is calculated on a monthly basis. The calculation and its components are discussed and reported monthly to the entire Management Board in the Enterprise Risk Meeting (ERM).

The following risk categories represent the relevant risk type within BAWAG Group that are quantified and compared with the available risk bearing capacity:

- **Credit risks**: Credit risk is quantified by using the IRB approach. Additional capital surcharges are applied for credit risk concentrations in connection with loans to major customers/to groups of affiliated customers and for the risk arising from credit lines[1)] not subject to capital requirements under legal regulations.

- **Market risks**: The quantification of interest rate risk in the banking book and credit spread risk are based on value-at-risk models, also considering correlation effects between the two market risks. Other market risks, such as funds risk or foreign currency risk in the banking book, are quantified with similar value-at-risk valuation models. Both risk types are quantified by using value-at-risk models based on historical full valuation approach and generalized hyperbolic distribution. Conservative correlation assumptions are taken into account as well.

- **Liquidity risk**: Structural liquidity risk quantification is based on current liquidity gaps applying assumed potential deteriorations of own funding costs. Quantification methods based on historical worst-case analyses are used for market liquidity risk in the banking book and basis spread risk.

- **Operational risk:** This category covers operational risk (including compliance risk) quantified using Standardized Measurement Approach, as described in Basel VI regulation.

- **Other risks**: for the following risk types economic capital has been quantified: participation risk, reputation risk, and strategic risk. Participation risk is quantified using the PD/LGD approach based on IFRS book values, while for all other mentioned risk types, the required economic capital is quantified using simplified quantification methods.

1) Consideration risk from not utilised, uncommitted (non-retail) limit.

The individual relevant risk types are subsequently aggregated to form the total risk of the group, without considering correlation effects, and are set into relation with the risk bearing capacity. The aim of BAWAG Group´s ICAAP steering is to ensure an adequate coverage of all risks at any time. This aim is supported via a specifically allocated capital buffer subject to flexible allocation at Management Board discretion.

The economic risk bearing capacity is composed of the following components:

- Tangible IFRS equity (scope of consolidation is CRR)
- Regulatory IRB shortfall (Comparison of loan loss provisions, ECL and expected losses)

A confidence level of 99.9 per cent is applied for the calculations. The confidence level indicates the probability that potential losses are not exceeding the quantified risk.

The normative perspective is also fully integrated into the strategic risk management, capital management and planning processes of BAWAG Group.

In connection with the normative perspective, Pillar I risks as well as material risks are quantified, projected and subsequently considered in the respective capital (RWA) and P&L views. The following risk types are considered and quantified:

- **Credit risk**: The quantification of credit risk is based on the regulatory approach (Pillar I view) and is considered under the capital view (RWA). Credit risk losses are also accounted in the P&L view in the form of expected credit losses.

- **Market risk**: The quantification of market risk for the trading book is based on the regulatory approach (Pillar I view) and is considered under the capital view (RWA). BAWAG Group has identified interest rate risk in the banking book and credit spread risk as the material market risks and are considered in the P&L under net interest income, gains & losses and other comprehensive income.

- **Operational risk**: The quantification of operational risk is based on the regulatory approach (Pillar I view) and is considered under the capital view (RWA). Operational risk losses are also accounted for in the P&L view.

The methodology and results of both ICAAP perspectives discussed in the regular ICAAP & Stress Testing Committee (ISTC) on quarterly basis and reported to the ERM. The ERM oversees the assessment of the results and defines any corrective action for the risk appetite or business strategy, where necessary.

The link between the ICAAP perspectives and capital management is formally defined within the internal risk and capital governance.

The capital ratios defined within the capital planning process and monitored on a monthly basis by the Capital Management Meeting are used as a benchmark for the normative perspective. The capital contingency plan is drawn up to account for extreme stress scenarios. As part of the normative perspective and stress test exercises, senior management reviews whether the stressed capital ratios remain above the recovery levels. In case of breach of the recovery levels measures need to be taken to improve the capital position sufficiently in order to keep the capital ratios above the recovery levels even under a stressed scenario.

Stress Test Framework

BAWAG Group performs stress tests on a regular basis in order to assess potential effects on the group's financial situation stemming from unusual yet plausible specific events and variables change like the impact of a severe economic downturn on the group's risk profile and financial position. Stress testing is considered in BAWAG Group as an important management tool and an essential part of internal risk management.

Governance procedure has been defined and established for the conduct of stress tests and the key decisional body is the ICAAP & Stress Test Committee. The group Portfolio Analysis and Stress Test in the division Risk Controlling is in charge for the coordination and guidance of each stress test exercise.

Stress Test program

A comprehensive program for the management of stress testing within BAWAG Group has been defined as integral part of the stress test framework. The program includes several stress test exercises applying a series of techniques, performed on regular basis as well as on demand. Regular stress tests exercises are for example:

- scenario stress test (ICAAP), performed on a quarterly basis
- reverse stress testing, performed once a year
- sensitivity analyses, performed on demand or at least once a year (like FMA FX-TT stress test)
- ad-hoc-analyses, performed on demand (like specific COVID-19 scenario impacts).

ICAAP Stress Test

The ICAAP stress test is a macroeconomic stress test with general assumptions of a dynamic balance sheet and without possible mitigation measures during the projection period. BAWAG Group stress test exercise is based on macro-economic scenarios (baseline, adverse and including idiosyncratic shocks) covering a three-year horizon starting from the reference date of the stress test exercise.

Macroeconomic scenario effects are transmitted to the portfolio via regression models (e.g.: IFRS 9 models) as well as stress factors based on expert judgment (for not available historical data or for models with low explanatory power). Outcomes of the ICAAP stress test are expressed in terms of effects on capital ratios through both P&L and RWA.

Reverse Stress Test

The Reverse Stress Test is designed to identify a set of scenarios leading to a breach of warning or recovery thresholds of the CET1 ratio. The ICAAP Stress Test framework is utilized as basis for the identification of such scenarios along with targeted sensitivity analyses.

ICAAP & Stress Test Committee

The ICAAP & Stress Test Committee (ISTC) provides the central coordination of the stress testing processes at Group level. The main objective is to ensure effective oversight and control over the operative proceedings of all ICAAP and stress test analyses and to recommend strategic decisions.

Meeting is held on quarterly basis and the scope of activity includes:

- ICAAP normative and economic perspectives analyses and monitoring;
- all cross-divisional stress test or similar economic analyses.

For the analyses in scope, the ISTC is in charge of the following items:

- Approval of the process guidelines for each stress test or economic analysis
- Approval of the process guidelines for ICAAP normative and economic perspectives analysis
- Approval of the baseline and adverse scenarios and related assumptions for each stress test exercise and ICAAP perspectives

- Discussion and approval of the results of stress test exercises and ICAAP perspectives
- Definition of the recommended action / mitigation plan for ERM approval based on the ICAAP and stress test results.

Portfolio Steering Framework

Credit Risk Limits in the economic perspective are determined for all segments as part of the Risk Strategy. BAWAG Group follows a detailed Portfolio Steering framework concept based on dynamic and hierarchical capital allocation.

For the main risk categories, namely Credit Risk, Market Risk and Liquidity Risk as well as the MB capital buffer, the defined limits are dynamic by nature depending on the current level of the risk bearing capacity (RBC). The calculation of the limits is updated on a monthly basis jointly with the calculation of the current RBC. For the Operational Risk and the residual risk categories, grouped under the “other risks” category, the capital allocation is fixed. The risk quantification for the “other risks” is revalidated at least annually in conjunction with the strategic capital allocation process and further updated on a need basis.

The following four levels of capital allocation are considered:

- Level 1: Capital allocation to risk categories and the capital buffers
- Level 2: Capital allocation to business segments (credit risk) and sub-categories (market and liquidity risk)
- Level 3: Capital allocation to business sub-segments (only for credit risk)
- Level 4: Exposure limits for geographical and sectoral concentrations (only for credit risk and the relevant business sub-segments).

Portfolio Steering Committee

This committee provides the central coordination of the credit portfolio steering processes at Group level. The main objective is to ensure effective oversight and control over the Credit Risk capital allocation and capital utilization levels and to inform strategic decisions on such topics or, alternatively, to define recommendations for the Enterprise Risk Meeting at Management Board level. Meeting of the PSC is held on quarterly basis and duties of the PSC are as follows:

- Monitoring of Credit Risk capital allocation and capital utilization at all levels
- Approval of the standard Portfolio Steering Framework Report
- Assessment of the portfolio dynamics and the current utilization of the assigned limits
- Assessment of the needs and opportunities for re-allocation of capital within the capital allocation hierarchy
- Tactical capital allocation, within the restrictions defined by the Portfolio Steering Framework embedded in the ICAAP Policy
- Assessment of the impact of relevant prospective credit decisions requiring capital re-allocation
- Assessment of the status of risk concentrations in the bank’s portfolio, across all relevant risk categories
- Monitoring of the single-name concentrations for credit risk, including the Large Capital Consumers and the Outlier List
- Prioritization and assessment of the enhancements to the Portfolio Steering Framework to be sought over time
- Definition and evaluation of in-depth analyses regarding specific discussion topics related to the core responsibilities of the Committee.
- Definition of the recommended action / mitigation plan for ERM approval, where necessary.

CAPITAL ALLOCATION AND LIMITATION AT TOTAL BANK LEVEL

Article 438 point (a) CRR
Article 439 point (a) CRR

The process for limitation and capital allocation runs parallel to planning and budgeting at least once a year, and if required, more often. Within the defined process, the established premises such as confidence level and capital buffer (risk appetite) are reviewed and updated. Steering portfolios are defined for credit risk and are geared to the customer segments or organizational responsibilities as well as countries and industries. The bank subsidiaries are included in the control portfolios. For market and liquidity risks, sub-limits are defined.

The capital allocation/limitation according to Article 39a of the Austrian Banking Act is defined under the following premises and information:

- The Management Board sets forth the strategy for the next five years in the annual medium-term plan
- Confidence level, holding period, capital buffer, steering units
- Planning and budgeting process and any changes in risk value/balance sheet items under consideration of an adequate liquidity position
- Existing limit setting systems (e.g. in connection with market risks)
- Limitation for the steering units according to the quantification methods defined for the individual risk categories.

The capital allocation, as a major component of group-wide risk management and limitation of the risk categories, is approved by the entire Management Board, presented to the Risk and Credit Committee of the Supervisory Board and in a final step, approved by the Supervisory Board.

CREDIT RISK

OBJECTIVES AND PRINCIPLES OF CREDIT RISK MANAGEMENT

Article 435 (1) points (a) – (e) CRR
Article 439 point (a) CRR

Strategies and processes

Corporate Customers

Strategies and processes presented in this section on corporate customers are also largely applied to sovereigns, the financing of government authorities, and institutions. Loans are processed and decided upon according to extensive work instructions. The decision-making powers are set forth in competency order.

Credit is granted on the basis of the following considerations:

- 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 (the national accounts for sovereigns) including planning calculations of the company and other information to ensure a meaningful analysis for the rating and the decision.
- The assessment of a customer's creditworthiness and credit bearing capacity is based on ratings that must systematically cover all information made available from the relationship manager. The final rating confirmation is handled by the responsible organizational risk division. The loan decision is taken solely according to the Competence and Power Regulation.
- BAWAG Group strives to collect suitable collaterals to minimize the credit risk which are assessed by using a standardized 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 in a customer relationship requires approval from the competent authorized person. Each application requires a positive front-office recommendation (from the customer advisor) before being submitted to the risk-unit.
- If key ratios are defined in a credit relationship as auxiliary conditions (known as covenants), they must be stated in the credit application and approved. Compliance with the key ratios at the contractually fixed dates must be checked by the responsible risk unit.

Retail and Small Business Customers

Risk from new business is managed by using clear and 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 downstream in the risk division. Special attention is paid in this portfolio on processing compliance and assuring data quality. A central monitoring process ensures on-going quality assurance.

Credit risk in retail business is measured monthly focusing on the following elements:

- Portfolio trends in terms of overdue/late payments (e.g. vintage and flow rate analyses)
- Portfolio trends in terms of risk class distribution and risk concentration
- Portfolio trends in terms of credit affordability and collateralization
- Portfolio trends with regard to defaulted loan facilities

- Portfolio trends in terms of incurred risk costs and losses
- Scorecard performance (approval rates and manual decision)
- Performance monitoring of fraud detection
- Portfolio distribution trends by products & channels
- Collection and workout performance

The findings of the analysis are reported periodically to the ERM.

Independently of this process, risk-relevant data from standardized assessments between business managers and risk management are discussed and documented in monthly committee meetings. This process ensures a regular and standard flow of information whilst also enabling to respond directly to changes in risk parameters and market conditions.

In the collection process additional measures support the dunning process to be more efficient on working with overdrafts and loans in delay.

Structure and organization of relevant risk management functions

Credit risk is an integral part of many business activities. Credit risk is controlled in the Commercial Risk Management and Retail Risk Management divisions. In daily business, credit risk is controlled by each business area in coordination with the specific credit risk division based on the powers granted and applying the four-eye principle. The rules regarding the powers granted can be found in the Competence and Power Regulation, published on the company intranet website.

