Pillar 3
Risk Report
2014

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2014

BANQUE
INTERNATIONALE
À LUXEMBOURG

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Introduction

BIL group – 2014 key events

BIL group's Risk Management department has followed the development of the Bank's activities and risk profile during 2014. During the year, the Bank has pursued the projects initiated in 2012 regarding the on-going evolution of its monitoring and controlling frameworks.

Among the various projects conducted in 2014, the implementation of the Basel III requirements, as transposed within the EU legislation through the CRD IV package, can be pointed out as a major step toward the overall risk management practices enhancement.

The setting up on November 4, 2014 of the Single Supervisory Mechanism (SSM), where the European Central Bank (ECB) took on – together with the National Competent Authorities (NCA) – the direct supervision of around 130 credit institutions within the euro area, among which Precision Capital – and thus BIL group –, is also an important change which will lead to the improved harmonisation of practices and thus transparency at the European level.

Prior to the SSM becoming fully operational, the ECB and the NCAs have conducted a comprehensive assessment including an in-depth asset quality review (AQR) of the participating banks 'balance sheets and a EU-wide stress test aiming at assessing their reliance to specific baseline and adverse macroeconomic scenario. The results of this assessment confirmed the overall soundness and strong capital position of Precision Capital and its two majority owned banks, BIL and KBL *epb*.

Corporate structure and risk profile

During 2014, BIL has continued to deploy its "BIL is Back" strategy which focuses on offering a wide range of products and services to a diversified customer base in Luxembourg as well as in neighbouring and more distant countries.

Moreover, BIL has taken some strategic decisions to optimise the group's structure and to provide efficient and added-value services:

- In October 2014, BIL has opened its Dubai branch to serve and develop its basis of Middle East clients. While the branch hired its own on-site risk manager, the main risk functions are carried out at the Head Office level.
- Moreover and all along this year, the Bank has continued to launch new products (i.e. "Sharia Compliant" issues, Luxembourg warrant loans…) in order to better serve its specific clients' needs.

Other important strategic decisions have impacted the Bank's corporate structure since end 2014:

- In line with its strategic ambition, BIL has continued to expand its international development with the acquisition of KBL Switzerland. This acquisition aims at increasing BIL's presence in the country, improving thus the services offered to its customers and therefore attracting a new wealthy international clientele.
- In the same time, BIL sold its Belgian subsidiary to Puilaetco Dewaay, the Belgian subsidiary of KBL *epb*, and closed its Bahrain Branch.

In 2014, the Bank has also adapted its investment strategy policy taking into account the evolution of its market environment. In a complex economic context, the Bank investment portfolio has reached its targeted size (around EUR 5 billion) during the year. As a reminder, the main purposes of this portfolio is to create value while serving as a liquidity reserve for the Bank (i.e. Basel III, Liquidity Coverage Ratio – LCR). The portfolio is primarily composed of top-quality assets with low capital requirements (i.e. Risk Weighted Assets - RWA). A very small share of the portfolio may be dedicated to riskier assets, i.e. non-LCR or non-Central Bank eligible assets. The risk profile of this portfolio is monitored by the Financial Risk Management unit according to the portfolio guidelines which provide a set of limits in terms of duration, liquidity aspects, geographical area, currency, RWA, rating and concentration.

Internal governance

According to Circular CSSF 12/552 (as amended) and EBA's recommendations, BIL has set-up in October 2014 an Internal Control Committee (ICC) in order to facilitate the effective risk control by Management Board and to coordinate the activities of the Bank's three Internal Control functions (i.e. Internal Audit, Compliance, Risk). This committee decides on transversal issues related to Internal Control and helps converging towards common positions for the three functions. From a risk point of view, this committee focuses on operational risk topics.

In 2014, the Bank also decided to reorganise its Operational Risk Management unit in order to reach a more sound and consistent structure allowing the efficient handling of these matters, in line with the challenges imposed by the business and regulatory environment changes:

- The streamlining objective of the overall organisation together with the research for a more efficient operational risks coverage have naturally conducted BIL group to transfer the Insurance and Reinsurance activities from the Secretary General, Legal and Tax department to the Risk Management department.
- The nature of the controls made by the Client Risk team (i.e. second-level controls regarding the compliance of the investments made by the Bank for its clients, including among other ex-post suitability, appropriateness and respect of contractual/regulatory constraints) and the evident complementary of their activities, have conducted the Bank to transfer this team to the Compliance department and to rename it as Investment Compliance team.

During this year, the Real Estate Advisor function has also been transferred to the Credit Risk unit in order to fulfil an independent risk assessment and monitoring of the Real Estate Development portfolio of the Bank and to perform the periodic real estate valuations as per "Procedures and Credit Policy Manual" (PCPM) guidelines. This function is part of the Retail, Midcorp, Corp and Private Bank Analysis team.

Other minor changes have impacted the Risk Management structure in 2014 (e.g. merger of the Risk Reportings and the Data Management & Risk Systems teams within the Credit

Risk Management unit, setting-up of a Credit Process Optimisation function, etc.) with no impact on the duties of the its four main units.
For further details related to Risk Management governance and organisation, please refer to Section 2.

Changes in the regulatory framework

In 2014, BIL has continued to invest time and resources in making sure that it is and will remain compliant with regulatory standards.
The effective implementation of the Basel III requirements, as transposed within the EU legislation through the CRD IV package, can be pointed out as a major step toward the overall risk management practices enhancement. These new requirements, in force since January 1, 2014 with a phase-in period running until 2019, have important repercussions on the Bank's strategy and overall risk profile perception.
In concrete terms, the implementation of the CRD IV package has impacted the Bank's RWA through the application of new specific rules (e.g. additional charges linked to the Credit Valuation Adjustment (CVA) requirements, the unregulated financial institutions and large financial institutions, new treatment of Small and Medium Enterprises etc.) that resulted in an overall increase of BIL group's regulatory capital requirements. The CRD IV package also resulted in a new definition of capital and minimum ratios aiming at increasing in terms of both quality and quantity the Bank's capital base (please refer to the Section 1, Own funds and capital adequacy, for further details).
During the first quarter of 2014, the Bank reported on extended Common Reporting (COREP), including the leverage ratio and enhanced its monitoring of forbearance exposures and non-performing loans. During the second quarter, the Immovable Property Losses report was published. Finally, during the last quarter of 2014, Asset Encumbrance reporting completed the Bank's Financial Reporting (FINREP).
Beyond these important changes, 2014 was a prolific year in terms of publications.
The European Banking Authority (EBA) has produced many papers framed by Regulatory Technical Standards (RTS), Implementation Technical Standards (ITS), Guidelines, Opinions and Consultation Papers in order to facilitate the implementation of the CRD IV package.
In January 2014, the Basel Committee published a consultative document on the Net Stable Funding Ratio (NSFR) and the final standard in October 2014, in which the Committee revised certain aspects of the liquidity regulatory framework. Among other financial stability measures, the Committee improved the alignment of the NSFR with the Liquidity Coverage Ratio (LCR).
In October 2014 the European Commission (EC) also adopted Delegated Acts on the LCR in which it expands the range of assets eligible as High Quality Liquid Assets (HQLA, the numerator of the LCR) and modifies some assumed inflow and outflow rates (denominator of the LCR). This regulation shall apply as from October 1, 2015 on. The timetable for the phase-in of the standard from 2015 to 2018 has also been revised.
At the same time, a Delegated Act issued by the EC has defined the Leverage Ratio specificities and how banks will need to calculate it.
At the end of 2013 the EU's Finance Ministers (Ecofin) reached a compromise agreement on the mutualisation of the cost of resolving banking crises. This agreement, which will serve to break the vicious circle between banking risk and sovereign risk in Europe includes: the set-up of (i) a Single Resolution Mechanism (SRM) from January 1, 2015, which will cover all the banks participating in the SSM and which in the first year will only handle the approval of viability and resolution plans, (ii) a Single Resolution Fund (SRF), which will come into force in 2016 and will be fully funded in 2026.
In line with those requirements, the Bank has actively worked on the establishment of its first recovery plan which should be submitted to the Bank's Joint Supervisory Team (JST) during the first half of 2015.

Comprehensive Assessment

Prior to assuming the direct supervision of the largest euro zone banks on November 4, 2014, the ECB carried out a comprehensive assessment of their corresponding balance sheets. The prime objective of this health check was to increase confidence in the euro zone's banking system, by encouraging greater transparency, ensuring a more independent supervision as regards national discretions as well as a more consistent application of the prudential rules.
The Comprehensive Assessment involved several stages:
• A Supervisory Risk Assessment aimed at addressing key risks in the banks' balance sheets, including liquidity, leverage and funding. In particular, this exercise comprised quantitative and qualitative analysis based on backward- and forward-looking information aimed at assessing banks' intrinsic risk profiles, their positions in relation to their relative peers and their vulnerability to a number of exogenous factors;
• An Asset Quality Review (AQR), examining the asset side of the participating banks. This exercise included an assessment of the banks' internal accounting and risk practices together with an in-depth review of some of their credit and market exposures, both on the provisioning and valuation sides;
• A Stress Test, building on and complementing the AQR and aiming at assessing participating banks' relative resilience to forward-looking baseline and adverse macro-economic scenarios.
BIL group's Risk, Finance, Loans Services and commercial teams were heavily involved in the AQR and Stress Test exercises.
As part of the AQR, more than 1.200 credit files among the bank's more significant ones have been reviewed. This review encompasses their classification, quality, collateral value together with their provisioning levels. Moreover BIL's internal accounting and risk procedures and practices have also been assessed during this exercise.

As at end 2014, nearly all the quantitative recommendations issued during this exercise have been incorporated within the Bank's financial statements (e.g. specific and collective provisioning) while most of the qualitative findings (e.g. accounting procedures) were either closed or well advanced in their remedial process.
On the Stress Testing side, Precision Capital's results have highlighted the group's financial soundness and resilience to both the baseline and adverse macro-economic scenarios featuring this exercise:

- Under the Baseline Scenario of the Stress Test, Precision Capital's 2016 CET1 ratio stands at 12.5%, comfortably above the 8% minimum set by the ECB;
- Under the most severe Adverse Scenario of the Stress Test, Precision Capital's 2016 CET1 ratio stands at 8.3%, well above the minimum threshold of 5.5% set by the ECB.

Although full results were not available for either bank independently, given that Precision Capital does not hold any other material assets, these results therefore reflect the overall soundness and strong capital position of the balance sheets of both KBL *epb* and BIL.

BIL group Pillar 3 Risk Report

On a yearly basis, BIL group publishes a Pillar 3 disclosure report. This report aims at complying with the Circular CSSF 14/583 and the CSSF regulation 14-01, which are the transpositions of the CRR (EU 575/2013) into national law. In addition, this report takes into account the recommendations and improvements proposed by the European Banking Authority (EBA)[1].
The aim of this report is to help banks improve their risk disclosures in order to restore investor confidence and enhance market discipline. BIL group considers the publication of this report to be a major step forward in improving the transparency of banks' risk profiles.

Structure

BIL group's Pillar 3 disclosure report is divided into six sections and two appendices.
The first section covers the Bank's capital management and capital adequacy. The second section describes the structure and functioning of the BIL group's risk organisation and governance. The third section is dedicated to the credit risk management and deals with the organisation, the methodological procedures and the detailed breakdowns of the Bank's credit risk exposures. The fourth section describes methodological procedures for the management of market risk while disclosing the Bank's corresponding risk profile. The fifth section presents the operational risk framework and related key risk figures. Finally, the last section discloses information relating to remuneration policies and practices.
The appendices include two glossaries of relevant terms to facilitate understanding of the report.

General comment

Unless otherwise stated, the figures disclosed in this report are expressed in euro. More specifically, figures shown in tables are expressed in millions of euro.
Data is provided at a consolidated level, including subsidiaries and branches of BIL group.

1 *EBA/CP/2014/09 Guidelines on materiality, proprietary and confidentiality and on disclosure frequency*
EBA/CP/2013/48 Disclosure of encumbered and unencumbered assets
EBA/CP/2013/41 Disclosure for the Leverage Ratio

1. Own funds and capital adequacy

The aim of capital management is to guarantee BIL's solvency and maximise its profitability, while ensuring compliance with internal capital objectives and capital regulatory requirements. The Bank's ratios comfortably exceed the required levels, thereby reflecting its ability to reply to the new Basel III requirements.

BIL monitors its solvency using rules and ratios issued by the Basel Committee on Banking Supervision and the European Capital Requirements Directive.

These ratios (Common Equity Tier 1 capital ratio, Tier 1 capital ratio and total capital ratio) compare the amount of regulatory capital, eligible in each category, with BIL group's total weighted risks. From a regulatory point of view, these ratios should always comply with the existing regulation and should amount to a minimum of 7% for the CET1 ratio, and 10.5 % for the total capital ratio.

As at December 31, 2014, compared with the Basel III *pro-forma* calculated at the end of 2013, the Bank increased its core capital, leading to a CET1 ratio of 15.28% and a total capital ratio of 19.56%.

The supervisory bodies (ECB and CSSF) require BIL to disclose the calculation of capital necessary for the performance of its activities in accordance with the prudential banking regulations, on the one hand, and in accordance with the prudential regulations on financial conglomerates on the other hand.

BIL did comply with all regulatory capital rules for all periods reported.

In line with CRR requirement, the Bank also discloses in this section information related to its leverage ratio. At the end of the year, the ratio reached a level of 4.42%, comfortably above the minimum level set at of 3%.

1.1 Regulatory capital adequacy (Pillar 1)

1.1.1 Accounting and regulatory equity

In line with the regulatory requirements, BIL has limited the scope of the Pillar 3 report to its banking activities. Therefore, the scope of consolidation differs from the scope of consolidation of the financial statements (as provided in the BIL group's annual report). The difference between the accounting methods and the prudential methods, as at December 31, 2014, is limited to the insurance related company, BIL Reinsurance, which is accounted for by the equity method for prudential purposes, instead of full consolidation for accounting purposes. The corresponding difference is not material.

	31/12/13		31/12/14	
	Financial statements	**Regulatory purposes**	**Financial statements**	**Regulatory purposes**
Total shareholders' equity	1,161	1,161	1,232	1,232
of which core equity	*1,066*	*1,066*	*1,087*	*1,087*
of which Gains and Losses not recognised in the statement of income	*94*	*94*	*145*	*145*
Non-controlling interests	0	0	0	0
of which core equity	0	0	0	0
of which gains and losses not recognised in the statement of income	0	0	0	0
Discretionary participation features of insurance contracts	0	0	0	0
TOTAL	**1,161**[1]	**1,161**	**1,232**	**1,232**

Notes:
- *Comments on regulatory requirements are described in note 6 of the Risk Management Report published in the 2014 annual report.*
- *For regulatory purposes, insurance companies are accounted for by the equity method. Therefore, non-controlling interests differ from those published in the financial statements. Discretionary participation features relate only to insurance companies.*

As at end-2014, shareholder's equity had increased by 71 million (+6%). This increase is mainly due to the net profit of 123 million recorded in 2014 and an increase of 58 million in the revaluation reserves on assets available for sale. The payment of an interim dividend of 100 million and IAS 19 re-measurement reserves of –10 million have negatively impacted the shareholders' equity.

1.1.2 Regulatory capital

- Following the application of the new regulation as from January 1, 2014, the comparison between the 2013 Basel II capital and 2014 Basel III capital appears not relevant. For this reason, the table below shows BIL group's regulatory capital calculated under Basel III at the 2014 year-end compared with the Basel III *pro-forma* at the end of 2013.

According to the Basel III rules and the phasing-out of some prudential filters, the Bank's regulatory capital consists of :

- Common Equity Tier One (CET1) capital : Capital instruments, share premiums, retained earnings not including current year profit, foreign currency translation adjustment less intangible assets, defined benefit pension fund, own shares and deferred tax assets that rely on future probability.
- Tier 1 capital : CET1 capital and Additional Tier 1 capital (AT1). The AT1 capital is represented by the issue of 150 million Contingent Convertible bond (CoCo) on June 30, 2014.
- Tier 2 capital : Eligible portion of subordinated long-term debt and IRB excess of provisions.

1 *The equity method is now applied for Europay Luxembourg SC and Société de Bourse de Luxembourg SA which were previously considered as immaterial. The Bank considers that the application of the equity method regarding these companies provides a more adequate information. 2013 financial statements have been restated in order to give comparative figures.*

	Pro-forma - 31/12/13	31/12/14
TOTAL REGULATORY CAPITAL (EXCLUDING PROFIT OF THE YEAR)	**894**	**979**
CET 1 capital	**704**	**765**
Core shareholders' equity	1,037	1,068
Cumulative translation adjustements (group share)	-12	-11
Accumulated OCI	132	145
Phasing-out CSSF 14-01	-45	-93
Items to be deducted:	-408	-344
Intangible and Goodwill	-68	-66
Defined benefit pension fund	-4	-2
Deferred Tax assets	-332	-276
IRB provision shortfall (-)	-4	
AT1 capital	**0**	**150**
Tier 2 capital	**190**	**64**
Subordinated debts	190	60
IRB provision excess (+)	0	4

At year-end 2014, total regulatory capital amounted to 979 million. The increase compared to 2013 is mainly due to the strengthening of the bank's own funds with, particularly, the CoCo issued for 150 million qualified as Additional Tier 1 according to the CRD IV package.

1.1.3 Regulatory capital adequacy

The following tables show the weighted risks and capital requirements for each type of risk at year-end 2013 and year-end 2014. The capital requirement amounts have been obtained by applying 8% to the corresponding weighted risks.

Higher weighted risks in December 2014 are coming from the Bank's business evolution and direct Basel III impacts such as the treatment of DTA for 68 million, the Credit Valuation Adjustment for 38 million (but also UFI implementation, SME factor, etc.).

Please also note that the segmentation for year-end 2014 has changed with the implementation of Basel III Directive, as compared to the end 2013 situation.