Risk measurement systems (approved approaches)

Article 452 point (a) CRR

With the decision of the FMA of 23 April 2013, BAWAG Group received approval in accordance with part 3 title II chapter 3 section 1 CRR to calculate the basis of assessment for credit risk as per Article 107 (1) CRR applying the internal ratings based (IRB) approach pursuant to part 3 title II chapter 3 CRR starting on 1 April 2013. The approval extends to the institutions of the BAWAG Group described below and the indicated exposure classes. For individual exposure classes, credit institutions and business units indicated below, the basis of assessment for credit risk will be determined using the Standardized Approach to credit risk pursuant to Article 148 and Article 150 CRR (permanent or temporary partial use) with approval from the ECB as per part 3 title II chapter 2 CRR. BAWAG Group uniformly applies the IRB approach and jointly satisfies Article 144 and Article 145 CRR for the institutions of BAWAG Group.

Portfolios in the IRB approach

Approval to use the IRB approach applies to the following credit institutions in the Bank Group:

- BAWAG P.S.K. AG

For the exposure class ‘exposures to corporates’ (Article 147 (2) point c CRR), the approaches specified by the supervisory authority are used in the scope of the IRB Approach for the risk parameter LGD and conversion factors. The risk weights pursuant to Article 147 (2) point c CRR apply for exposures from Specialised Lending.

In the exposure class ‘retail exposures’ (Article 147 (2) point d CRR), the parameter PD as well as LGD and conversion factors are based on the group’s own estimates.

Exposures in the exposure class ‘participations’ (Article 147 (2) point e CRR), are calculated based on the simple risk weight approach pursuant to Article 155 (2) CRR and using grandfathering in accordance with Article 495 (1) CRR.

‘Securitizations’ (Article 147 (2) point f CRR) are calculated using the Ratings Based Approach pursuant to Article 261 CRR provided external ratings are available.

Portfolios in the temporary standardized approach

The IRB approach is being implemented pursuant to Article 148 CRR for exposures to institutions (Article 147 (2) point b CRR) and for exposures to holding companies having control over their subsidiaries.

The IRB approach should be implemented for

- start:bausparkasse exposure category “retail exposure”
- German Retail & SME
- easyleasing
- German leasing portfolios

Portfolios in the standardized approach

Permission was/will be obtained from the FMA/ECB pursuant to Article 150 CRR to apply permanently the standardized approach to credit risk to calculate the basis of assessment for credit risk for the following exposure categories and immaterial lines of business:

- exposures to central governments and central group’s pursuant to Article 150 (1) point a CRR
- exposures to institutions pursuant to Article 150 (1) point b CRR
- exposures belonging to the classes of exposures to the Austrian federal government, provincial governments and public-sector entities pursuant to Article 150 (1) point d CRR
- guarantees and counter-guarantees of central governments pursuant to Article 150 (1) point j CRR
- exposures to local and regional governments and public-sector entities as well as legally recognized churches and religious communities falling into the exposure class ‘Institutions’ pursuant to Article 150 (1) point a CRR
- exposures within the Bank Group pursuant to Article 150 (1) point e CRR
- within the exposures to corporates, the immaterial business units insurance companies, political parties, leasing companies and other financial companies pursuant to Article 150 (1) point c CRR
- participations whose credit obligations qualify for 0% risk weight under the Standardized Approach to Risk Weight in application of the provisions of Article 150 (1) point g CRR
- in accordance with Article 150 (1) point c CRR, for the exposures of the following subordinate institutions pursuant to Article 30 (1) BWG:
  - BAWAG P.S.K. Wohnbaubank AG
  - easyleasing GmbH and BAWAG Leasing Holding GmbH and its leasing subsidiaries, if not provided for in the temporary standardized approach
  - start:bausparkasse AG, if not provided for in the temporary standardized approach
  - real estate companies of BAWAG Group if they provide ancillary services as subordinate institutions of the Bank Group
  - other smaller financial institutions and providers of ancillary services

Furthermore, the regulatory capital requirements for the International Retail Mortgage Portfolio are calculated by using the standardized approach.

Reporting systems

The entire Management Board is informed monthly about all risks in the ERM based on the comprehensive, monthly Group Risk Report. In addition, the entire Management Board is informed immediately in case of any material change in the risk situation.

Risk hedging and mitigation[1)]

Article 435 (1) point (d) CRR

Collateral is recognized and assessed in accordance with the Credit Collateral Catalogue (KSHK) which reflects the principles of the CRR, of other relevant legal regulations and internal procedural rules. The KSHK together with the collateral checklist serves as the basis for cataloguing collaterals according to internal risk criteria. The KSHK also determines the amount to be set for the market value and lending value (internal value "Belehnwert") and whether the collateral may or may not be applied to reduce risk under the current regulatory requirements. If new collateral not yet defined in the Credit Collateral Catalogue (KSHK), the organizational unit Strategic Risk must check whether this new collateral is eligible for recognition and select the method for the valuation of the market value and the limits for the lending value in coordination with the affected areas and submit these items to the ERM for approval.

Monitoring is conducted regularly, and the currently valid lending value estimates are reconciled with the historical realization proceeds and checked.

The lending value ("Belehnwert") is the value at which the collateral is internally estimated in terms of reducing exposure. The lending value incorporates values empirically obtained from salability, duration of realization 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 standardized 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.

1) Refer also to 'credit risk mitigation techniques in the internal rating based approach'.

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

Strategies, processes and management

Article 435 (1) point (a) CRR

The counterparty default risk is treated as part of the credit risk. Details on strategies and procedures of the management of credit risks are presented in section ‘Objectives and principles of credit risk management’.

Structure and organization of relevant risk management functions and risk reporting systems

Article 435 (1) point (c) CRR

Counterparty default risk is a version of credit risk designating the potential risk of default in treasury transactions, especially derivative transactions. It quantifies the risk of loss that would materialize if the credit rating of a counterparty of BAWAG Group worsened during the term of a transaction – all the way to the worst-case scenario of a default.

The credit risk divisions assess actual counterparties based on front-office requests. A limit system is employed to monitor this risk category and sets separate limits for the three asset classes’ derivatives, money market and securities (product limit system). Risk Controlling (RX) is responsible for monitoring compliance with the set limits. The extent to which the limit is being used is calculated methodically following the regulatory approach ‘Positive market value plus add-on’ as defined in in Article 274 CRR utilizing credit risk mitigation techniques (refer to section ‘credit risk mitigation’).

This monitoring of limit use is done in real time and in the form of daily reports. The division Risk Controlling reports daily to the front office and the back office on any instances of limits being exceeded. The front office and back office then order countermeasures to be taken subject to an escalation process coordinated by Risk Controlling.

All relevant provisions for counterparty risk and the associated processes are described in detail in the risk management manual for Treasury Markets, which is annually updated and approved by the entire Management Board. The rules are supplemented by various process instructions for Treasury & Markets and credit risk manuals for the credit segments.

Risk hedging and mitigation

Article 435 (1) point (d) CRR
Article 439 point (b) CRR

BAWAG Group can demand the furnishing 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 Group, 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, CHF) and securities from issuers with very good ratings (government bonds of select European countries and the United States).

If securities are provided as collateral, a haircut 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 (exchange rate fluctuations are taken into account for collateral denominated in foreign currencies and the market value of securities). The customary intervals for valuation in the market are daily, weekly or monthly. For the majority of contracts, a daily valuation is provided.

The possibility of realizing the deposited collateral in the event of the partner's bankruptcy and its further use (e.g. re-hypothecation 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.

For derivative business, currently only cash collateral denominated in € and USD, in case of a Clearer additionally in CHF and GBP, is allowed. 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, CHF, GBP) its value does not change due to price changes.

Correlation risks

Article 439 point (c) CRR

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.

Possible correlation risk is taken into account in connection with deliberations on the collateral portfolio. Any specific correlation risk is 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 generally allowed. This practice is also intended to help avoid specific correlation risks. In determining the limit and limit structure during the rating check, BAWAG Group 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.

Settlement and delivery risk is composed of the pre-settlement/fulfilment risk and the replacement risk. Pre-settlement/fulfilment risk results from the unilateral provision of an input by BAWAG Group under a mutual transaction. It exists until the complete fulfilment of the counter-performance. Replacement risk occurs if the full settlement of a transaction is not carried out immediately on its conclusion. If the counterparty defaults prior to full performance, the group has to find a replacement in the market based on the conditions prevalent at that time. Due to changes in market value in the meantime, BAWAG Group may incur losses from the necessary replacement. From an economic point of view, replacement risk is identical to the counterparty risk. In contrast to counterparty risk, however, it does not occur for forward transactions, for which a future settlement was explicitly agreed. It exists in the framework of step-by-step transactions where, due to standard market practices, a period of several days may separate conclusion of the contract and settlement.

Rating downgrade and its impact on collateral

Article 439 point (d) CRR

Contractual clauses on dependencies between the collateral provided and the rating assigned 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 rating downgrade of the Bank would not have any material effect on the additional amount to be provided.

Measures for exposure value

Article 439 point (f) CRR

Treasury business is focused on asset and liability management. Derivative financial transactions are conducted in the form of interest rate and currency swaps, forward exchange dealing, interest rate and foreign exchange options. BAWAG Group was not engaged in securities lending, commodity lending or in any margin lending transactions or long settlement transactions as of 31 December 2020.

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 Group 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 BAWAG Group 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 involved 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 Group is guided by the procedure stipulated for determining capital adequacy.

Estimation of the scaling factor

Article 439 point (i) CRR

Own estimates for determining the scaling factor are not in use.

CREDIT RISK MITIGATION

Policies and processes for netting

Article 453 point (a) CRR

BAWAG Group has made use of off-balance-sheet netting since 31 December 2008. Netting pertains exclusively to derivative instruments with counterparties that have signed a corresponding master agreement entitling BAWAG Group to undertake netting. In the case of additional agreements covering open receivables by collateral (Credit Support Annex) BAWAG Group intends to include as much derivatives as possible by the CSA-Agreement. Furthermore, attention is paid to the low correlation between the probabilities of default of the debtor and the security.

Netting is applied to the entire derivative business. 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. All netting cases are regulated by an adequate standardized process. Data are maintained and calculated via an EDP-supported system.

Credit risk mitigation techniques in the internal rating based approach

Article 452 point (b) (iii) CRR

The Credit Collateral Catalogue is the main tool in determining the eligibility of a certain collateral. The list shows the possible combinations of types of collateral and types of goods, their eligibility in each risk approach and the assignment to CRR collateral types. The principles underlying the credit risk mitigation techniques are presented from the perspective of internal risk management. In addition, the Credit Collateral Catalogue describes the material minimum regulatory requirements for each type of collateral. Compliance with the quality requirements is checked when the collateral is presented by the customer, in connection with the loan decision and when entered, by selecting the collateral key for it.

During the calculation of risk-weighted assets, the reliability of delivered collateral is checked and, where there is leeway to act, it is assigned to the individual exposure items after taking into account the stipulated discounts.

Types of collateral and collateral valuation and management

Article 453 points (b) – (c) CRR

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

- BAWAG Group has the right to accept or reject collateral or to assign to collateral the value deemed necessary and reasonable in order to protect the group´s interests.
- The Credit Collateral Catalogue defines what combinations of goods (characteristics of the economic good/asset) and collateral (to which BAWAG Group 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 if necessary 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 realize it.
- All collateral must have a market value that is easy to determine or an internally calculated value, and BAWAG Group 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 defined by the ERM.

The compliance of the collateral with the legal criteria and the policies is determined during the credit application process in the front office and reviewed 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:

Table 3: Types of collateral and collateral valuation and management

Type of collateral	Estimated values	Frequency of valuation
Financial collateral	Market value according e.g. current GEOS price data (with volatility adjustments taken into account)	Automatic daily valuation except for deposits at other banks
Residential real estate	Market value	The centralized Residential Real Estate Appraisal team determines the value of all residential properties in Austria on the basis of a standard methodology and valuation tool. Valuation of real estate properties in other countries is also done by independent experts according to international standards. The periodic review and updating of property values is automated based on the real estate price index published by the Association of Real Estate and Asset Trustees of the Austrian Federal Economic Chamber (Fachverband der Immobilien- und Vermögenstreuhänder der Wirtschaftskammer Österreich) for Austrian residential properties, on the Halifax House Price Index for residential properties in Great Britain and by MAC (MeilleursAgents.com) for French residential properties. The values of the properties in the Netherlands are periodically updated based on CBS index (Centraal Bureau voor de Statistiek) and the real estate properties situated in Germany are periodically checked with the help of the market volatility concept ("Marktschwankungskonzept").
Commercial real estate	Market value	The value of commercial real estate is assessed by an independent expert at the current market value, at the maximum. Once a year, the risk units additionally check whether any material changes have occurred. A new valuation is ordered where warranted. A new valuation is conducted by the Appraisal Real Estate Department at least every three years for loans > € 3 million and at least every five years for loans < € 3 million
Other physical collateral	Market value (no use for regulatory purposes)	At least once a year
Pledging or assignment of life insurance policies	Repurchase value (only classical and funds-oriented life insurances where the surrender value cannot be reduced are used for regulatory purposes)	Automatic updating of repurchase value (through the insurance platform). For all other insurance companies when data is not transmitted via the platform: The 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

Guarantors/counterparties for credit derivatives

Article 453 point (d) CRR

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. With respect to the eligibility of the guarantees, there are internal minimum requirements defined in the Underwriting Guidelines Commercial. These guidelines explain under which conditions the customers are allowed to get limits granted for derivative transactions and guarantees. For instance, the rules say that derivative limits may only be granted to banks with a very good credit rating (the equivalent of a minimum rating of A-[1)]). Any exceptions must be well-founded, separately requested and explicitly approved.