Type of risk	Basel III treatment	Segmentation	Pro-forma 31/12/13 Pro-forma risk weighted assets	Pro-forma 31/12/13 Pro-forma capital require-ments	31/12/14 Risk weighted assets	31/12/14 Capital require-ments
Credit risk	Standardised	Central Governments and Central Banks	12	1	0	0
		Corporates	861	69	727	58
		Covered Bonds	0	0	6	0
		Institutions	37	3	1	0
		Multilateral Development Banks (MDB)	0	0	0	0
		Public Sector Entities	0	0	26	2
		Retail	0	0	0	0
		Regional Goverment and Local Authorities (RGLA)	0	0	35	3
		Secured on Real Estate	0	0	295	24
		Short Term Exposures	0	0	2	0
		Securitisation		0	20	2
		Other Non credit obligation assets	371	30	291	23
		Past due	0	0	29	2
		Equity	95	8	11	1
		High Risk Exposures	0	0	45	4
		SUB TOTAL	1,377	110	1,487	119
	Advanced	Central Governments and Central Banks	272	22	425	34
		Corporates - Other	507	41	725	58
		Corporates - Specialised Lending	2	0	4	0
		Corporates - SME	246	20	230	18
		Institutions	396	32	276	22
		Retail - Other SME	37	3	20	2
		Retail - Other NON SME	279	22	250	20
		Retail Qualifying Revolving	0	0	0	0
		Retail secured by immovable property SME	1	0	17	1
		Retail secured by immovable property non SME	500	40	683	55
		Other Non credit obligation assets	6	0	1	0
		Equity	98	8	23	2
		SUB TOTAL	2,344	187	2,653	212
	Credit valuation adjustment	CVA	80	6	38	3
		SUB TOTAL	3,800	304	4,178	334
Market risk	Standardised	Interest Rate Risk / Trade debt instruments	64	5	70	6
		Position Risk on equities	47	4	49	4
		Foreign Exchange Risk	8	1	17	1
		SUB TOTAL	119	10	136	11
Operational risk	Standardised		697	56	692	55
TOTAL			4,616	369	5,006	400

The total RWA amount of 5,006 million integrates the charge related to deferred tax assets (DTA)[1].

1 *DTA charge of 68 million is recorded in Central Governments and Central Banks, under the IRB approach.*

1.1.3.1 Weighted risks

Since January 1, 2008, the Bank has used the Basel framework – through its different evolutions – to calculate its capital requirements with respect to credit, market and operational risk, and to publish its solvency ratios.

At the end of 2014, the Bank's total RWAs amounted to 5 billion, as compared with the 4.6 billion as at end 2013.

On the credit risk side, the overall increase observed in 2014 (+0.4 billion), is explained by the cumulative impacts of the new Basel III requirements (linked to the additional charges related the unregulated financial institutions and large financial institutions, new treatment of Small and Medium Enterprises etc.) and the bank's risk profile evolution (i.e. increase on the *Corporate, Public Sector, Individuals, SME and Self Employed* portfolios).

While operational risk RWAs slightly decreased by 5 million in 2014, the market risk RWAs increased by +17 million, principally explained by the growth of the trading portfolio.

	Pro-forma 31/12/13	31/12/14	2014 vs 2013	Contribution to the increase
Weighted credit risks	3,720	4,140	11.29%	420
Weighted market risks	119	136	14.29%	17
Weighted operational risks	697	692	-0.72%	-5
Weighted CVA risks	80 [1]	38	-52.50%	-42
TOTAL WEIGHTED RISKS	**4,616**	**5,006**	**8.45%**	**390**

For Credit Risk, BIL group has decided to use the Advanced-Internal Rating Based (A-IRB) approach on its main counterparties (i.e. Sovereigns, Banks, Corporate, SMEs and Retail).

When it comes to Market Risk, the Bank has adopted the Standardised method for the calculation of its weighted risks. This choice is based on the Bank's very moderate trading activity, whose sole purpose is to assist BIL customers by providing the best service relating to the purchase or sale of bonds, foreign currencies, equities and structured products.

1.1.3.2 Capital Adequacy ratios

	Pro-forma 31/12/13	31/12/14
Common Equity Tier 1 Capital (CET1)	704	765
Additional Tier One Capital	0	150
Total Own funds	894	979
Risk Weighted Assets	4,616	5,006
Common Equity Tier 1 Capital Ratio (CET1)	15.25%	15.28%
TOTAL CAPITAL RATIO	**19.37%**	**19.56%**

The sum of the different weighted risks categories constitutes the denominator for the calculation of the solvency ratios.

Compared with the Basel III *pro-forma* at the end of 2013, BIL group's Total Capital ratio and Common Equity Tier 1 ratio have increased, thanks to the strengthening of the bank's own funds with, particularly, the CoCo issued for 150 million qualified as Additional Tier 1 according to the CRD IV package.

1.2 Leverage ratio

The leverage ratio is introduced by the Basel Committee to serve as a simple, transparent and non-risk-based ratio to complete the existing risk-based capital requirements. In 2014, the Bank was fully compliant with the current EBA definition[2]. The delegated act issued by European Commission on December 10, 2014 and published in the OJEU (official journal of European Union) on January 17, 2015 amends the calculation of the leverage ratio. The leverage ratio based on this new definition will be computed from 2015 Q2 on.

The Basel III leverage ratio is defined as the capital measure (the numerator) divided by the exposure measure (the denominator), with this ratio expressed as a percentage and having to exceed a minimum of 3%.

While the capital measure for the leverage ratio is the Tier 1 capital taking account of the transitional arrangements, the total exposure measure corresponds to the sum of the following exposures: (a) on-balance sheet exposures; (b) derivative exposures; (c) securities financing transaction (SFT) exposures; and (d) off-balance sheet (OBS) items.

At the end of the year, BIL group's leverage ratio amounted to 4.42%. This comfortable level is explained by the Bank's limited use of derivatives and securities financing transactions.

1 *CVA estimated on a best effort basis*

2 *http://www.eba.europa.eu/documents/10180/359626/Annex+X+-+Leverage+ratio+templates.xlsx/a1a3b5d0-4da3-458c-984d-6a7566591460*
http://www.eba.europa.eu/documents/10180/359626/Annex+XI_Instructions_Leverage.docx/95548c57-eb8c-424c-b7ce-14093a92c1b0

The composition of the BIL group's exposure reflects its business model, based on a commercial orientation.
To ensure consistency between the total accounting assets amounts and the total leverage ratio exposures, the following table gives aggregated figures of the different retreatments allowed by the current regulation at the end of 2014.
The total accounting balance sheet of the Bank reached 20.28 billion while the total leverage ratio exposures amounted 20.7 billion.
In the leverage ratio calculation, the Bank computes its derivatives exposures after netting rules and application of received collateral in compliance with the Basel II treatment (i.e. "to be included" field) , while the accounting exposure corresponds to the Mark-to-Market values of these derivatives (i.e "to be eliminated" field).
The Securities Financing Transactions (SFT) are computed by the Bank according to Basel II treatment and after application of add-on value (i.e. "to be included" field).
Finally, the leverage ratio denominator includes a part of off-balance sheet items. This retreatment includes commitments (i.e. "to be included" field) converted under the standardised approach into credit exposures equivalents through the use of credit conversion factors (CCF).

	Amounts Balance sheet	To be eliminated	To be Included	Leverage Exposure	Comments
Derivatives	425	-425	133	133	Replace book value with EAD
Securities financing transactions	0	0	9	9	Replace book value with EAD
Assets deducted in Tier 1	-437	-437	437	-437	Eliminated to avoid duplication
Other Assets	19,860	0	0	19,860	Included in full
TOTAL ASSETS	**20,285**			**20,002**	
TOTAL OFF-BALANCE SHEET ITEMS				**1,141**	**OFF-BALANCE WEIGHTED BY STANDARD CCF**
Total exposure (denominator)				**20,705**	
Tier 1 capital - transitional definition (numerator)				915	
LEVERAGE RATIO				**4.42%**	

The Bank manages its balance sheet through the ALM desk and follows closely this ratio.

1.3 Internal capital adequacy Assessment Process - Pillar 2

1.3.1 ICAAP Framework

1.3.1.1 Definition of the ICAAP

Article 73 of Directive 2013/36/EU defines the ICAAP as a set of "[…] sound, effective and comprehensive strategies and processes to assess and maintain on an on-going basis the amounts, types and distribution of internal capital that they consider adequate to cover the nature and level of the risks to which they are or might be exposed".
ICAAP is an internal instrument, which shall allow BIL group to hold the internal capital it deems appropriate in order to cover all the risks to which it is or could be exposed as a result of its Business Model and Strategy Plan, this being framed by its Risk Appetite and its risk bearing capacity.
Under the ICAAP, BIL group is required to identify all the relevant risk types it is or could be exposed, to quantify them using its own methods and to maintain adequate capital to back them. This capital must be of sufficient quantity and quality to absorb losses that may arise with certain probability and frequency.
The ICAAP shall fully reflect all the risks to which the consolidated entity (i.e. BIL, its subsidiaries and branches) is or could be exposed, according to its business model and strategy, as well as the economic and regulatory environment under which the Bank operates or could come to operate. The ICAAP shall therefore not only take into account the current situation of the Bank but shall definitively be forward-looking in order to ensure the internal capital adequacy on an on-going basis.
In order to achieve this objective, ICAAP must be anchored within BIL group's decision-making processes, its business and risk strategies and its risk management and control processes. This requires the ICAAP to be, amongst others things, an integral part of BIL's limit systems and internal reporting frameworks, especially due to the fact that it is a system of forward-looking strategies and processes.

1.3.1.2 Purpose of the ICAAP

The main purpose of the ICAAP is, for the Board of Directors, to proactively make a strategic assessment of its capital requirements and adequacy considering its strategies, the Bank's business model and current situation. Further, the ICAAP also establishes the capital required for economic

purposes and helps identifying its planned sources of capital to meet these objectives.
One of the benefits of the ICAAP includes greater corporate governance and improved risk assessment within banks, and thereby increases the stability of the overall financial system. It also helps to maintain capital levels in accordance with the Bank's strategy, risk profile, governance structures and internal risk management systems.
Another important purpose of the ICAAP is, for senior Management, to inform the Board of Directors on the on-going assessment of the Bank's risk profile, Risk Appetite, Strategic Model and Capital Adequacy. It also includes the documentation as to how the Bank intends to manage these risks, and how much current and future capital is necessary to meet its future plan.

1.3.1.3 ICAAP Components

BIL group's ICAAP is based on the following building blocks:

Risk appetite framework

Risk appetite expresses the maximum level of risk BIL group is willing to take to reach its business and strategic objectives.
The aim is to provide BIL group with a risk appetite statement and supporting measures which:

- provide an objective and measurable view of whether or not the Bank is within risk appetite
- are aligned to the overall strategic objectives
- adequately consider the key risk areas applicable to the group.

The starting point of the Risk appetite framework is the strategic business plan. The Business Model and Business Strategy are translated into five Risk Appetite Pillars: Capital, earning stability, liquidity, reputation and operational effectiveness. For each of these pillars, a set of macro and micro indicators associated to relative tolerance levels have been defined to quantitatively express the risk appetite.
All financial and regulatory ratios are applied with warning thresholds to indicate watch and alert status and are approved each year by the Board of Directors.

Risk identification and cartography

According to Circular CSSF 07/301 the Bank shall, [i]n order to determine its internal capital requirements for risks, […] first identify the risks to which it is exposed. The permanent and total internal capital adequacy requires this identification to refer to all the risks to which the institution is or might be exposed. This is the comprehensive nature of the ICAAP.
BIL group's risk cartography aims at fulfilling this principle. As a first natural step of the ICAAP, the risk cartography to be established must be (i) exhaustive, (ii) cover the risks to which the Bank is or might be exposed, and (iii) be forward-looking in order to take into account the future developments which may affect its internal capital adequacy and risk management framework.

The risk identification cycle conducted internally is based on a four steps process.

Risk glossary

The risk glossary is an exhaustive list of risks the Bank is or might be exposed to as a consequence of its activities and overall environment. This list summarises the definitions commonly agreed at the Bank's level and is strongly inspired by the regulatory references (e.g. CRR, CRD IV) and the common admitted market practices.

Risk identification

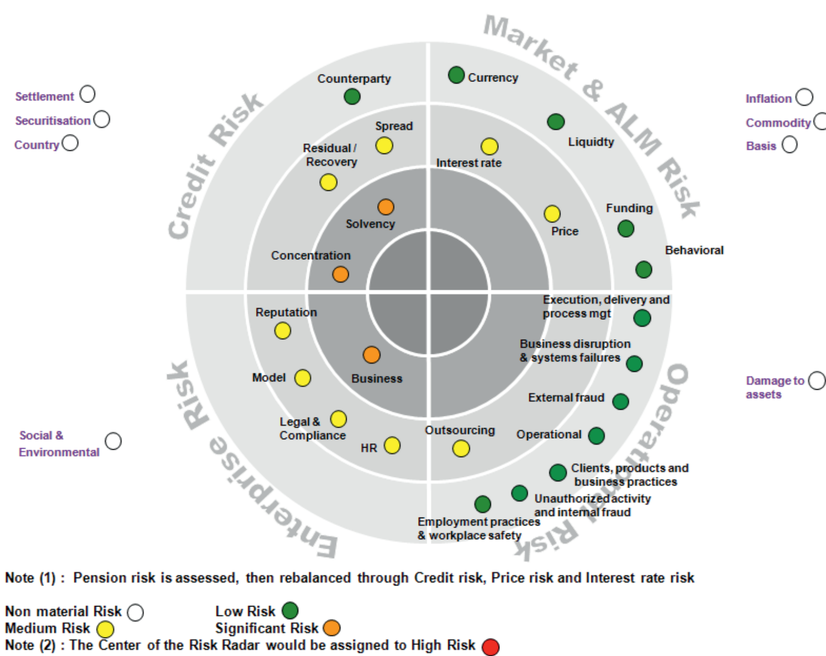
The second step of the cartography process consists in identifying the main risks the Bank is or might be exposed to according to its current and planned activities and the expected evolution of its business environment.
Specific analyses are internally conducted, based on (i) the Bank's current aggregated risk cartography, outcome of the previous ICAAP, (ii) the more detailed ECAP map, (iii) the on-going follow-up and monitoring of the Bank's activities realised by the Risk Management and other internal control functions (i.e. Internal Audit, Compliance, etc.), and (iv) other outcomes provided by the Bank's various internal stakeholders (i.e. Financial Planning, etc.).
Finally, findings and issues highlighted by the regulators through their supervisory exercises (e.g. Comprehensive Assessment, SREP etc.) and views on the evolution of the Bank's environments (e.g. legal, regulatory, market, political expectations etc.) allow for the objectification of the risk identification.

Risk assessment

The materiality of each identified risk is based on its nature, in light of the Bank's activities, and the overall impact its materialisation has or could have on BIL group's viability.
The overall risk assessment is based on the risk effective gross materiality and the mitigation techniques the Bank has put in place in order to prevent its occurrence or reduce its impacts.
Depending on its materiality and its nature, the risk identified will then be covered by economic capital, when deemed necessary, or apprehended through the establishment of dedicated internal governance, process and procedures. Whenever risks could strongly affect the achievement of the Bank's business objectives, reputation, create liquidity pressure, impact capital and/or revenues or lead to regulatory compliance issues, they are considered as material.
A severity level (i.e. High, Significant, Medium, Low and Immaterial) is finally applied to each risk identified allowing thus to draw BIL group's risk cartography.

Risk cartography

The 2014 Cartography process has led to the following Risk Radar:



Risk assessment

The risk assessment process carried out by the Bank is performed in coherence with the Risk identification and cartography process. One of the main components of risk assessment is Economic Capital (ECAP).

Economic capital can be seen as the methods or practices allowing banks to consistently assess risk and attribute capital to cover the economic effects of risk-taking activities. Economic capital is defined as the potential deviation between the group's economic value and its expected value, with a given confidence interval and time horizon.

Economic capital aims at summarising in one single figure the unexpected losses of the Bank regarding the risks facing by its different activities and entities.

Capital adequacy process

The capital adequacy process mainly links the economic capital requirements with the Bank's Available Financial Resources (AFR) that represent the loss absorbing financial capacity and availability over a one-year horizon. These AFR are materialised by the available financial capacity to cover the incurred risks and absorb the losses. For details, please refer to the section Capital adequacy.

Capital Planning and Stress Testing

Capital Planning can be defined as a tool allowing the Banks' management to have a clear view on the appropriate level of capital necessary for supporting its strategy deployment, taking into account various scenarios in a forward-looking perspective.

Stress testing is a risk management technique used to evaluate the potential effects on an institution's financial condition of a specific event and/or movement in a set of financial variables. The traditional focus of stress testing relates to exceptional but plausible events.

1.3.2 Capital adequacy

The following section summarises (i) the Available Financial Resources calculation, (ii) the Economic Capital assessment and (iii) the Pillar 1 and Pillar 2 capital adequacy.

1.3.2.1 Available Financial Resources

Definition

Available Financial Resources (AFR) represent the loss absorbing financial capacity and availability over a given time horizon (one year for BIL group). AFR are materialised by the available financial capacity to cover the incurred risks and absorb the losses.

Core principles

Principle 1: Permanent, loss absorbing and available resources. The bases of the AFR measure are BIL groupBIL group's CET1 ratio but with some adjustments to have an economic view of the Bank's available resources and to respect the second principle.

Principle 2: Consistency with Economic Capital. ECAP is a measure of the Bank's unexpected losses. According to this, AFR do not aim at absorbing the existing incurred losses for which provisions have been booked; the current P&L is not filtered for the AFR contrary to CET1.

Principle 3: Continuity of operations. Any resource should comply with a going concern scenario, meaning that the Bank is not looking for a measure in a resolution scenario.

Principle 4: Solidarity between the different constituents within the group. Minority interests are considered making part of the available financial resources (up to a certain level in line with current Basel III understanding).