The small volume of hedging transactions that existed on the reporting date in the form of credit derivatives was concluded exclusively with major international banks rated AA or A.

Collateral risk concentrations

Article 453 point (e) CRR

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 order to cope with the potential concentration of the Credit Risk Mitigation techniques, large collateral providers list is provided within the Portfolio Steering Framework report on monthly basis. The list contains guarantors with collateral market value over € 50m and shows internal rating, net exposure towards BAWAG Group and specific comments for each guarantor explaining the usage of the guarantee. List is presented on monthly basis to the Portfolio Steering Committee and during the quarterly meeting is discussed in term of guarantee effectiveness and potential countermeasures.

VALUE ADJUSTMENTS AND RESERVES

Definition of 'past due', 'forborne loans and forbearance measures', 'impaired', 'general credit risk adjustments' and 'specific credit risk adjustments'

Article 442 point (a) and (b) CRR
Article 442 point (i) (i) CRR

Definition of 'past due'

According to the CRR, days past due begin once an obligor has breached an advised limit, has been advised a limit smaller than current outstandings, or has drawn credit without authorization and the underlying amount is material. Days past due for credit cards commence on the earliest maturity date. Also, a receivable is deemed past due if the counterparty failed to make their contractually agreed payments.

1) Rating given by the rating agency Standard & Poor's.

Definition of ‘Forborne loans and forbearance measures’

Measures of forbearance can be extended if borrowers face financial difficulties and are considered to be unable to meet contractual obligations. BAWAG Group has sound and transparent processes in place to define the conditions under which concessions, in the form of the modification of terms and conditions, may be granted. Depending on the customer segment, possible measures include the temporary postponement or reduction of interest or principal payments, the restructuring of credit facilities or other forbearance measures. In exceptional cases, a permanent reduction of interest rates may be granted.

Measures of forbearance or refinancing are instruments to ultimately reduce the existing risk and avoid default with respect to debt claims, if it is expected that a default can thereby be forestalled. However, forbearance measures are by no means used to avoid or postpone the recognition of an unavoidable impairment or disguise the level of credit risk resulting from forborne assets.

By implementing forbearance measures appropriate in terms of time and scope, BAWAG Group supports clients in maintaining financial stability. If the supporting measures are not successful, exposures will be recognized as non-performing and impaired according to regulatory and accounting standards. For clients or a group of clients where a default is identified, a provision is booked in accordance with internal guidelines.

For reporting as well as internal risk management purposes, BAWAG Group implemented processes and methods according to regulatory standards in order to identify exposures for which forbearance measures have been extended. These are classified as forborne.

Definition of ‘impaired’

A key feature of ECL estimation under IFRS 9 is the stage allocation of assets. If a financial asset shows a significant increase in credit risk (SICR) or is recognized as credit-impaired, the ECL estimate of the asset is the lifetime expected credit loss (stage 2 or stage 3), and the 12-month expected credit loss otherwise (stage 1).

Stage 1: 12-month ECLs

The 12-month calculation applies to all financial instruments at initial recognition (with a few exceptions, e.g. for purchased or originated financial assets that are credit-impaired on initial recognition “POCI”) and those which do not show a significant increase in credit risk since initial recognition (in the case of POCI, only the cumulative changes in lifetime expected losses since initial recognition are recognized).

Stages 2 and 3: Lifetime ECLs

When a financial instrument has been in stage 1, but a significant increase of credit risk since the initial recognition is observed, the instrument is transferred to stage 2. If the instrument’s credit risk increases further to the point that it is credit-impaired, the instrument is then transferred to stage 3. The measurement of the risk provisions for stage 2 and stage 3 are lifetime expected credit loss, estimated by lifetime risk parameters.

The Group examines the stage allocation of assets at each reporting date. The transfer criteria from stage 1 to stage 2 are in three pillars:

- quantitative criteria
- qualitative criteria
- backstop criterion

The quantitative criteria examine the worsening of lifetime PDs since the initial recognition, while the qualitative criteria gather additional information about the assets to assess the SICR. As an additional backstop criterion, payment in arrears is considered in the Group. If one of the criteria is satisfied, a financial instrument is transferred from stage 1 to stage 2. Hence, if none of transfer criteria is active, the asset is kept or reassigned to stage 1.

The quantitative criteria examine the financial asset's credit risk profile based on two aspects:

- the relative PD change
- the absolute PD change

If both indicators surpass the pre-determined thresholds and indicate a significant increase in credit risk, then the asset is transferred to stage 2.

The Qualitative criteria

Qualitative staging criteria factors selected by the Group are:

- Entry in watch list (non-retail customers)
- Entry in warning list (retail customers)
- Forbearance flag If one of these factors is flagged as active, a financial asset is transferred to stage 2.

Backstop criterion

As a backstop criterion, the Group employs payment in arrears for more than 30 days. All financial instruments that are more than 30 days past due would be transferred to stage 2, if not yet in stage 3. In cases where no staging factor is active, the exposure is automatically reassigned to stage 1.

Stage 3: Lifetime ECLs

At each reporting date, the Group assesses whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or group of financial assets is impaired, and impairment losses are incurred if:

- there is objective evidence of impairment as a result of a loss event that occurred after the initial recognition of the asset and up to the reporting date ("a loss event");
- the loss event had an impact on the estimated future cash flows of the financial asset or the group of financial assets; and
- a reliable estimate of the loss amount can be made.

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

RATING SYSTEMS AND RATING PROCESSES

External ratings systems

Article 444 points (a) – (d) CRR

The weighted exposure amounts are calculated for regulatory purposes for a part of the loan portfolio (banks, subsidiaries in TPU) using the standardized credit risk approach according to Part 3 Title II Chapter 2 of the CRR. It is generally geared solely to ratings from Moody's.

The distinction between issuer rating and issue rating as described in Article 139 CRR is taken into account when external ratings are used. Issuer ratings are used in particular only if no issue rating is available and the conditions in Article 139 CRR are satisfied.

The commission implementing regulation (EU) 2016/1799 is consulted with regard to the mapping of external ratings to the individual Credit Quality Steps. The following table shows the relationship of the application of the ratings of ECAI for specific exposure classes.

Table 4: Mapping of external ratings to the individual Credit Quality Steps

Exposure Classes acc. to Article 112 CRR	Moody's	S&P	Fitch
Central Governments or Central Banks	X		
Regional Governments or local authorities	X		
Public Sector entities	X		
Multilateral Development Banks	X		
International Organisations	X		
Institutions	X		
Corporates	X		
Retail Exposures			
Secured by mortgages on immovable property			
In Default	X		
Associated with particularly high risk			
Covered Bonds	X		
Securitization positions	X	X	X
Exposures to Institutions and corporates with a short-term credit assessment			
Units or shares in Collective Investment undertakings	X		
Equity			
Other items			

The assignment of Ratings is based on a daily data feed of the ECAI Moody's which is processed in the IT systems of the bank. This data is joined with the client or, respectively, security master data automatically in order to safeguard an up-to-date and – in terms of the calculation of own funds requirements – complete set of input data.

Internal rating systems

Article 452 point (b) (i) CRR

Customer segmentation and overview of the internal rating systems

BAWAG Group employs internal rating and scoring systems for its own risk management. Customers are assigned to 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 defined parameters.

The relevant rating and scoring process is determined based on these criteria and, in retail business, also on the selected product. Individual regulations of the CRR 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 following table summarizes the significant rating and scoring models for the customer segments Banks as well as Commercial and Retail Customers. Beyond that, rating systems applied in accordance with the standardized approach are used for customer groups.

Table 5: Overview of rating and scoring systems

	Rating system	Model type	BAWAG P.S.K.	Others[1)]
	Corporate Standard	log. regression	x	x
	Cash Based Accounting	Expert model	x	x
	Commercial Real Estate	log. regression	x	x
	Social Housing	Expert model	x	x
Corporates	Specialised Lending	Cash Flow Model	x	x
Banks	Banks	log. regression	x	x
	AS[2)] – Overdraft	log. regression	x	x
	AS – Consumer Loan	log. regression	x	x
	AS – Mortgage Loan	log. regression	x	x
	AS – CoBranded Credit Card	log. regression	x	x
	AS – Small Business Retail	log. regression	x	x
	BS[3)] – Loan	log. regression	x	x
	BS – Current Account Private	log. regression	x	x
	BS – Currant Account Others	log. regression	x	x
	BS – Credit Card	log. regression	x	x
Retail	BS – SME Account	log. regression	x	x

1) Other institutions.
2) AS stands for application scoring.
3) BS stands for behavioral scoring.

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.

Relationship between internal and external ratings

Ratings from Moody's are employed to calculate the minimum capital requirements for regulatory purposes which are applied in accordance with permanent or temporary partial use. For securitizations, 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 following table shows the relationship between the internal rating notches and the external ratings.

Table 6: Rating notches and classes for all segments

	External rating agencies		
Rating notch	Moody's	S&P	Fitch
1,1	Aaa[1]	AAA[1]	AAA[1]
1,2	Aaa[1] , Aa1	AAA[1], AA+	AAA[1], 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

1) Aaa and AAA correspond to Class 1,1 for sovereigns and to Class 1,2 for all other segments.

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).

Rating systems and processes in the retail segment

Article 452 point (b) (i) CRR
Article 452 point (c) (iv) CRR

Retail private customers

Retail private 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 which can be recorded as a debit is opened or the customer or product information change, retail customers are subject to an application scoring for determining their rating. After a product relationship lasts six months (at the earliest), they are subject to an automatic monthly behavioral scoring.

Application scoring
Application scoring is based on the product and on the different scorecards for the product categories:

- loans for which real estate was provided as collateral
- current accounts
- non-collateralized standard loan facilities
- 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 up to certain risk class or score thresholds. 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 authorized employees in sales. Only authorized staff in the risk centers is 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, and household account) and credit application information (e.g. loan amount). These characteristics are checked for compliance with credit extension guidelines in keeping with the rules for decision making.

Application scoring for credit cards
For credit cards for current account holders, a rating check which consists of the personal data of the customer and the product data is necessary. An appropriate risk class is assigned to the customer on this basis.

Co-branded credit cards are credit cards that are issued jointly with organizations or companies outside the financial sector and that are managed within BAWAG Group. These co-branded credit cards are assigned to a product-based risk class and to a ‘decision recommendation’.

Application scoring for consumer loans
For standard loans, BAWAG Group 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.

Behavioral scoring
A distinction by product group is made in behavioral scoring. Payment accounts (e.g. salary accounts) are divided into three different scorecards. Credit products as well as credit cards are in each case grouped in a single scorecard. Payment behavior and product specifics are incorporated in all scorecards to calculate a behavioral scoring risk class.

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

Forming the customer risk class
Every month, BAWAG Group conducts an aggregation to create a customer risk class from the different procedures for application scoring and behavioral scoring for the individual products. This is done at least once at the end of the month – if behavioral 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.

Small and medium-sized enterprises

The Retail category takes in all enterprises with operating revenues of less than € 50 million and an exposure (for the entire customer group) of less than € 1 million in BAWAG Group If these enterprises cannot be assigned to a special rating based on business purposes (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 behavioral 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 behavior) as well as additional items of external and internal information (e.g. warning list, credit bureau [Kreditschutzverband von 1870 (KSV)], CRIF).

BAWAG Group 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 AustriaTM model from Moody's KMV is used for the financial rating for businesses that use accrual accounting and that have more than € 0.5 million in operating revenue. Information from the commercial customer portfolio was instrumental in the development of that model.

Like the other rating models, this system is also subject to a validation process on an annual basis and ongoing enhancements.

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 behavioral 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.

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

Behavioral scoring is independent of the retail segment Private or Small Business. It is geared to product behavior.

Forming the customer risk class
Every month, BAWAG Group conducts an aggregation to create a customer risk class from application scoring and behavioral 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.

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

Article 452 point (c) (i – iii and v) CRR
Article 452 CRR

The rating systems must be applied to corporates and institutions that avail themselves of an exposure at BAWAG 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 BAWAG Group's own portfolio and Treasury products.

The rating process for corporates basically calls for the customer advisor to solicit information relevant to the rating and conduct a qualitative assessment of the customer (rating based on soft facts) in the central corporate data system. The customers' financial data is also centrally recorded and assessed (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; four-eye principle). It is altered if needed and confirmed in the system. The risk class must likewise be approved by the employee authorized 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.

Corporate Standard

This area of application pertains to companies 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 € 1 million or consolidated operating revenue equal to or greater than € 50 million.