1.3.2.2 AFR as of end 2014

According to those principles, the Bank's AFR are based on the own funds, in line with Basel III requirements, and are adjusted according to economic considerations in order to ensure consistency with the key principles of the measure. As of December 31, 2014, the BIL group Available Financial Resources amounted to 891 million.

BIL GROUP AFR	year-end 2014
RESOURCES	
Owns funds	979
Retained earnings	4
AFS Bonds	104
CFH & FXH reserves	-2
Hybrid	0
AT1	150
TOTAL	**1,235**
DEDUCTIONS	
Intangible & goodwill	-66
DTA Netting with DTL	-276
OCR stock	-1
TOTAL	**-344**
TOTAL AFR	**891**

Each time, a methodological or a perimeter change is deployed for ECAP, an assessment of the corresponding impact on AFR is realised commonly with Finance and Risk departments and the change is taken into account in the AFR calculation.

1.3.2.3 Economic Capital

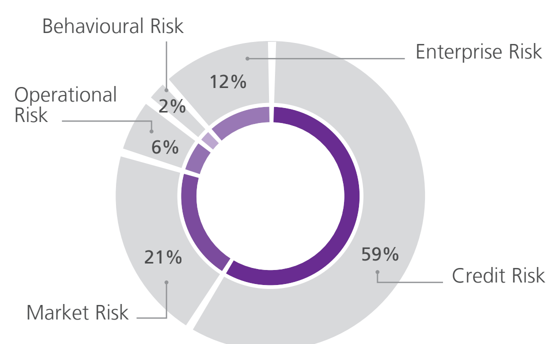
In the context of BIL group, ECAP can be defined as the amount of capital that would be necessary to cover the unexpected risks inherent in the Bank's activities and thus ensure the continuity of its business over a given time period with a certain level of confidence. ECAP could thus be interpreted as the worst-case loss the Bank's shareholders could face with a 99.93% confidence interval, corresponding to a long-term rating of A- over a one year horizon.

The process for quantifying economic capital is based on the following two steps:

- Measurement of risk capital (RC) by type of risk, on the basis of dedicated statistical methods. Each risk is thus individually assessed.
- Aggregation based on an inter-risk diversification matrix to obtain a global ECAP figure and its reallocation to the various levels of risk (entities, business lines, etc.).

Firstly, an ECAP engine allows to aggregate the risk capital estimated for each risk and then allocate it to all risk levels (entities, business lines, etc.). This tool is based on the Markowitz approach: the total estimated capital is diversified using a calibrated correlation matrix.

As at December 31, 2014, BIL group's economic capital amounted to 705 million, allocated according to the following structure:



1.3.2.4 Capital adequacy

BIL group's capital adequacy is represented in the following table:

Risk Category	Risk Type	Pillar 1	Pillar 2
Credit	Credit Risk	334	281
	Concentration Risk		25
	Credit Spread Risk		107
Market	Price Risk	11	40
	Interest Rate Risk		92
	Currency Risk		7
	Funding Risk		8
Operational	Operational Risk	55	45
Behavioural	Behavioural Risk	-	15
Enterprise Risk	Business Risk	-	64
	Model RIsk	-	20
Total Capital level		**401**	**705**
Capital Supplies		**979**	**891**
Ratio AFR/ECAP		**244%**	**126%**

As of 2014 year-end, the ratio of economic capital resources to economic capital consumption had reached the level of 126%.

2. Risk Management

2.1 Risk Management responsibilities

The responsibilities of BIL group's Risk Management department can be summarised as follows:

- **Ensuring that all risks are under control** by identifying, measuring, assessing, mitigating and monitoring them on an on-going basis. Global risk policies and procedures define the framework for controlling all types of risks by describing methods to be used and defining limits, as well as the escalation procedures to be activated in case of needs,
- **Providing the Management Board and the Board of Directors** with a comprehensive, objective and relevant overview of the risks bore by the institution. Dedicated reports and presentations are made on a regular basis to the Bank's relevant management bodies (e.g. CRO, Management Board, Board of Directors),
- **Ensuring that the risk limits are compatible** with the Bank's strategy, business model and structure through an effective risk appetite framework, which defines the level of risk the Bank is willing to take in order to achieve its strategic and financial goals,
- **Ensuring compliance with banking regulation requirements** by submitting regular reports to the regulators (ECB, CSSF, BCL, EBA, etc.), taking part in regulatory discussions and analysing all new requirements related to risk management that could affect the regulatory monitoring of Bank's activities.

2.2 Risk organisation and governance

BIL group's risk management framework is based on a clear organisational structure with a transparent decision-making process that facilitates prudent management of risks.
The Bank's risk management model is based on the following principles:

- independence of the risk function with respect to the business
- collegial decision-making to ensure that opinions are challenged
- precise policies and procedures detailing limits of risk, responsibilities, monitoring and reporting of risks taken by the Bank
- central control, whereby all departments, subsidiaries and branches report both organisational related and technical matters to Risk Management at BIL's Head office
- implementation of the same risk monitoring and data control system in all entities of BIL group.

2.2.1 Organisation

To reflect a sound management of risk and develop an integrated risk culture, the Bank has set up an effective risk management organisation, in adequacy with its activities, encompassing the relevant risks induced by its activities:

At the Management Board level, the overall Risk Management framework remains under the Chief Risk Officer (CRO)'s responsibility, and the CRO is responsible for providing any relevant information on risks to the Management Board, enabling the capture and management of the Bank's overall risk profile.
The CRO delegates the day-to-day supervision of the department to the Head of BIL group Risk Management.
In terms of organisation, BIL group's Risk Management department is based on four specific units described hereafter.

Credit Risk Management

The Credit Risk department is in charge of defining credit risk policies and guidelines, analysing and assessing credit risks borne by the Bank's counterparties, monitoring the corresponding credit risk portfolio and calculating the related RWA (see section 3.1.1 relating to the credit risk organisation for further details).

Financial Risk Management

The Financial Risk Management department is in charge of defining policies and guidelines, identifying, analysing, monitoring and reporting on risks and results related to the Bank's financial market activities (see section 4.1.1 relating to the financial risk organisation for further details).

Operational Risk Management

The Operational Risk department covers the management of operational risks such as Corporate Operational Risk, Insurance/Reinsurance activities and Security Risk Prevention and Regulation (see section 5.1.1 relating to the operating risk organisation for further details).

Strategic Risk Management

The Strategic Risk Management department deals with all the activities related to the modelling and monitoring of the Bank's group-wide risks. This department also sets up and coordinates the production of regulatory reports such as the ICAAP and Pillar 3 Disclosure reports.

2.2.2 Governance

Each of the departments described above ensures that the CRO and Management Board have an accurate understanding of every type of risks within the Bank, and are aware of major issues concerning sources of risk. Each of these departments is involved in risk governance and is responsible for defining policies, guidelines and procedures encompassing risks within its scope.
The Management Board ensures that risk taking and risk management standards fit with the principles and targets set by the Board of Directors. The existence of risk management committees does not relieve the Board of Directors or the Management Board of the general supervision of the Bank's operations and risks. They have very specific remits and help with developing and implementing good governance and decision-making practices.
The Board Risk Committee is a specialised committee supporting the Board of Directors on subjects related to risk. Among its roles, the Board Risk Committee reviews and recommends to the Board of Directors changes to BIL group's Risk Management framework and the global risk limits of capital allocation. It reviews global risk exposure, major risk management issues and capital adequacy requirements. Moreover, this committee reviews, assesses and discusses any significant risk or exposure and relevant risk assessments with the independent auditor on an annual basis; it reports to the Board of Directors on a regular basis and makes recommendations on any of the above matters, or other ones when deemed necessary.
Other specific risk committees are constituted and receive their mandate from the Management Board within a precise and defined scope. They facilitate the development and implementation of sound practices of governance and decision-making. These committees are described in more detail below.

2.2.2.1 Responsibilities of the Risk Committees

Topics	Committee
Overall responsibility for the administration and governance of the Bank Decision/Approval on strategic topics related to risk management	Board of Directors
Overseeing risk issues and policy arising from the Bank's business activities and assisting the Board of Directors in matters of risk policy and risk review	Board Risk Committee
Responsible for the efficient, sound and prudent daily management of operations of the Bank and related risks Implementation and management of a strong, adequate and efficient risk policy	Management Board
Decision/Approval of procedures and risk policies in the scope of risk management	Risk Policy Committee
Decision/Approval of credit engagements	Committments Committee Lending Committee Employee Loans Committee
Decision/Approval on defaults or provisioning	Default Committee
Decision on Market limits	ALM Committee
Funding and Liquidity Crisis Management	Contingency Funding and Liquidity Committee
Decision/Approval of new products, and on operational risk matters	New Products and Operational Risk Committee
Strategic and transversal subjects common to Risk and Finance departments (Governance, Risk Appetite, Risk Cartography, Economic Capital, Stress Tests, Transversal Reporting, Follow-up of BIL group's branches/subsidiaries risks, Regulatory Watch, Recovery Plan…)	Strategic Risk Committee
Security of information	Security Committee
Crisis management	Crisis Committee

2.2.2.2 Risk policies, guidelines and procedures

The risk management framework is also governed by an integrated set of policies, guidelines and procedures. These documents establish uniform methodologies and terminologies used within BIL group's risk management. They clarify risk identification, assessment and monitoring processes and facilitate the setting up of a sound and efficient risk management framework.