The customer's risk class is calculated from a combination of a financial rating from a statistically based balance sheet rating and an assessment of qualitative characteristics (e.g. management, organization, market/sector, general factors, and account management). The risk analyst can overrule[1)] or override[2)] 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. support from dominant shareholders, personal partner with unlimited liability) or, under certain restricting circumstances, consideration of external ratings.

The system is subject of a yearly validation and ongoing enhancements, analogous to all rating systems. In 2017, the Corporate Standard modell was re-developed with the regulatory approval in April 2019.

Cash Based Accounting

This expert model covers Austrian counterparties with cash-based accounting in the exposure class 'corporates'. This model got the initial approval in 2013.

Corporate Real Estate

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 Corporate Standard Austria process. It combines hard-fact and soft-fact ratings which can be altered by overruling/override. The model was re-developed and reviewed by regulator in 2017. An approval from ECB was received in 2018.

Social 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.) which can be altered by overruling/override.

Specialised Lending

According to the CRR, Specialised Lending refers to exposures created in relation to companies specially set up to finance or operate real properties that comply with the criteria set down in Article 147 (8) point (a) to (c). For Specialised Lending BAWAG Group applies the regulatory Slotting Approach. The first model, which used qualitative criteria to assign a slot, was replaced by a cash flow tool in 2017. Based on cash flow predictions for the whole maturity a probability of default is calculated for different risk drivers (e.g. interest rate risk, rental risk, sales risk). Additionally, the expected loss rate is determined for the project. The expected Loss is calculated based on Probability of Default and Loss Rate, which is mapped to a slot according to Article 158 (6) CRR.

Banks (institutions)

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

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

1) 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).
2) 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 authorized employee.

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. Finally, the confirmed rating is assigned to a certain probability of default based on the master scale. The rating model was refined in 2018 and will be used for pillar 2 purposes.

Participations

For participations, 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 155 CRR.

Central governments and central banks

The standardized 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's[1)], the risk weight is assigned to the six rating notches as follows:

Table 7: Description of ratings

Rating notch	1	2	3	4	5	6
	Aaa/Aa3	A1/A3	Baa1/Baa3	Ba1/Ba3	B1/B3	Under B3
Risk weight	0%	20%	50%	100%	100%	150%

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

A risk weight of 0% is assigned to risk positions to central governments and central banks of EEA member states denominated in the national currency of this central government and this central bank and refinanced in this currency.

Use of internal estimates

Article 452 point (b) (ii) CRR

The risk parameters in the rating systems are integral parts of the 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).

Control mechanism for rating systems

Article 452 point (b) (iv) CRR

In the course of the internal model development, the quality is assured by applying four-eye principle in a consistent way. Furthermore, validation reports on rating and scoring systems are prepared in course of an initial model validation or once a year. They are produced by a central risk management office for all rating models used throughout BAWAG Group and comprise the following activities:

1) Only ratings from Moody's are allowed.

Table 8: 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
Method 5.1	Testing of rating and scoring systems as regards calibration by comparing the mean forecast PD and the mean observed default rate
Method 5.2	Testing of individual risk classes as regards calibration by comparing the mean forecast PD and the mean observed default rate using binomial distribution tests
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	Analyses of migration matrices

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

Validation (VA) is the organizational unit responsible for validating the rating systems used in BAWAG Group. It reports directly to the CRO.

Additionally, the following categories are prepared regularly as part of standardized monitoring reports:

- distribution of the customers and exposures across the Basel segments according to CRR, an internal subdivision of the exposure classes
- distribution of the risk classes across the Basel segments according to CRR
- risk classes based on overruling
- discriminatory power of the rating and scoring system
- analyses regarding calibration

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

Besides the internal quality assurance in the course of the model development and the validation, internal audit conducts yearly assessments as well as in case of material model changes.

Estimation and validation of the risk parameters

Article 452 point (c) and (h) CRR
Article 452 CRR

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 as a default event throughout the Group. The definition of default corresponds to the regulatory reference definition ('90 days past due' and 'unlikely to pay) as set forth in Article 178 CRR. The new definition of default based on EBA/GL/2016/07 including the lower materiality thresholds of Regulation (EU) 2018/1845 was introduced on 1st July 2020.

Table 9: Description of the reference definitions for default

Reference definition for default	Description
90 days past due	More than 1% of the groupwide on-balance exposure is more than 90 days past due..
Unlikely to pay (UTP)	Restructuring (e.g. non-accrued status, distressed restructuring …)
	Specific credit risk adjustments (e.g. manual loan loss provisions, write-offs ...)
	Soft and hard UTP triggers (e.g. licence withdrawn, repayment gap ….)
	Legal proceedings (filing for bankruptcy, bankruptcies ...)

At present, BAWAG Group mainly uses statistical PD estimation models. The models are calibrated based on long-term average rates of default, going back till 2008, 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, utilization 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 rate of default actually observed. The stability of the estimation models is also observed over extended periods of time.

In the previous period, no significant deviation of predicted and observed default rates were identified for the key PD estimation models.

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 realization of collateral and other non-collateral proceeds.

Internal Bank estimates are only carried out 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-collateralized portion of the exposure, a non-collateralized 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-collateralized 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 since 2008 were used for model development as long as the data were of sufficient quality and were 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.

Credit conversion factor

The credit conversion factor (CCF) is the expected utilization 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 exposure at default (EAD).

Internal Bank estimates are only carried out 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 since 2008 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.

MARKET RISK

OBJECTIVES AND PRINCIPLES OF THE MANAGEMENT OF MARKET RISK

Article 435 (1) points (a - d) CRR
Article 449 point (m) CRR

Strategies and processes

BAWAG Group has a clearly defined market risk appetite framework. The Group's market risk strategy has a focus on balance sheet hedging and mitigating earnings (volatility of Net Interest Income, Gains & Losses and Other Comprehensive Income) and economic risks arising from market risk factors. Consequently, the bank has decided to discontinue all trading book activities. This risk appetite is reflected in the bank's limit framework, which ensures the management of the respective risk categories within narrow limits.

The quantification and monitoring of market risks comprise of interest rate risk, volatility risk, credit spread risk, funds risk and foreign currency exchange risk. The measurement and monitoring of risk positions is provided by applying sensitivity analyses as well as the analysis of the associated loss potential derived from periodic stress tests. The steering of risks is achieved through setting limits for the individual types of risk, which are approved by the Management Board.

The objectives of the limit system are 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 utilization 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 capacity and, thereafter, of risk appetite in the scope of the overall ICAAP framework.

Structure and organization of relevant risk management functions

The division Risk Controlling (RX) reports directly to the CRO. The division is responsible for steering, measurement, and controlling of liquidity and market risk of BAWAG Group. The most important responsibilities concern the monitoring of market risk, in particular interest rate risk, volatility risk, credit spread risk and foreign currency exchange risk. This is achieved through the limitation of the individual types of risk, whereby in this regard it is RX's responsibility to set such limits as approved by the Management Board within the ICAAP.

Additionally, within the area of Market Risk, the counterparty credit risk monitoring of Treasury positions is located.

The relevant committee with regard to market risk is the Strategic Asset Liability Committee (SALCO). Topics in the context of total risk including ICAAP are handled within Enterprise Risk Meeting (ERM).

Market Risk limit framework

Market risks are limited at least at two levels at a minimum, and where regulatory limits apply, at three levels:

- by ICAAP limits within the context of overall bank risk management (e.g. VaR)
- operational limits for the management of the specific risk category (e.g. PVBP limits, Greeks limits, volume limits, etc. including limits by accounting method and time bands).
- regulatory limits (e.g. the Outlier Ratio of 20% for interest rate risk)

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 IFRS. The basis point value is also sub-divided into maturity ranges and limited 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. In general, BAWAG Group follows the strategy of minimizing or avoiding foreign currency risk in the banking book.

In addition, a limit framework has been set up to capture the impact of interest rate changes on the bank's future earnings capacity and the resultant implications for internal capital buffer levels. The (cumulative) net interest income risk limit handles the impact on the future earnings capacity/planned NII in a stress scenario over the three-year planning horizon.

In addition to and as part of the ICAAP, both historical VaR and various stress tests are reported for the economic and normative ICAAP perspective respectively.

Reporting systems

The market risk reporting comprises of internal and external risk reporting. Limit compliance is checked daily for FX risk and Interest Rate Risk-BPV and reported to the Management Board. Compliance with the basis-point value limits (enterprise and maturity range limits as well as limits relevant to OCI and P&L for interest rate risk and credit spread risk) is monitored monthly at institution and Group level.

Furthermore, stress tests, reverse stress tests and scenario analyses are conducted. Intended future measures are included in all reports as needed. A net-interest-income simulation (NII simulation) with associated stress tests is performed monthly.

All relevant key figures along with the stress tests, are reported to the SALCO or as part of the Group Risk Report to the ERM. A VaR is calculated monthly at the Group level.

External reporting comprises of the reporting to the Joint Supervisory Team.

Risk hedging and mitigation

Market risks are steered within the applicable limit framework.

To manage market risks within the economic and earnings perspective, the division Treasury & Markets (TM) develops hedging and positioning strategies.

To steer the volatility of Gains & Losses and Other Comprehensive Income, BAWAG Group applies hedge accounting pursuant to IAS 39. The following hedge accounting methods are currently used:

- Micro fair value hedge: hedging against the risk of interest rate changes for fixed-interest instruments held as assets and liabilities.
- Portfolio fair value hedge ('EU carve-out'): application to sub portfolios of sight deposits.
- Cash flow hedge accounting: hedging of FX risks of future spread in-come and cross currency basis risks.
- Net investment hedge accounting: hedging FX risk arising from participations in foreign currency.

Interest rate derivatives that are not assigned to a hedge accounting relationship are recognized at their fair values.

For AGAAP accounting, BAWAG Group uses a macro-hedge as specified in the FMA circular letter on accounting issues in connection with derivatives for managing interest rate risk. The management of interest rate risk covers all interest-bearing positions derivatives business in the banking book. Non-interest-bearing positions (equity capital, participations, etc.) are excluded from the macro-hedge.

INTERNAL MODELS FOR LIMITATION OF MARKET RISK

Article 455 point (a) (i - iv) CRR

BAWAG Group does not make use of an internal model to calculate its own funds requirements for market risk.

INTEREST RATE RISK FROM POSITIONS NOT HELD IN THE TRADING BOOK[1)]

Article 435 (1) point (a - d) CRR
Article 448 point (a), (b) CRR

Measurement of interest rate risk

The methods currently used for the banking book include sensitivity analysis, stress tests and value-at-risk as well as volume limits for open positions.

The interest rate risk in the banking book is measured at least monthly. An analysis of interest rate risk is conducted for subsidiary banks and interest rate risk relevant other financial institutions.

There are two complementary methods of measuring the potential impact of IRRBB:

- Present value perspective (changes in economic value - EV, or EVE when measuring the change in value relative to equity): Account is taken of risks resulting from changes in the market value of transactions accompanied by shifts in interest rate curves. Changed interest rate curves are simulated for the main currencies in the monthly stress tests.

  In addition to and as part of the ICAAP, the VaR is also reported for the economic steering circle.

- Income perspective: Risks that may cause an unexpected decline in the interest margin (interest margin risk, impact of possible interest rate scenarios).

Present Value perspective

Economic value of equity (EVE): the change of EVE (ΔEVE), represents a risk measure, which is the present value change in EVE, meaning, in the net present value of the balance sheet excl. equity under a particular interest rate stress scenario.

The PVBP (Present Value of Basis Point) is the difference between the Net Present Value (NPV) based on the yield curve shifted by 1bp and the NPV based on the current yield curve. The NPV is calculated based on a discounted cash flow full valuation method. The NPV is obtained either by discounting the expected cash flows of the contract (Marked to Model) or using a given Market Value observation of the contract (Marked to Market).

1) Please note that the text was amended on September 28, 2021 to consider additional information in accordance with regulatory requirements.

The following table depicts BAWAG Group's interest rate risk sensitivities as of 31 December 2020 on the basis of the PVBP concept:

Table 10: Interest rate sensitivities

31.12.2020 in EUR thousand	<1Y	1Y–3Y	3Y–5Y	5Y–7Y	7Y–10Y	>10Y	Total
EUR	8	(271)	(289)	32	832	394	705
USD	(7)	(76)	(31)	(11)	28	0	(98)
CHF	4	2	(1)	(5)	(9)	(7)	(15)
GBP	13	(8)	(5)	(2)	0	0	(3)
Other currencies	(5)	(17)	(6)	0	0	0	(28)
Total	13	(370)	(331)	13	851	387	561

For the VaR (Value at Risk) within ICAAP the Group applies a historical simulation combined with a general hyperbolic distribution. Based on the market data history, monthly loss scenarios are defined. The time intervals are not overlapping to ensure independent scenarios. To prevent the underestimation of heavy tails, special cases (including the most general one) of a flexible family of distributions – the generalized hyperbolic (ghyp) distributions – is calibrated to the defined loss scenarios. For each a 1-year VaR is determined and finally, a robust mean is calculated to minimize the model risk. Several well-known distributions (normal distribution, student-t-distribution, normal inverse gauss distribution) belong to the ghyp family.