3. Credit risk

Credit risk represents the potential loss (reduction in value of an asset or payment default) that BIL may incur as a result of a deterioration in the solvency of any counterparty.

3.1 Credit risk governance

3.1.1 Organisation

The Credit Risk department is composed of the following teams:

- **Country & Bank Analysis Team and Retail, Midcorporate, Corporate and Private Bank Analysis Team**

These two teams are in charge of the assessment and monitoring of the risk related to banks and sovereign counterparties on the one hand, and retail, corporate and institutional counterparties on the other hand. Both teams are in charge of assigning internal ratings to BIL counterparties and monitoring the corresponding portfolio.

- **GIP (Gestion intensive et particulière)**

This team actively manages and monitors the assets deemed to be "sensitive" in order to prevent and minimise the potential losses for the Bank in the event of the default of the counterparty.

- **Data Management & Risk Systems**

Data Management and Risk systems teams are in charge of the development and maintenance of the data and risk systems used for the calculation of credit risk capital requirements and the corresponding regulatory reports. These teams are also responsible for producing regulatory and internal reports related to credit risk, such as the COREP, Large Exposures Report and Quarterly Risk Report, and for responding to ad hoc requests from regulatory authorities.

Furthermore, some of the Strategic Risk Management teams are involved in the calculation of the capital requirements for credit risk:

- **IRS (internal rating systems) modelling and integration**

This team is in charge of modelling the Bank's internal rating systems (developed within the A-IRB framework) and their subsequent integration within the businesses. Its responsibilities also include the monitoring of some key credit risk indicators (non-performing loans, provisioning) and the realisation of the Bank's credit risk-related stress tests.

- **Risk Controlling**

This team aims at validating the adequacy and performance of the Bank's internal credit risk models (Model Validation), while ensuring their correct use by the credit risk teams (e.g. use-test requirements, data homogenisation within the systems (Rating Systems Quality Control).

3.1.2 Policy

BIL's Risk Management department has established a general policy and procedure framework in line with the Bank's risk appetite. This framework guides the management of credit risk from an analysis, decision-making and risk monitoring perspective. The Risk Management department manages the loan issuance process by delegating, within the limits set by the Bank's management, and by chairing credit and risk committees. As part of its credit risk monitoring tasks, Credit Risk Management supervises changes in its portfolios' credit risks by regularly analysing loan applications and reviewing ratings. The Risk Management department also draws up and implements the policy on provisions, decides on specific provisions, and assesses defaults.

3.1.3 Committees

BIL's Risk Management department oversees the Bank's credit risk, under the supervision of the Management Board and dedicated committees.

The Risk Policy Committee defines the general risk policies, as well as specific credit policy in different areas or for certain types of counterparty and sets up the rules for granting loans, supervising counterparty rating and monitoring exposures. The Risk Policy Committee validates all changes in procedures or risk policy, internal rating systems, principles and calculation methods referring to risk.

In order to streamline the decision-making process, the Management Board delegates its decision-making authority to credit committees or joint powers. This delegation is based on specific rules, depending on the counterparty's category, rating level and credit risk exposure. The Board of Directors remains the ultimate decision-making body for the largest loan applications or those presenting a level of risk deemed to be significant. The Credit Risk Management department carries out an independent analysis of each application presented to the credit committees, including determining the counterparty's rating, and stating the main risk indicators; it also carries out a qualitative analysis of the transaction.

Alongside supervision of the issuance process, various committees are tasked with overseeing specific risks:

- **The Default Committee** identifies and tracks counterparties in default, in accordance with Basel regulations, by applying the rules in force at BIL and determines the amount to be accounted for specific provisioning purposes. The same committee supervises assets deemed to be "sensitive" and placed under surveillance (Special Mention and Watchlists),
- **The Rating Committee** ensures that the internal rating systems are correctly applied and that rating processes meet pre-defined standards,
- **The Internal Rating Systems Performance Committee** ensures the monitoring of BIL's internal rating systems' performance through time (i.e. backtesting, benchmarking, model validation) and discusses all the strategic choices related to this matter (e.g. new model development, material changes, etc.).

3.1.4 Risk measurement

Credit risk measurement is primarily based on internal systems introduced and developed within the Basel framework. An internal rating is assigned to each counterparty by credit risk analysts, using dedicated rating tools. This internal rating corresponds to the probability of default of the counterparty, expressed by means of an internal rating scale. It is a key factor in the loan issuance process. Ratings are reviewed at least once a year, making it possible to identify counterparties requiring the close attention of the Default Committee.

To manage the general credit risk profile and limit concentration of risk, credit risk limits are set for each counterparty, establishing the maximum acceptable level for each one. Limits by economic sector and by product may also be imposed by the Risk Management department. The latter actively monitors limits, which can be reduced or freeze at any time, in light of changes in related risks.

Metrics

The metrics used to measure risk exposure may differ from accounting metrics.

The credit risk exposure measure known as exposure-at-default (EAD), which is used for the calculation of regulatory capital requirements includes (a) current and potential future exposures, and (b) credit risk mitigants (CRM) covering those exposures (under the form of netting agreements, financial collateral for derivatives and repo exposures, and guarantees for others).

Moreover, BIL has defined an internal measure compliant with IFRS 7 norms, known as maximum credit risk exposure (MCRE) in order to compare figures published in the annual financial statements. This metric corresponds to the EAD with a credit conversion factor (CCF) of 100%, after deduction of specific provisions and financial collateral (netting agreements).

Focus on the forbearance measure

Since the first quarter of 2014, BIL monitored closely its forborne exposures, in line with EBA Final Draft ITS requirements published in October 2013 and updated on July 25, 2014.

The previous CSSF definition of restructured credit is close to the EBA definition; the latter provides institutions with more details regarding the way this notion should be addressed across different jurisdictions. According to EBA's definition, forborne exposures are debt contracts in respect of which forbearance measures have been extended. Forbearance measures consist of concessions towards a debtor facing or about to face difficulties in meeting its financial commitments ("financial difficulties"). Those measures include in particular the granting of extensions, postponements, renewals or changes in credit terms and conditions, including the repayment plan.

Once those criteria are met, the credit files are flagged as being restructured and are added to a list closely followed by the team "Gestion Intensive et Particulière".

Following the publication of EBA standards, BIL group has adapted its internal forbearance definition in order to fully comply with the suggested one. Concretely, analyses have been conducted internally on specific credit files with the aim of defining and identifying relevant operational criteria for the forbearance classification. These efforts continued during the first quarter of 2014 and led to dedicated methodologies being set up that will be further refined in order to meet EBA's requirements.

In order to comply with those requirements, BIL group has set up a dedicated project aimed at (1) identifying the criteria leading to the forborne classification, (2) classifying the Bank's existing exposures between the forborne and non-forborne ones and (3) implementing these criteria across the systems.

For non-retail counterparties, dedicated analyses have been carried out at single credit files level in order to identify those that should be classified as forborne according to EBA's definition. For the retail counterparties, a specific methodology has been implemented in order to detect all of the forborne candidates. In a nutshell, this methodology first identifies the credits for which concessions have been granted to the debtors and then analyses if these concessions coincided with financial difficulties at the debtor level (based on criteria like past due, rating etc.). This methodology was used in 2014 for the resumption of the retail stock while from 2015 on, the Bank will also apply the non-retail methodology to the retail exposures.

The granting of forbearance measure is likely to constitute an impairment trigger, meaning that the loan should be assessed for impairment either individually or as part of a collective assessment.

For credit files in forbearance and in case of early repayment, the costs related to these transactions are either borne by the debtor (in one shot or spread over the term of the new loan) or recognised directly in the Bank's profit and loss.

As at end 2014, BIL group's forborne exposures amounted to 197 million including 12 million as given banking guarantees. The significant decrease observed since end 2013 (386 million as at December 2013) is mainly explained by the deep analyses conducted this year in order to refine the forborne perimeter on the retail portfolio, firstly assessed in 2013 thanks to a statistical approach.

3.2 Credit risk exposure

Credit risk exposure refers to the Bank's internal concept of maximum credit risk exposure (MCRE):

- the net carrying value of balance sheet assets other than derivative products (i.e. the carrying value after deduction of specific provisions)
- the mark-to-market valuation of derivative products
- the total off-balance sheet commitments. The total commitment corresponds to unused lines of liquidity or to the maximum amount that BIL is obliged to honour under guarantees issued to third parties.

The substitution principle applies where the credit risk exposure is guaranteed by a third party with a lower risk weighting. Therefore, counterparties presented hereafter are final counterparties, i.e. after taking into account any eligible guarantees.

The following tables presenting exposures breakdown do not include the charge in RWA related to deferred tax assets in accordance with Article 48 §4 of the CRR.

As of December 31, 2014, the Bank's total credit risk exposure amounted to 21,028 million, namely EUR 660 million above the end 2013 level. Exposures under IRB approach being stable, this rise is therefore explained by exposures rated in standardised approach.