Income perspective

Net interest income risk is quantified through the simulation of future interest income and expense under various scenarios. The analysis incorporates all of the Group's NII-relevant assets, liabilities, and off-balance instruments. On-balance-sheet contracts with maturities scheduled within the simulation period are replaced upon runoff with planned new business volumes & margins, thereby reflecting the general ALM policy of the bank.

The market rate scenarios applied cover parallel and non-parallel upward and downward shifts of relevant yield curves, thereby incorporating limits to the degree to which rates are allowed to drop below zero.

Furthermore, loan prepayment rates (which govern the early redemption of a certain portion of the loans under a given market rate scenario) are also modelled along with alternate new volume, rate and margin scenarios.

Hedging strategies, for example the hedging of FX credit spread risk and non-maturity deposits, are generally assumed to be continued through the end of the simulation horizon.

Variation in earnings and economic value

Based on the internal interest rate risk measurement model, the following tables show BAWAG Group's variation in both, NII and EVE in case of an upward and downward rate shocks (in line with Article 113 of EBA/GL/2018/02 Guidelines on the management of interest rate risk arising from non-trading book activities), broken down by currency.

Table 11: Instantaneous change of the economic value of equity

in EUR million	200bp	(200)bp
Total	228	69
EUR	211	18
USD	3	49
GBP	9	4
CHF	6	(4)
OFX	(1)	2

Table 12: Change of the forecasted net interest income within 12 months

in EUR million	200bp	(200)bp
Total	178	(26)
EUR	179	(36)
USD	(0)	13
GBP	3	(5)
CHF	1	0
OFX	(5)	2

Assumptions regarding Non-Maturity Positions

For positions without a defined interest rate (non-maturity positions), BAWAG Group applies 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 components:

- Future oriented interest rate scenarios derived based on a forward-looking 2-Factor Hull/White Model.
- Client rate prediction based on historical data. Client rates are expressed as functions of market interest rates - the model applies return-based regression models. The functions are then used to estimate client rates for each interest rate scenario.
- Volume prediction: volume trends are developed according to plan figures; seasonal fluctuations are captured by time series models.
- Optimization: The model defines the optimal replication portfolio satisfying a set of liquidity, regulatory and internally defined constraints.

The duration of the replication model is constrained in accordance with EBA guidelines for each product group. Furthermore, the bank has defined a set of different model constraints in order to reflect different types of risk appetite (conservative, moderate, liberal) and mitigate inherent model risks.

Retail non-maturity deposits (NMDs) of BAWAG Group are generally classified into transactional and non-transactional portfolios or further sub-portfolios depending on the product characteristics. The transactional accounts have a duration ranging from 2.98 to 3.14 years, depending on the product's characteristics, due to stable long-term core deposits. The duration of non-transactional accounts, predominantly savings products, is 2.5 years.

Commercial NMDs of BAWAG Group have a duration ranging from 1.08 to 1.56 years.

The interest rate replication model is reviewed and validated once a year. Back-testing and the adjustment of replication assumptions are carried out prior to the planning process.

Assessment of call rights and prepayment behavior

The measurement of interest rate risk also considers embedded call rights and customer prepayment behavior. To determine the value of such embedded options, two different approaches are applied:

- Rational right holders: For professional market participants (e.g. large corporate customers), who are able and willing to take action if prevailing market conditions are in their favour, rational behaviour is assumed. For such clients call and termination rights are valued using the method of replication with swaptions.
- Behaviour-based assessment: For clients who do not fulfil the assumption of a rational acting right holder (e.g. retail and SME customers), prepayments are modelled on the basis of historically observed behaviour of homogeneous customer groups.

The prepayment models capture historical dependencies between past prepayment rates, market interest rates and portfolio specific parameters (e.g. weighted average maturity). It does so using a time series lasso regression (with fixed-origin rolling cross validation). In addition to own developed models, also expert estimates as well as externally derived information is applied.

The selected model is used to make a one-year estimate for future prepayments in a form of a Conditional Prepayment Rate (CPR) p.a.

The CPR of retail loans ranges between 2.5% p.a. and 35% p.a. depending on the market and characteristics of the product. Commercial loans prepay with a CPR ranging between 0.9% p.a. and 35% p.a.

In addition to prepayment models relevant for the assets, a model was developed for savings deposits to derive the early termination rate (ETR) from the 10-year data history. The ETR amounts to 2.5% p.a.

Scenario analysis

A static and a dynamic analysis is currently being carried out for BAWAG Group (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 analyzed 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, +/-300 bp) as well as non-parallel shifts (flattening, steepening).
- Worst case scenario (derived from historical time series).
- Regulatory scenarios based on EBA/GL/2018/02 Guidelines on the management of interest rate risk arising from non-trading book activities.
- Forward looking scenarios based on macroeconomic expectations.
- Other scenarios as required.

In the dynamic simulation of interest income, different scenarios are investigated along with their impact on net interest income (parallel and non-parallel shifts of the yield curve).

Interest risk reporting systems

The entire Management Board is informed monthly about all risks in the SALCO based on the comprehensive Market Risk Report and in the ERM (part of Group Risk Report). In addition, the entire Management Board is informed immediately in case of any material change in the risk situation.

OPERATIONAL RISK

The definition of operational risk refers to ‘the risk of losses due to inadequacy or failure of internal processes, people and systems or due to external events’. This definition includes all its subtypes e.g. legal risk, compliance risk, outsourcing risk, conduct risk and ICT risk.

STRATEGIES, PROCESSES AND MANAGEMENT

Article 435 (1) point (a) CRR

A clear organizational structure and authorization levels form the basis of operational risk governance. Operational risks are managed by established group wide processes for loss data collection via OpRisk Monitor (ORM), yearly risk assessment process for all divisions and subsidiaries, uniform materiality and risk assessment of outsourcing activities, sound product implementation process (PIP), as well as monthly key risk indicators.

By exceedance of defined thresholds e.g. red KRI, high risks identified mandatory measures for risk mitigation are agreed and monitored. In addition, BAWAG Group works continuously to bolster defenses against cyber-attacks. The selected security approach is based on regulatory requirements and the security policy set.

A consistent guideline and a risk-adequate internal control system (including automated controls embedded in the IT infrastructure) as well as security control set including a variety of organizational and technological measures are in place to manage and mitigate BAWAG Group’s operational risk. Aligned teams in the first and second line of defense ensure the implementation and effectiveness of these measures.

STRUCTURE AND ORGANIZATION OF OPERATIONAL RISK MANAGEMENT

Article 435 (1) point (b) CRR

The guidelines for operational risks management are defined in the ‘OpRisk Management Policy’, the ‘IKS Policy’, the ‘Outsourcing Policy’, the ‘Product Implementation Process Policy’ and in the respective internal manuals and technical documentations. Within the ‘OpRisk Management Policy’, the Management Board determines principles for the management of operational risks that are applicable throughout the Group. These activities are coordinated centrally by the unit Operational Risk & ICS in order to ensure a common approach. 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. All employees are responsible to identify operational risks and to proceed according to the appropriate regulation.

RISK MEASUREMENT SYSTEMS

Article 435 (1) point (c) CRR

The following risk measurement systems are in use:

Loss data collection

Events, losses, profits, recoveries and near-losses resulting from operational risks in the business segments and areas are collected continuously as part of an institutionalized loss reporting system to provide a database for the management of operational risks (decentralized capturing in an intranet application).

The losses resulting from operational risk are collected in a centrally administrated web-based database within clearly defined regulations and processes. The collected data are analyzed to identify patterns/clusters and faulty processes.

Definitions:

- Operational risk events are incidents occurring during a business process that affects other than expected owing to inadequacy and failure of internal processes, people, 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.
- Losses from operational risks result from operational risk events with a negative financial impact. 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 and timing of the events, they might reflect the existing or historical environment of the checks.
- Profit from operational risks has a positive financial impact. 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. Therefore, these events provide valuable clues to risk management.
- Recoveries refer to the reduction of a loss (e.g. insurance). Operational risk recoveries are divided into insurance recoveries and other recoveries.

  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 caused by this event.

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

- Losses, which had a high probability ('near-losses') are risk events that ultimately did not result in a financial impact. Near losses refer to mistakes, system failures or process accidents that could have a negative financial effect but have no impact thanks to favourable circumstances. The identification of near losses can open up possibilities for improving system structures and processes and reducing the extent of loss that occurs. A near loss is an event signalling that a system or process weakness can result in losses if not remedied.

Risk Control Self Assessment (RCSA)

Annual RCSA per business unit (division/subsidiary)

Using the RCSAs framework, all organizational units and subsidiaries identify and assess their material processes, operational risks, the risk of disregarding regulatory requirements and the effectiveness of their control measures on a yearly basis via a uniform framework. This includes the assessment of individual control measures, the estimation of probabilities and the extent of losses arising from individual risks. A link to the Business Continuity Plan and Business Impact Analysis is also established within the RCSA. In addition, the responsible divisions and subsidiaries define worst-case estimations.

Each year individual key topics are examined and assessed based on internal and external necessity.

If the risk potential exceeds a defined limit, the implementation of appropriate measures is mandatory. Their implementation is subject to continuous subsequent monitoring. An intranet application enables all divisions to make decentralized enquiries about the agreed actions and to process and report the completion of these actions in a decentralized way.

Ad-hoc RCSA

The identification and assessment of potential risks and measures in the case of ad hoc issues is realized through clearly defined processes, especially for outsourcings and the implementation of new products and new systems.

Outsourcing RCSA

An Outsourcing RCSA must be conducted mandatorily for significant outsourcing -projects. The object of this RCSA is to identify and assess any operational risks associated with outsourcing projects and must be performed before an agreement is signed so the risk assessment findings can be incorporated in the contract.

Outsourcing specifications are defined in the outsourcing policy. Along with operational risk, the policy covers the assessment of other risks such as strategic risks, regulatory risks and risks from collaborating with business partners.

Key Risk Indicators

Key Risk Indicators (KRIs) show risks in the banking processes and indicate signal change in the risk profile in a timely manner in order to identify and forecast negative trends or a changed risk profile in company workflows and divisions/subsidiaries in a timely manner.

Based on the results from the annual RCSAs, the main operational risks are identified and used as the basis for the elaboration or annual review of the definition and threshold values of the KRIs. Each KRI is valued using a traffic light system (red / yellow / green) and reported monthly to the divisions and subsidiaries. If the thresholds are exceeded, an intensified observation (yellow) or a mandatory measure for risk reduction (red) must be specified. The measures and their implementation are constantly monitored and reported periodically.

Operational Risk assessment of new business segments or products

New business segments or products have to be introduced by using a product implementation process in which all defined divisions submit their vote and any possible conditions in an end-to-end analysis of the process. The responsible department conducts the ICS.

Latitude of Judgment and Uncertainty of Estimates – City of Linz

Uncertainties in estimations also apply to the claim of BAWAG Group against the City of Linz. On 12 February 2007, the City of Linz and BAWAG Group concluded a swap agreement. This transaction was intended by the City of Linz to optimize a CHF bond (please note that the party to the transaction and consequently the lawsuit is BAWAG P.S.K. AG, a subsidiary of BAWAG Group AG).

Because of the development of the Swiss franc exchange rate starting in the autumn of 2009, the City of Linz was obligated to make increased contractual payments to BAWAG Group. On 13 October 2011, the Linz City Council decided that it would make no more payments in connection with the swap agreement. Consequently, BAWAG Group exercised its right to close out the transaction.

The City of Linz filed a lawsuit against BAWAG Group at the Commercial Court of Vienna (court of first instance) at the beginning of November 2011 seeking payment of CHF 30.6 million (equaling € 24.2 million at the exchange rate at that time), which corresponds to the net cash payments made by the City of Linz whilst performing the swap agreement. BAWAG Group filed a (counter) suit against the City of Linz for the fulfillment of its contractual entitlements from the same transaction in the amount of € 417.7 million, which mainly reflects close-out costs BAWAG Group incurred. The court combined the two suits. The first hearings were held in the spring of 2013 and a court commissioned expert opinion as well as a supplementary opinion thereto were submitted in August 2016 and December 2017. On 8 April 2019, the City of Linz filed a motion for an interim judgment (*Zwischenurteil*) with respect to their CHF 30.6 million claim to determine whether the swap agreement is valid. The court responded to such motion with a separation of the previously combined two proceedings and suspended BAWAG Group's (counter) claim pending the outcome of the interim judgment (*Zwischenurteil*). On 7 January 2020, the court of first instance issued an interim judgment (*Zwischenurteil*) in which it held that the swap agreement is void. The Court of Appeal confirmed the interim judgment (*Zwischenurteil*) of the court of first instance on 31 March 2021 and permitted a regular appeal (*ordentliche Revision*) to the Supreme Court. BAWAG Group filed its appeal to the Supreme Court on 4 May 2021 and the decision of the Supreme Court is outstanding.

The interim judgment relates to the validity of the swap agreement only and is not a decision on the mutual payment claims of BAWAG Group and the City of Linz. Therefore, notwithstanding the final decision on the validity of the swap agreement by the Supreme Court, ultimately mutual payment claims will be decided by the court of first instance and potentially (again) the Court of Appeal and the Supreme Court. BAWAG Group therefore takes the view that its strong legal position remains unchanged and is well prepared for the forthcoming court proceedings. It is difficult to assess how much longer the lawsuit is going to continue. However, based on experience it is assumed that the further legal proceedings until a final judgment is enforceable will take several years.

Future court decisions on the validity of the swap agreement may impact the recognition of the receivable asserted thereunder. In case the swap agreement is held void by the Supreme Court, BAWAG Group would have to de-recognize the receivable against City of Linz. A potential consequential damage claim resulting thereof would only be recognized after a final judgment has determined the amount awarded to BAWAG Group. In addition, even if the courts ultimately were to hold that the swap agreement is valid, BAWAG Group may still not be awarded, in full or in part, the payment sought, in which case it may also be required to further write down its receivable.

BAWAG Group has valued the transaction until termination according to the general principles (see Note 1 Accounting policies in Annual Report) and has adequately accounted for the risks associated with the claim arising from the swap agreement. In particular, management had to estimate the risks that are associated with the transaction, such as non-payment, legal, process and other operational risks and had to make judgements as part of the continuous valuation process; this resulted in a respective valuation adjustment.

After the termination of the transaction, the swap was derecognized, and a receivable was recognized under Receivables from customers (classified under At amortized cost – receivables from customers). In 2011, when derecognizing the swap, a credit value adjustment of € 164 million (equals around 40% of € 417.7 million) was set off against the gross receivable, thus a new receivable was recognized in the amount of approximately € 254 million.

Stress tests

Operational Risk is part of stress testing activities. For the semi-annual stress test the operational risk stress-parameter are defined as expert estimation based on macroeconomic stress-scenarios. The impacts are calculated on the basis of the historical loss data. An operational stress test scenario was developed for the reverse stress test activities but has a very limited probability of occurrence.

Risk reporting systems

Reports are produced periodically on material operational risks and on the actions needed to prevent similar future risks. These documents enable the Management Board and the DH to manage operational risks and minimize possible losses arising from those risks.

- The ERM receives a summary of the P&L impact the KRIs, the quantified RCSA results and the regulatory own funds requirements, as well as the ICAAP limit including the utilization as part of the Group Risk Report.
- The divisions and the subsidiaries receive periodic summaries of the losses, RCSA-results, KRIs and the open measures.
- The results from the annual and ad hoc RCSAs are reported in separate RCSA reports to the respective DH, to the responsible board member, the CRO, and Internal Audit.
- The results from the Outsourcing RCSAs are reported periodically in the NFR&ESGC.
- Relevant PIPs are reported periodically in the NFR&ESGC.
- An overview of all pending measures for reducing operational risk (as set forth in the RCSA and the PIP) is reported via NFR&ESGC to the responsible board member quarterly.

RISK HEDGING AND MITIGATION

Article 435 (1) point (d) CRR

BAWAG Group has laid the basis for operational risk mitigation with its segmented organizational structure, clear rules on competencies and responsibilities and work instructions. In addition, consistent guidelines on corporate authorization levels help to achieve the goal of a controlled risk situation, as well as the implemented ICS, which (adequately) captures the risk. The ICS does so, for example, by means of the four-eye principle, separation of functions, access checks, limited authorizations, computer-assisted plausibility checks and system tests. Also a central regulated insurance management helps to hedge the risks.

OWN FUND REQUIREMENTS

Article 446 CRR

The regulatory own fund requirements for operational risks are calculated by using the standardized approach pursuant to the Article 317 CRR. The advanced measurement approach pursuant to the Article 321 CRR is currently not applied.

Therefore, it is not subject to disclosure obligations in accordance with the Article 454 CRR.

LIQUIDITY RISK

Article 435 (1) points (a) – (d) CRR

STRATEGIES, PROCESSES AND MANAGEMENT

The ALM team in division Treasury & Markets (TM) and the SALCO (Strategic Asset Liability Committee) handle liquidity management throughout the Group. Risk Controlling (RX) independently measures and monitors liquidity 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.
- Liquidity represents together with capital the most important scarce resource of the bank and must therefore be controlled.
- Liquidity has a price that fluctuates with supply and demand.
- Primary responsibility for liquidity management is allocated to the division TM, which is part of the CFO organization. Within TM, the TMA department is tasked with the main responsibility for liquidity management including acting as the central function with control to monetize the liquidity buffer.
- ALM does not pursue its own profitability goals in the process.
- BAWAG Group follows a centralized approach to liquidity management. This includes that the size and quality of the liquidity buffers, liquidity risk relevant KPI's, the funding strategy and the execution of refinancing measures as well as the disposition of excess liquidity is determined by BAWAG Group and aligned with its subsidiaries. Subsidiaries are generally expected in accordance with their governance and legal or regulatory constraints (e.g. legal lending limits, LCR inflow caps etc.) to refinance their funding needs or to deposit their excess liquidity with BAWAG P.S.K.
- RX is responsible for liquidity risk measurement, quantification, monitoring and controlling, and providing independent risk oversight.
- Control activities are geared primarily to liquidity cover, secondly to liquidity structure and thirdly to liquidity costs.
- Organizationally, ALM manages liquidity independently of the business areas, but the effects of liquidity actions are analyzed 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 counterparty for all business areas with respect to obtaining and extending liquidity.
- Liquidity control takes account of possible negative effects from risks to BAWAG Group'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 based on planning and forecast calculations for each currency
- Develop and maintain the strategic refinancing structure
- 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 and counterparties
- Optimize 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 regulatory limits for liquidity
- Invest excess liquidity based on planning and forecast calculations
- Adjust liquidity prices in the short term to optimally control liquidity
- Take into account strategic elements for the procurement of funds such as the franchise value for customer deposits and customer relationships

Liquidity Risk Statement

BAWAG Group has established a group-wide Internal Liquidity Adequacy Assessment Process (ILAAP) framework which defines the group's liquidity risk management processes, steering mechanisms, funding strategies and liquidity risk limits to adhere the overall risk appetite. The overall risk appetite defined by the Management Board serves as the boundary condition for the risk strategy. The limits set for liquidity risk within the ILAAP are strategic specifications for steering and limitation of the group ´s overall risk position and express the group's risk appetite. Compliance with these limits ensures an adequate liquidity position.

Within the overall business and risk strategy the management of BAWAG Group has outlined the focus on maintaining a conservative low-risk balance sheet with an explicit commitment to a strong capital position, low levels of leverage, a strong liquidity position with a conservative funding profile and a deposit-based funding strategy.

Retail and corporate savings products have been the core part of the Group's funding strategy over the years and will continue to be the dominant source of funding for the balance sheet. This strategy is confirmed by a growing share of stable customer deposits contributing more than 65% of total balance sheet funding, whereby the most important pillar relates to retail deposits.

The stable deposit base is supplemented with a diversified strategy of wholesale funding. The funding instruments comprise of both unsecured bonds as well as bonds secured by mortgages (covered bonds & RMBS) and public sector collateral.

In addition to the stable deposit base, in September 2020 BAWAG Group issued Tier 2 and AT1 Notes with principal amount of € 200 and € 175 million, respectively. Furthermore, in the course of 2020 the bank has successfully placed € 1.750 million Mortgage covered bonds (January € 500; September € 750; November € 500). The long-term goal is to maintain a strong deposit funding and a diversified wholesale funding profile.

The maintenance of a robust liquidity and funding position is considered to be a core element of the successful implementation of the overall business strategy.

BAWAG Group has implemented a liquidity risk limit framework covering the relevant time horizons from short to long term as well as comprehensive stress testing procedures to measure potential liquidity risks and to ensure liquidity adequacy also in adverse scenarios. These stress analyses are based either on empirically available data, hypothetical but plausible stress scenarios, or forward-looking information derived from business forecasts. The liquidity stress testing is designed to identify and address the key vulnerabilities of the group towards contingent liquidity risks and to determine the size of its liquidity buffer and counterbalancing capacity needs beyond the regulatory minimum standards.

BAWAG Group maintains a significant liquidity buffer to cover unexpected liquidity outflows in a stress scenario. The holding of the liquidity buffer therefore represents a preventive measure to reduce liquidity risk. Furthermore, the Group has Contingency Funding Plans in place which define what constitutes a liquidity contingency, the monitoring procedures in place to identify the occurrence of a liquidity contingency event, changes in the governance resulting from the declaration of a liquidity contingency, as well as the measures available to rectify a liquidity crisis. BAWAG Group has a set of pre-defined measures that can be undertaken in case of a liquidity contingency to improve the liquidity situation of the group.

On the basis of its ILAAP the group conducts an ongoing self-assessment of its liquidity risk profile, risk measurement and management framework and its liquidity adequacy. The outcome of this process is documented annually in the Group's Liquidity Adequacy Statement (LAS) signed by the Management Board of BAWAG Group. On the basis of the ILAAP, the Management Board is convinced that the current risk management framework allows a comprehensive identification, quantification, measurement and steering of all relevant liquidity risks and considers the liquidity and funding position of BAWAG Group as solid and fully adequate as of 31 December 2020.

STRUCTURE AND ORGANIZATION OF RELEVANT RISK MANAGEMENT FUNCTIONS

Organizational structure

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

The CFO, as a member of the Management Board, performs the function of liquidity manager for the Group as a whole. The Treasury & Markets division (TM) reports to the CFO and incorporates the liquidity management. The CFO monitors the activity of the organizational units and regularly informs the entire Management Board about the liquidity situation. TM bears the central specialized responsibilities for liquidity management. A central Collateral Management for BAWAG Group is integrated in Asset Liability Management (ALM).

Controlling is responsible for operational accounting of the liquidity costs and premiums in the profit center calculations and for the methods used in the FTP system. The liquidity cost system derives prices from current market rates. The fine tuning is done by ALM to balance short-term gaps.

Risk Controlling (RX), a division reporting to the CRO, measures the current liquidity risk, prepares limit proposals for the S-ALCO and monitors compliance with the defined limits and liquidity buffers.

Treasury & Markets (TM) is responsible for the operational execution of money market and capital 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.

The reporting of the current and projected liquidity position as well as the funding potential is performed by the Treasury & Markets division. One of the most important key ratios is FACE (free available cash equivalent), which is internally defined at BAWAG Group. The liquidity buffer is divided into a short-term and medium-term portion that can be liquidated. The reporting of the liquidity risk is done by RX.

RISK MEASUREMENT SYSTEMS

The liquidity risk is calculated by rolling out the cash flows from existing transactions. These cash flows are calculated from business data drawn from the central data warehouse. Based on the transaction data for customer business (loans, deposits, securities, etc.), the cash flows from repayment of principal are rolled out at individual transaction level within the market risk management system OneSumX and are reported in aggregated form according to defined criteria (e.g. product type, customer category, and behavior with respect to the repayment of principal). Positions with undefined maturities (current accounts and customer deposits) are assigned to the time bands based on the modelled liquidity replication assumptions reflecting the historical retention period and volume fluctuations.

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. The stressed funding cost resulting from closing the funding gaps is quantified as well. Special attention is payed to the structural risk in FX funding, which is articulated in FX basis spread risk. To measure this risk a concept of PVBP (similar to the interest rate risk) has been implemented. Furthermore, stress tests are then conducted in BAWAG Group´s 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 then weighted with the relevant stress factors (outflow assumptions).

The stress scenarios are distinguished as follows:

- Intraday stress
- Idiosyncratic stress
- Systemic stress
- Mixed stress scenario
- Reverse stress test

The stress tests also take account of the liquidity buffer and the counterbalancing capacity, i.e. unencumbered liquidity reserve. 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. The stipulated risk limits must be adhered to in the stress tests with account taken of the liquidity buffer and the counterbalancing capacity; otherwise, TM must suggest or initiate countermeasures. The stress test results determine the size of the liquidity buffer and the counterbalancing capacity.

RISK REPORTING SYSTEMS

The liquidity status is presented and reported in standardized, regular reports. These reports 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 liquidity management 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 to the SALCO on a monthly base. 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. TM is responsible for closing unplanned tactical gaps (in a time horizon of 15 months) by taking preemptive actions.

On the one hand the reports on the structural liquidity status are produced under a dynamic perspective as part of total Bank planning. In the process, TM coordinates the planning of overall funding, which comprises theoretical scenarios, business shifts and planned assumptions for new business. The funding plan has a time horizon of three years. On the other hand, the structural liquidity risk is also measured monthly under a static perspective (in total and in separate currencies) and quantified with stress assumptions.

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 liquidity buffer and 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, BAWAG Group 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 securitized refinancing (and reconciles it with the business plan).

LIQUIDITY COVERAGE RATIO

The Commission Delegated Regulation 2015/61 with regard to liquidity coverage requirement for Credit Institutions (“Delegated Act”) has become effective as of 01 October 2015. The Delegated Act supplements and amends the rules for the calculation and reporting of the liquidity coverage requirement (“LCR”) of the CRR. At the consolidated level, BAWAG Group is subjected to LCR requirement and to the LCR Disclosure requirement. LCR requires banks to hold high-quality liquid assets (HQLA) to cover net cash outflows over the period of 30 calendar-days and is calculated under the assumption of the severe liquidity stress.