This variation is explained, on the one hand, by the increase of 405 million observed on counterparties with low or zero risk (i.e. *Multilateral Development Banks, Public Sector Entities*, *Regional Governments and Local Authorities* and *Sovereigns*)

and on the other hand, the increase of 255 million observed on *Corporate sector and Securitisation*.
Please note that the 2013 data issued hereafter is displayed in a compliant Basel III Corep pro-forma. This explains the differences that can be observed with last year report.
Several metrics will be used throughout this report to express different views on the Bank's risk exposures. The following table can be used as a reminder of the global exposure, broken down by regulatory method and by measure of risk:

APPROACH	MCRE	EAD	RWA
A-IRB	17,700	18,687	2,585
STANDARD	3,328	3,123	1,487
SUBTOTAL	**21,028**	**21,810**	**4,072**
Charge on DTA			68
TOTAL	**21,028**	**21,810**	**4,140**

3.2.1 Exposure breakdown by asset class at year-end and average exposure

This table represents the year-end total and annual average exposure expressed in MCRE.

The year-end total exposure includes figures obtained using both the standardised approach and advanced methods. The average exposure is computed as the monthly average of the individual asset class exposures.

IRB approach	2013 Year-end exposure*	2014 Year-end exposure	2014 Average exposure
Central Governments and Central Banks	5,589.88	5,322.34	5,823.80
Corporates - Other	1,308.31	1,694.12	1,326.89
Corporates - SME	1,943.09	1,867.76	1,946.89
Corporates - Specialised Lending	3.91	5.02	10.76
Equity	69.13	12.01	30.92
Institutions	1,946.42	1,891.28	2,432.55
Retail - Other non-SME	3,186.72	2,466.65	3,277.88
Retail - Other SME	358.72	154.98	347.17
Retail - Secured by real estate non-SME	3,241.83	4,204.37	3,396.79
Retail - Secured by real estate SME	20.50	81.58	26.06
Total IRB approach	**17,668.51**	**17,700.13**	**18,619.71**
Standardised approach			
Collective Investment Undertakings	3.19	0.00	1.06
Corporates	671.47	826.88	742.27
Covered Bonds	60.37	67.31	70.48
Equity	1.00	4.95	7.37
High Risk Exposures	60.54	30.02	43.96
Institutions	4.29	2.03	5.36
Multilateral Development Banks	30.37	95.20	87.04
Other	393.68	369.46	432.96
Past Due	16.12	19.35	12.58
Public Sector Entities	79.60	143.72	118.51
Retail	0.18	0.44	5.50
Regional Governments And Local Authorities	18.63	175.00	63.32
Secured On Real Estate	381.70	390.38	395.19
Short-Term Exposures	0	7.78	23.17
Sovereigns	366.64	487.00	387.42
Supra	613.96	608.12	574.77
Securitisation	0	100.09	13.63
Total Standardised approach	**2,701.75**	**3,327.73**	**2,984.60**
TOTAL	**20,370.26**	**21,027.86**	**21,604.31**

**2013 average exposure is not available under the new Basel III Corep segmentation.*

The main differences between the average and the year-end exposures for the year 2014 are explained as follows:

- Exposure to Institutions under IRB approach firstly increased during the first half of the year to finally decreased over the second half of the year, respectively due to loans granted and matured loans, explaining the difference between the year-end and the average exposure.
- Counterparties associated with very low risk such as Multilateral Development Banks, Public Sector Entities, Sovereigns and Regional Governments and Local Authorities increased of 405 million which is mainly explained by the purchase of bonds. This rise is mitigated by the decrease of Central Governments and Central Banks exposures for 270 million.
- Corporate exposures increased throughout the year of 470 million. The increase in corporate exposures is mainly due to loans granted.
- The decrease of 57 million in equities is mainly explained by the sales of financial holdings during the second half of the year.
- New exposures to securitisation increased the year-end total exposure by 100 million.

3.2.2 Exposure breakdown by asset class and geographical area

The table below shows the total exposure expressed in terms of MCRE broken down by exposure class and geographical area at year-end 2014. It comprises figures obtained using both the standardised and the advanced methods.

IRB approach	Euro zone	Rest of Europe	US & Canada	Rest of the World	Total exposure
Central Governments and Central Banks	3,812.36	1,191.62	0	318.36	5,322.34
Corporates - Other	1,625.29	31.26	27.40	10.16	1,694.12
Corporates - SME	1,866.75	1.01	0	0	1,867.76
Corporates - Specialised Lending	0	5.02	0	0	5.02
Equity	11.95	0.03	0.02	0	12.01
Institutions	1,122.03	337.97	78.60	352.69	1,891.28
Retail - Other non-SME	2,151.55	271.29	5.34	38.47	2,466.65
Retail - Other SME	154.95	0.04	0	0	154.98
Retail - Secured by real estate non-SME	4,127.88	51.87	2.54	22.08	4,204.37
Retail - Secured by real estate SME	81.58	0	0	0	81.58
Total IRB approach	**14,954.34**	**1,890.11**	**113.91**	**741.76**	**17,700.13**
Standardised approach					
Corporates	753.52	8.30	0	65.05	826.88
Covered Bonds	67.31	0.00	0	0	67.31
Equity	4.71	0.24	0	0	4.95
High Risk Exposures	27.93	1.77	0.31	0.01	30.02
Institutions	2.02	0.00	0	0	2.03
Multilateral Development Banks	0.00	95.20	0	0	95.20
Other	363.90	5.02	0	0.54	369.46
Past Due	19.35	0.00	0	0	19.35
Public Sector Entities	142.94	0.78	0	0	143.72
Retail	0.44	0.00	0	0	0.44
Regional Governments And Local Authorities	175.00	0.00	0	0	175.00
Secured On Real Estate	389.62	0.00	0	0.75	390.38
Short-Term Exposures	7.78	0.00	0	0	7.78
Sovereigns	424.94	38.20	0	23.85	487.00
Supra	0	511.70	0	96.42	608.12
Securitisation	81.09	0.00	0	19.00	100.09
Total Standardised approach	**2,460.57**	**661.22**	**0.31**	**205.63**	**3,327.73**
TOTAL EXPOSURE	**17,414.91**	**2,551.34**	**114.22**	**947.39**	**21,027.86**

As at December 31, 2014, the Bank's exposure was mainly concentrated in Europe (95%, 20 billion), primarily in Luxembourg (60%), France (12%), Belgium (8%) and Germany (7%):

- Corporate activity is concentrated in Luxembourg (75%).
- Retail activity is concentrated in Luxembourg (77%) and its neighbouring countries (9% in France, 3.3% in Germany and 4% in Belgium).
- The main sovereign exposures of the Bank are the Swiss National Bank, Luxembourg and the Central Bank of Luxembourg, Belgium, France and the European Financial Stability Facility Fund.

Corporate and Regional Governments and Local Authorities exposures (RGLA) increased throughout the year, respectively of 470 and 160 million. The increase in RGLA exposures is mainly explained by the purchase of bonds in the euro zone, while the change in corporate exposures is due to loans granted in local markets.

The exposures to the rest of the world increased by 211 million. This is mainly explained by facilities granted to some Asian institutions, with maturities respectively up to May and September 2015.

3.2.3 Exposure breakdown by asset class and obligor grade

The table below shows the total exposure (expressed in terms of MCRE) broken down by exposure class and obligor grade at year-end 2014. It comprises figures obtained using both the standardised and the advanced methods.

IRB approach	AAA+ to AA-	A+ to BBB-	Non investment grade	Non-Rated	Default	Total exposure
Central Governments and Central Banks	4,044.72	1,276.85	0	0.78	0	5,322.34
Corporates - Other	8.80	1,198.76	475.20	0.71	10.65	1,694.12
Corporates - SME	0	646.52	1,171.61	0	49.62	1,867.76
Corporates - Specialised Lending	0	0	5.02	0	0	5.02
Equity	0	7.37	0	4.64	0	12.01
Institutions	359.44	1,369.49	160.46	1.88	0.01	1,891.28
Retail - Other non-SME	23.95	1,021.16	1,318.00	0.06	103.49	2,466.65
Retail - Other SME	0	26.23	124.34	0	4.41	154.98
Retail - Secured by real estate non-SME	0	2,431.45	1,632.06	0	140.87	4,204.37
Retail - Secured by real estate SME	0	5.63	73.01	0	2.95	81.58
Total IRB approach	**4,436.91**	**7,983.44**	**4,959.70**	**8.07**	**312.00**	**17,700.13**
Standardised approach						
Corporates	0.23	192.31	83.95	550.39	0	826.88
Covered Bonds	0	67.31	0.00	0.00	0	67.31
Equity	0	0.16	0.61	4.18	0	4.95
High Risk Exposures	0	0.66	8.08	21.28	0	30.02
Institutions	0	1.79	0.20	0.04	0	2.03
Multilateral Development Banks	95.20	0	0	0	0	95.20
Other	39.06	0	0	330.40	0	369.46
Past Due	0.00	0	0	0.00	19.35	19.35
Public Sector Entities	20.20	20.45	0	103.07	0	143.72
Retail	0	0	0	0.44	0	0.44
Regional Governments And Local Authorities	64.29	36.80	0	73.91	0	175.00
Secured On Real Estate	0	34.34	2.57	353.47	0	390.38
Short-Term Exposures	0	0	0	7.78	0	7.78
Sovereigns	259.39	0	0	227.61	0	487.00
Supra	511.70	0	0	96.42	0	608.12
Securitisation	0	0	0	100.09	0	100.09
Total Standardised approach	**990.07**	**353.83**	**95.40**	**1,869.08**	**19.35**	**3,327.73**
TOTAL EXPOSURE	**5,426.99**	**8,337.27**	**5,055.10**	**1,877.16**	**331.35**	**21,027.86**

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As at December 31, 2014, 65% of the exposure was classified as investment grade, compared with 67.7% in 2013.
The non-investment grade exposure is mainly composed of mid-corporate and retail exposures.
The increase of 850 million among the non-rated exposures is mainly due to an increase of 390 million of corporate exposures and of 290 million of secured of real estate, under the standardised approach.