Hiqh Quality Liquid Assets (HQLA)

Assets are considered to be HQLA if they can be easily and immediately converted into cash at little or no loss of value. The LCR defines HQLA in three asset categories: Level 1, Level 2A and Level 2B, and applies haircuts and limits to certain asset categories.

HQLA consists primarily of central bank and government assets assuring highest reliability in times of stress. All BAWAG Group securities that are included into HQLA needs to meet internal requirements that secures low levels of concentration in regard to issuers and their origin.

Net Cash Outflows

Net cash outflows are defined as the total expected cash outflows minus total expected cash inflows in the specified stress scenario for the subsequent 30 calendar days. Total expected cash outflows and inflows are based on the contractual maturity of assets, liabilities and off-balance-sheet commitments. Where contractual maturity is not applicable, the LCR sets forth maturity assumptions by multiplying the outstanding balances of these categories by the rates at which they are expected to flow under the scenario. Inflows are subject to an aggregate cap of 75% of total expected cash outflows.

The structure of the LCR outflows reflects the group’s conservative funding structure with retail deposits being the most important source of the liquidity and with very low counterparty concentrations among all funding items.

Outflows related to derivative exposures and other collateral requirements reflect contractual derivative settlements as well as contingent derivative outflows (largest net cumulative collateral outflow or inflow in a 30 calendar-day period over the last two years).

The BAWAG Group has no significant individual currency concentrations above the regulatory thresholds. For this reason, the LCR metrics are only reported in total and in euros.

For the last quarter of 2020, the average LCR value for the last 12 months is 180% with a HQLA portfolio of € 8.006 million and € 4.444 million net outflows.

CONCENTRATION RISK

Article 435 (1) points (a) – (d) CRR

STRATEGIES, PROCESSES AND MANAGEMENT

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

The Risk Management Organization (Risk Controlling, Strategic Risk Management) manages, limits and controls concentration risks and reports them on a monthly basis to the PSC, composed by controlling, markets and risk divisions heads, as well as to the ERM, composed by relevant Management Board members.

Risk concentrations arise from large exposures in individual customer segments or from large total exposures in certain industries, countries or foreign currencies whose loss potential could endanger BAWAG Group's core business or has an impact on the risk profile.

Concentration risk at the level of individual transactions or products is dealt within a special sub-risk strategy. The management of country and industry limits is carried out as a standard process in accordance with binding internal guidelines.

STRUCTURE AND ORGANIZATION OF RELEVANT RISK MANAGEMENT FUNCTIONS

The main body is the monthly ERM, in which all Management Board members participate and where the CEO chairs. The CRO bears responsibility for the management of concentration risks in the Management Board. The ERM is set up as a committee at Management Board level and is responsible inter alia for approving the methods and the processes employed for measuring concentration risks. The ERM delegates to the PSC the steering and monitoring of the concentration risks. As mentioned above the Risk Management Organization bears responsibility for concentration risk management in coordination with the divisions Commercial Risk Management and Retail Risk Management.

RISK MEASURING SYSTEMS AND LIMITATION

Allocated economic capital is the basis for quantifying the concentration risk at the level of individual borrowers and groups of affiliated customers as well as with concentrations in industries, countries and currencies. The quantification is part of the Portfolio Steering Framework (in place since 2015). The methodological basis is constituted on the risk-weighted assets according to the IRB approach.

Appropriate limits are determined for countries, industries and currencies and constitute an integral part of efforts to control total bank risk.

All limits are monitored on an on-going basis and in accordance with the estimated risk potential.

If limits are exceeded the risk management units and the Management Board agree on suitable actions to limit or reduce the risk.

To prevent losses in connection with collateral concentrations that could put the financial stability at risk or result in a material change in BAWAG Group's risk profile, appropriate warning thresholds are defined and subjected to periodic monitoring and appropriate reporting processes.

All material risk factors are depicted in scenario analyses and stress tests using VaR models in order to analyze and monitor market concentration risks. For reasons of a prudent view, conservative assumptions regarding correlations between risk factors are made.

Regarding concentrations of operational risks, the focus lies on the one hand on activities with a long business history, on the other hand special attention is laid 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.

REPORTING SYSTEMS

The actual limit utilization and the qualified risk estimate are reported to the ERM on a regular basis. The communication medium in this context is the monthly Group Risk Report.

The discussion of the Portfolio Steering Framework report (that has separate sections focusing on concentration risks in the segments of countries, industries, currencies and customer groups) is performed in the PSC. This committee is delegated by ERM to monitor and manage the economic capital allocated on the bottom levels of Portfolio Steering Framework (level 3 business sub-segments and level 4 countries and industries, up to € 40 millions).

After the competent risk committees take notice of and approve the concentration risk reports, the reports are communicated to the relevant underwriting units.

RISK OF MONEY LAUNDERING AND TERRORISM FINANCING

Article 435 (1) points (a) – (d) CRR

STRATEGIES, PROCESSES AND MANAGEMENT

Following the business model of BAWAG Group focusing on retail, small business, corporate and public sector clients in developed markets of the DACH/NL-region (Germany, Austria, Switzerland, Netherlands), Western Europe and the United States, the risk of money laundering and terrorism financing is overall low.

Strategy and procedures for prevention of money laundering and terrorism financing (summarized as AML & KYC in the following paragraphs) have been approved by the Management Board. As required by law, a comprehensive risk analysis of specific money laundering risks is regularly conducted and updated.

Customer relationships as well as domestic and foreign transactions are automatically monitored along AML risk classifications which follow the risk analysis. Further, the customer, transaction and country screenings take into account the High Risk Country Regulation issued by delegated Regulation of the European Commission and the relevant sanction guidelines of the UN, OFAC, EU and the Austrian National Bank.

Employees receive training (self-study programs and classroom training) to sensitize them to specific constellations suspected of involving money laundering or terrorism financing.

Pertinent directives (summarized in a separate manual) and mandatory technical IT fields ensure compliance with all relevant regulations to prevent money laundering and terrorism financing under the Financial Market Money Laundering Act (FM-GwG) based on 4th and 5th EU Anti- Money Laundering Directive (EC 849/2015 and EC 843/2018) and under EU Regulation on information accompanying transfers of funds and repealing EC 847/2015.

STRUCTURE AND ORGANIZATION OF RELEVANT RISK MANAGEMENT FUNCTIONS

The mandatory AML-Officer is supported by a department leader and specialized staff. In his function as AML-Officer, the head of the division Anti Money Laundering & Know your Customer is directly reporting to the whole Management Board. The Organizational Manual outlines the duties and responsibilities of the division Anti Money Laundering & Know your Customer. The competences of the AML-Officer are:
- comprehensive inspections- and control rights (regular IKS checks) and access to all systems
- possibility for ad hoc audits at any time
- decision to report suspicious cases to FIU and to block accounts
- decision if a critical customer relationship will be established or an existing will be terminated.

RISK MEASUREMENT SYSTEMS

In addition to the yearly overall risk analysis, AML-suspicious cases are permanently analyzed for new patterns of behavior to update the AML systems. The exchange of money laundering suspicious cases has been conducted since 2017 group wide.

BAWAG Group operates a software system that classifies all customer relationships into AML-risk classes (applying specific risk factors like product, seat/residence, industry, nationality etc.). Upon applying for a product, respective measures vary along the respective risk class (e.g. intensified monitoring for higher risk classes). The software differentiates between the categories: low, medium, high and very high (like for example politically exposed persons). New patterns of behavior or findings can be translated into new transaction monitoring scenarios, another module of the AML software. The third module of the applied AML software module ensures customer monitoring against defined lists.

As to sanction screening the applied software ensures transactions, countries and sanction screenings against relevant lists.

RISK REPORTING SYSTEMS

The AML Officer reports to the entire Management Board and the Audit and Compliance Committee on a quarterly basis. Furthermore, the annual report has to be acknowledged by the Supervisory Board. Since 2017 an own Non-Financial Risk Committee on management board level has been established, which meets on a regular base. The goal is, among other targets, to decide upon necessary measures in the prevention of money laundering together with the management.

RISK HEDGING AND MITIGATION

Comprehensive guidelines are summarized in the Anti Money Laundering and Sanctions Manual, and a control system is in place for the opening and monitoring of accounts and all one-time 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, transactions requiring an ID to be shown). Additionally, the AML-Officer has established a monthly internal control system, which requires sample checks of the compliance with the internal account opening and transaction policies. Any errors are redirected for correction, for re-training or to take other effective measures to the person in charge. In addition to the comprehensive bank risk analysis that undergoes an evaluation once a year, BAWAG Group also conducts constant analysis to evaluate reported cases suspected of involving money laundering and to determine whether new behavior patterns require a software update or other actions to be taken. Furthermore, the strategy paper is subject to at least an annual review and re-approval of the Management Board.

RESIDUAL RISK FROM TECHNIQUES OF CREDIT RISK MITIGATION

Article 435 (1) points (a) – (d) CRR

STRATEGIES, PROCESSES AND MANAGEMENT

All risks which are not already covered in other risk sections are referred to as residual risks from techniques of credit risk mitigation:

- Concentration risks for collateral
- Legal risk of realization (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 give the management a sufficient basis of information in order to control collateral concentration risks adequately.

BAWAG Group covers legal risk and other risks by applying correspondingly conservative valuation approaches and collateral lending values.

In addition, potential credit losses due to collateral deterioration are simulated within Stress Testing and possible effects on the risk bearing capacity of BAWAG Group are considered.

STRUCTURE AND ORGANIZATION OF THE RELEVANT RISK MANAGEMENT FUNCTIONS

These risks are constantly monitored within the risk organization and regularly reported to the Portfolio Steering Committee. The concept of monitoring concentration risks regulates the possible actions and the powers with regard to imposition, execution and monitoring of concentration risks arising from collateral.

RISK HEDGING, -MITIGATION AND RISK MEASUREMENT SYSTEMS

Various steps are taken 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 in the course of collateral valuation. Details on the valuation procedure are given in the Credit Collateral Catalogue.

- Stress tests are conducted to analyze the fluctuations in collateral market values and lending values and their ramifications for the risk bearing capacity. Details about these stress tests can be found in the stress test.
- The residual security concentration risk is covered in the monitoring plan entitled ‘Concentrations of Collateral’.

MACROECONOMIC RISKS

Article 435 (1) points (a) – (d) CRR

STRATEGIES, PROCESSES AND MANAGEMENT

Macroeconomic risks designate potential losses that may arise by variations to macroeconomic risk factors, such as the GDP trend, the unemployment rate, the oil price, but also for political reasons, like Brexit.

Macroeconomic risks have myriad possible consequences. Unfavorable overall economic developments could result in negative repercussions for BAWAG Group such as a negative change in market prices, increased default rates, less demand for products, negative trends in the value of participations, falling savings rates (tight liquidity), etc.

Risk is identified during stress testing conducted to determine the type and scope of the required stress tests and to define the macroeconomic scenarios and the associated risk parameters. Stress tests are conducted periodically and are in the responsibility of the individual specialized units of the risk organization.

STRUCTURE AND ORGANIZATION OF RELEVANT RISK MANAGEMENT FUNCTIONS

The items are addressed here in an interdepartmental manner due to the interdisciplinary topics associated with macroeconomic risks.

RISK MEASUREMENT, RISK REPORTING SYSTEM AND RISK HEDGING OR MITIGATION

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

Within the annual Risk Self-Assessment process, macroeconomic risk is assessed and quantified. In general, macroeconomic factors are considered within the quantification of the individual risk types using validated models. Nevertheless, the Group holds in addition a capital buffer at Management Board Level for acquisitions and not identified risks - a potential residual risk stemming from a negative macroeconomic development for the Group is also covered by this buffer.

Furthermore, the Group controls the impact of macroeconomic changes within the reporting of stress test results 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 internal capital. Actions can also be of an organizational 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 organizational units.

Stress test results and in case actions needed are discussed in the dedicated ICAAP & Stress Test Committee and then presented for approval to the ERM.

PARTICIPATIONS NOT HELD IN THE TRADING BOOK

OBJECTIVES AND PRINCIPLES FOR THE MANAGEMENT OF PARTICIPATIONS

Article 435 (1) point (a) – (d) CRR

Strategies and processes

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 Management Board, participations are divided into the following categories:

- Majority participations in the financial services sector that are considered part of the core business 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 that perform services for BAWAG 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).
- Other participation items

BAWAG Group 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 Management Board and a risk assessment from the responsible risk unit.

Structure and organization of relevant risk management functions

The risk management function for participations is integrated in the unit Real Estate & Institutional Clients within the division Commercial Risk Management. This unit reports to the Chief Risk Officer (CRO). Monthly reports on participation risk (as a part of the Group Risk Report), the participation risk strategy (as a part of Risk Strategy), risk assessments on risk associated with equity capital actions and value determinations during impairment tests are submitted to the respective decision-making authority.

Risk measurement systems

For material operational participations, Controlling together with Accounting conducts a standardized analysis of target versus actual company figures during the year, with monthly reports to the relevant stakeholders.

All participations are rated at least once a year. The confirmed rating is issued by Credit Risk Management.

An impairment test for participations must be carried out annually and reviewed by Credit Risk Management. 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 and are approved by the full Management Board at year end.

Subsequent risk control is represented by the assessment and quantification of participation risk (IFRS not-consolidated participations according to) within the annual Risk Self-assessment process, using a simplified PD/LGD model and defining a constant buffer for the risk within the ICAAP framework.

Risk reporting systems

Participation risks are reported in the context of risk controlling on a monthly basis to the Management Board. This report is part of the Group Risk Report and contains material changes within the participation portfolio most notably with regard to acquisitions, disposals, ratings and book values.

Risk hedging and mitigation

The treatment of risks arising from participations is governed in the Participation Risk Strategy (as a part of Risk Strategy) and other related documents.

In addition, the department Reporting & Planning 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.

ACCOUNTING AND VALUATION METHODS

Article 447 point (a) CRR

UGB
The valuation of participations and shares in affiliated companies is based on acquisition costs. In case of persistent losses, an impairment was made. Impairments will be reversed up to the historical acquisition cost at the maximum in case the reason for the impairment no longer applies. Details to the accounting and valuation methods can be found in the notes of the AGAAP solo annual report.

IFRS
The valuation of non-consolidated participations is based on the fair value. Depending on the individual classification, changes in fair value are recognized in OCI or PnL.

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

SECURITIZATIONS

SECURITIZATION ACTIVITIES AND FUNCTIONS IN THE SECURITIZATION PROCESS

Article 449 points (a), (d), (e), (g), (i), (m), (n) (vi), and (r) CRR

In November 2016 BAWAG Group securitized a portion of its UK residential mortgage portfolio. The RMBS transaction Feldspar 2016-1 was the first RMBS issuance for BAWAG Group. The Feldspar 2016-1 transaction represents a pure funding transaction to which the regime of Part Three, Title II, Chapter 5 CRR is not applicable. Therefore, this transaction is considered outside the scope of Article 449 CRR.

Since the beginning of 2017, the group has acted as an investor in securitization transactions. All securitization positions of the group are assigned to the banking book.

RISKS FROM SECURITIZATIONS AND RESECURITIZATIONS

Article 449 points (b), (c), (f) and (m) CRR

The securitization portfolio consists of Collateralized Loan Obligations (CLOs) rated AAA and AA with risks mainly from West- and North European and US companies.

The securitization positions held by BAWAG Group consist primarily of senior tranches with adequate subordination. The portfolio includes no re-securitization positions.

BAWAG Group established an Investment and Monitoring Policy, which represents the foundation for the risk management process of the CLO portfolio. The policy specifies criteria, which should be assessed prior to an investment in individual CLO positions. It consists of both “must meet” and “should meet” criteria. “Must meet” criteria are necessary to be fulfilled for a CLO investment to be approved. Any breach of “should meet” criteria should be appropriately assessed and documented. In addition, the policy determines the risk monitoring process, which is carried out on a regular basis after an investment has been approved.

BAWAG Group uses valuation models to determine the market value of the portfolio. Models are also used to determine the economic value of the transactions. Models for calculating sensitivities, stress tests, etc. are developed based on the valuation models. All models are applied to the individual exposures underlying the transactions, i.e. for securitizations they are applied to the pool of exposures.

Risk reporting consists of quarterly risk reports prepared by Risk Controlling and submitted to the Credit Approval Committee (CAC) for approval.

Quarterly reports consist of an overview of the total CLO portfolio where key risk parameters for individual positions are summarized. This includes the seniority, weighted average life (WAL), weighted average maturity (WAM), attachment and detachment points, subordination level, expected recovery value, etc. Moreover, Risk Controlling provides an overview of key parameters in comparison to the previous quarter, as well as the analysis of the underlying collateral. In addition, as part of the quarterly reports stress testing of individual CLO positions is performed by applying the stressed parameters for PD and LGD. Starting point for the stressed parameters are long term averages of PDs and LGDs as reported by Moody’s in their Annual Corporate Default Study.

APPROACHES TO THE CALCULATION OF RISK-WEIGHTED EXPOSURE AMOUNTS

Article 449 point (h) CRR

Risk-weighted exposure amounts for securitization are calculated in accordance with Article 254 (1) CRR, where BAWAG Group has chosen to apply the preference of SEC-ERBA (Art. 263 CRR) over SEC-SA (Art. 261 CRR) in line with Article 254 (3) CRR.

Positions with no external rating from Moody's, Standard & Poor's or Fitch are assigned a risk weight of 1250 per cent.

ACCOUNTING POLICIES FOR SECURITIZATIONS

Article 449 point (j), (i), (ii) and (iv) - (vi) CRR

This requirement only concerns originators of securitizations and is thus irrelevant for BAWAG Group.

Article 449 point (j) (iii) CRR

BAWAG Group uses valuation models to determine mark-to-model values of individual positions and they are based on market spreads or comparable transactions.

ELIGIBLE EXTERNAL RATING AGENCIES USED FOR SECURITIZATIONS

Article 449 point (k) CRR

Basically, for investment deliberations the estimated ratings of Moody's, Standard & Poor's and Fitch regardless of the category of securitized exposure are utilized. If several ratings are available, the relevant risk weight for the capital requirements is determined as indicated in Article 138 CRR.

INTERNAL ASSESSMENT APPROACH

Article 449 point (l) CRR

BAWAG Group has no disclosure obligations in accordance with Article 449 point (l) CRR, because it does not apply the internal assessment approach.

LEVERAGE RATIO

Article 451 CRR

The Leverage Ratio according to Article 429 CRR is being calculated according to Article 499 (1) point (a) CRR (in consideration of transitional regulations of Tier 1 capital) and according to Article 499 (1) point (b) CRR (fully fledged definition of Tier 1 capital) for regulatory purposes and reported quarterly to the regulators. Since the new requirements of Delegated Regulation (EU) 2015/62 have been implemented in the regulatory reporting (30.9.2016) the figure is calculated on the basis of end-of-quarter-data.

Internally the Leverage Ratio is calculated and reported monthly in the Capital Management Meeting (CMM) and Enterprise Risk Meeting (ERM), where the management board is represented. This reporting also includes the comparison of the current indicator value with the defined alert and recovery threshold levels. In order to manage the risk of excessive leverage, the recovery plan defines procedures and processes for reacting to leverage ratio changes which can be implemented if necessary.

Due to business model and capital structure the share of encumbered assets measured by balance sheet volume is rather low. Therefore, asset encumbrance is not taken into account in managing the risk of excessive leverage.

In consideration of transitional regulations of Tier 1 capital the Leverage Ratio was at 6.06% at the end of 2020 which is a decrease of 39 bp compared with the previous year end calculation.

REMUNERATION POLICY DISCLOSURE

Article 450 (1) points (a) – (f) CRR

BAWAG Group AG and BAWAG P.S.K. AG established a Nomination and Remuneration Committee, which is set up as a Supervisory Board committee. The Nomination and Remuneration Committee approves the Remuneration Policy of the BAWAG Group, reviews the applied remuneration practices as well as the remuneration related incentive structure. It is responsible for the determination of terms and conditions of contracts of Management Board Members and the target determination and bonus granting for each Management Board Member.

The Nomination and Remuneration Committee approves the aggregate bonus pool for BAWAG Group and reviews the annual bonus allocation on a statistical basis and submits regular reports on its activities to the full Supervisory Board. The Nomination and Remuneration Committee consists of the chairman of the Supervisory Board, who also chairs the Nomination and Remuneration Committee and four further Supervisory Board members including two members of the works council. One member is an expert on remuneration and one is also a member of the Risk and Credit Committee. In the year 2020 there have been four meetings of the Nomination and Remuneration Committee.

The Remuneration Policy applies to the Members of the Managing Board and the employees of the BAWAG Group and is compliant with the provisions and principles of the Directive 2013/36/EU (CRD IV), the EBA guidelines on sound remuneration policies, the FMA circular on principles of remuneration policies and practices updated in January 2018 and the Austrian Banking Act.

Regarding the structure of remuneration all remuneration and other benefits granted by BAWAG Group are qualified as either fixed or variable remuneration as defined by the regulatory framework. Criteria for fixed and variable remuneration are clear, objective, predetermined and transparent.

For employees whose activities have a material influence on the risk profile (identified staff), the Remuneration Policy provides for an effective risk management. The assessment in this regard was carried out in accordance with the qualitative and quantitative criteria set forth in the Commission Delegated Regulation (EU) No 604/2014 and will subsequently be carried out in accordance with Directive 2019/878 (CRD V).

In accordance with the above-mentioned legal framework identified staff receive the bonus distributed over a period of 5 years and at least 50% in phantom shares (based on shares of BAWAG Group AG) provided a certain amount of the variable remuneration is reached. In early 2018 for selected persons out of the group of identified staff a Long Term Incentive Program (LTIP) was implemented under consideration of the regulatory principles, which is awarded 50% in shares of BAWAG Group AG and 50% in phantom shares or optional 100% in shares of BAWAG Group AG under the precondition of a long-term corporate success measured by Pre-Tax Earnings per Share. For the year 2020 no additional LTIP was implemented. The high proportion of shares and phantom shares of the variable compensation for identified staff leads to a high level of alignment between the interests of the management and the shareholders focused on a growth of the corporate value as externally communicated to the shareholders.

Bonus awards granted to non-identified staff are deferred provided the bonus award granted exceeds a certain amount.

Malus and clawback provisions are in place in accordance with the regulatory framework.

In reviewing and deciding on any awards of a variable compensation (bonus or LTIP) to Members of the Management Board and employees, the Nomination and Remuneration Committee takes into account the market situation and market trends, the appropriateness of bonus payments, the risk trends and the strengthening of the equity base.

The aggregate bonus pool shall, absent of extraordinary circumstances, not exceed 10% of the consolidated IFRS-profit before tax (PBT) of BAWAG Group AG. In case of extraordinary circumstances (including, but not limited to, out performance of targets) such self-imposed limit may be exceeded. When determining the size of the bonus pool the following factors are being considered:

- Bonus payments are appropriate and disciplined considering BAWAG Group's earnings situation
- A correlation to the development of BAWAG Group's risk bearing ability
- Risk and compliance functions provide effective input in accordance with their roles into the setting of the bonus pool where those functions have concerns regarding the impact of employees' behaviour and the riskiness of the business undertaken
- The macro-economic risks as well as the monetary outlook

The following process shall apply for the determination of the size of the bonus pool in any year:

- Proposal of Management Board prior approval by the Nomination and Remuneration Committee which confirms that the proposed total bonus pool is in line with the midterm capital targets set by the Management Board
- Approval by the Nomination and Remuneration Committee

The Remuneration Policy 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. Bonus awards paid to identified staff consist of 50% cash and 50% phantom shares and 40% to 60% of the bonus is paid upfront, provided a certain bonus amount is reached. The portion of a bonus award which is not paid upfront is deferred and vests over a period of five years
- The appropriateness and market adequacy of remuneration are ensured, whereby a balanced relationship between fixed and variable components is achieved. In general, the target for variable remuneration is capped at 100% of the respective fixed remuneration. In case there has been a significant out performance, the variable remuneration may exceed such amount but, in any event, may not exceed the levels set by the applicable regulatory requirements which currently stand at 200%. A corresponding approval by BAWAG P.S.K.'s general meeting has been obtained on September 15, 2017
- The variable remuneration is determined on the basis of the individual's success as well as on the success of the respective organizational unit and BAWAG P.S.K.

Regarding identified staff the individually quantitative and qualitative targets are to be agreed between the employee and the relevant manager. The targets and the achievement and non-achievement of targets are documented. A clear structure in target setting is key for ensuring transparent target assessment. Therefore, the targets shall be specifically tailored for each individual function and set out with regard of the function holder's capacity and capability. Regardless of specific contents and areas of responsibility each target comprises of:

- a clear and transparent description of its content
- targets consist of quantitative and qualitative measurement criteria
- a reasonable timeline within Management by Objective

At the end of the Management by Objective cycle targets are assessed in a structured multi-stage procedure:

- Evaluation (by employee and manager) of target achievement along agreed measurement criteria
- Assessment of the targets by employee and manager
- Documentation of the assessment and derivable consequences

In addition, the results of internal and external audits, on-site reviews by regulators and the overall fulfilment of compliance requirements shall be used as a further indicator for the individual bonus allocation.

For risk and control function holders who are identified as identified staff the process of target setting and target assessment differs from that of other identified staff as KPIs or performance targets for the Group shall not be used. The targets have to be derived from the risk strategy and governance of BAWAG Group and business unit, defined by the Chief Risk Officer together with responsible division heads. The Management by Objectives process (line manager determines targets with employee personally) serves as quality check of the content of the targets. However, upon the compensation of staff in risk and control functions is decided regardless of the success of the business units they control.

Further information is available in the chapter information about the remuneration of the Managing Board and Supervisory Board of the consolidated annual report 2020 of BAWAG Group.

APPENDIX (QUALITATIVE DISCLOSURE): OVERVIEW RISK-REPORT

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	Corporate Governance		48, 254-265	Pages Internet BAWAG P.S.K.

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