3.2.4 Exposure breakdown by asset class and economic sector

The table below shows the total exposure (expressed in terms of MCRE) broken down by exposure class and economic sector at year-end 2014.
It comprises figures obtained using both the standardised and the advanced methods.

	Industry	Construction	Trade-Tourisme	Services				
IRB approach				Transportation and storage	Information and communication	Financial and insurance activities	Real estate activities	Professional, scientific and technical activities
Central Governments and Central Banks	0	0	0	0	0	1,198.71	0	0
Corporates - Other	675.00	81.88	260.41	122.65	33.20	320.69	102.42	37.31
Corporates - SME	284.01	585.68	182.11	37.21	28.92	176.44	436.85	50.29
Corporates - Specialised Lending	0	0	0	0	5.02	0	0	0
Equity	0	0	0	0	0	7.44	0	0.03
Institutions	0	0	0	0	0	1,865.64	0	0
Retail - Other non-SME	72.94	97.68	97.13	19.98	15.39	759.04	161.32	118.38
Retail - Other SME	16.54	30.00	59.76	6.83	6.08	3.50	5.29	10.35
Retail - Secured by real estate non-SME	110.96	142.91	188.97	23.92	25.20	681.12	386.23	125.27
Retail - Secured by real estate SME	2.66	20.05	29.89	1.17	1.88	1.18	15.77	1.90
Total IRB approach	**1,162.11**	**958.20**	**818.27**	**211.76**	**115.69**	**5,013.75**	**1,107.89**	**343.54**
Standardised approach								
Corporates	156.79	219.48	3.18	10.74	0.65	157.44	169.25	8.34
Covered Bonds	0	0	0	0	0	54.59	0	0
Equity	0	0	0	0	0	1.35	0	0
High Risk Exposures	0	0	0	8.07	0.34	20.76	0	0
Institutions	0	0	0	0	0	2.02	0	0
Multilateral Development Banks	0	0	0	0	0	95.20	0	0
Other	0	0	0	0	0	39.06	0	0
Past Due	0	0.33	0.16	0	0	0.01	18.84	0
Public Sector Entities	0	0	0	4.08	25.02	0	0	0.01
Retail	0	0.03	0.07	0	0.19	0.15	0	0
Regional Governments And Local Authorities	0	0	0	0	0	0	0	0
Secured On Real Estate	11.43	74.10	3.52	0	0	23.73	215.72	16.51
Short-Term Exposures	0	0	0	0	0	7.78	0	0
Sovereigns	0	0	0	0	0	0	0	0
Supra	0	0	0	0	0	0	0	0
Securitisation	0	0	0	0	0	29.18	0	0
Total Standardised approach	**168.22**	**293.93**	**6.92**	**22.89**	**26.20**	**431.28**	**403.81**	**24.86**
TOTAL EXPOSURE	**1,330.33**	**1,252.13**	**825.19**	**234.66**	**141.90**	**5,445.02**	**1,511.71**	**368.39**

IRB APPROACH	Services						Others	Total exposure
	Adminis-trative and support service activities	Public adminis-tration and defence-com-pulsory social security	Human health and social work activities	Arts, enter-tainment and recreation	Other service activities	Other Services		
Central Governments and Central Banks	0	4,112.38	0	0.51	0	0.01	10.74	5,322.34
Corporates - Other	23.28	0.00	32.20	1.32	3.57	0.19	0	1,694.12
Corporates - SME	35.55	0.00	23.00	10.00	2.63	0.22	14.85	1,867.76
Corporates - Specialised Lending	0	0	0	0	0	0	0	5.02
Equity	0	0	0	0	4.54	0	0	12.01
Institutions	0	0	0	0	0	0	25.64	1,891.28
Retail - Other non-SME	11.83	5.23	79.55	27.14	11.28	13.29	976.49	2,466.65
Retail - Other SME	8.20	0.00	3.57	0.61	3.39	0.86	0	154.98
Retail - Secured by real estate non-SME	18.05	18.59	145.30	16.72	19.54	17.64	2,283.95	4,204.37
Retail - Secured by real estate SME	1.20	0	3.70	1.34	0.84	0.01	0	81.58
Total IRB approach	**98.10**	**4,136.20**	**287.31**	**57.63**	**45.79**	**32.21**	**3,311.68**	**17,700.13**
Standardised approach								
Corporates	0.17	0.34	34.99	3.01	1.69	2.74	58.08	826.88
Covered Bonds	0	0	0	0	0	0	12.72	67.31
Equity	0	0	0	0	3.60	0	0	4.95
High Risk Exposures	0.32	0	0	0	0.52	0	0	30.02
Institutions	0	0	0	0	0	0	0	2.03
Multilateral Development Banks	0	0	0	0	0	0	0	95.20
Other	0	0	0	0	0	0	330.40	369.46
Past Due	0	0	0	0	0.01	0	0	19.35
Public Sector Entities	4.94	0.08	101.38	0.00	8.06	0.05	0.10	143.72
Retail	0	0	0	0	0.00	0.00	0.00	0.44
Regional Governments And Local Authorities	0	157.70	0	0	0.00	0.00	17.30	175.00
Secured On Real Estate	0	0.00	17.76	0.81	2.63	0.36	23.83	390.38
Short-Term Exposures	0	0.00	0	0	0	0	0.00	7.78
Sovereigns	0	422.32	0	0	0	0	64.68	487.00
Supra	0	0.00	0	0	0	511.70	96.42	608.12
Securitisation	0	0.00	0	0	23.14	0.00	47.77	100.09
Total Standardised approach	**5.42**	**580.43**	**154.13**	**3.82**	**39.64**	**514.85**	**651.32**	**3,327.73**
TOTAL EXPOSURE	**103.52**	**4,716.63**	**441.44**	**61.46**	**85.43**	**547.06**	**3,963.00**	**21,027.86**

3.2.5 Exposure breakdown by asset class and residual maturity

The table below shows the total exposure (expressed in terms of MCRE) broken down by exposure class and residual maturity at year-end 2014.
It comprises figures obtained using both the standardised and the advanced methods.

IRB approach	Less than 3 months	3 months to 1 year	1 year to 3 years	3 years to 5 years	More than 5 years	No defined maturity	Total exposure
Central Governments and Central Banks	301.90	241.78	750.75	202.11	2,151.48	1,674.34	5,322.34
Corporates - Other	305.76	270.85	296.00	330.87	361.31	129.32	1,694.12
Corporates - SME	83.06	229.63	130.44	93.20	842.03	489.40	1,867.76
Corporates - Specialised Lending	0.03	4.88	0.04	0	0	0.07	5.02
Equity	0	0	0	0	12.01	0	12.01
Institutions	424.21	430.75	326.82	332.78	271.14	105.58	1,891.28
Retail - Other non-SME	459.19	395.79	265.69	195.43	650.26	500.29	2,466.65
Retail - Other SME	7.06	26.54	32.19	22.01	22.38	44.81	154.98
Retail - Secured by real estate non-SME	206.90	106.45	85.50	90.79	3,547.57	167.16	4,204.37
Retail - Secured by real estate SME	0.91	4.77	2.43	3.94	55.22	14.32	81.58
Total IRB approach	**1,789.02**	**1,711.44**	**1,889.86**	**1,271.12**	**7,913.39**	**3,125.29**	**17,700.13**
Standardised approach							
Corporates	153.21	60.97	32.38	53.79	248.45	278.07	826.88
Covered Bonds	0	0	0	0	67.31	0	67.31
Equity	0	0	0	0	4.95	0	4.95
High Risk Exposures	0	0	0	0	30.02	0	30.02
Institutions	0.01	0.08	0.11	0	0	1.83	2.03
Multilateral Development Banks	0	0	0	0	95.20	0	95.20
Other	0.01	0.34	2.17	2.62	0.55	363.76	369.46
Past Due	0.01	0.03	0	0	0.66	18.65	19.35
Public Sector Entities	10.02	11.21	6.60	0.09	101.70	14.09	143.72
Retail	0	0.01	0.34	0.05	0.04	0	0.44
Regional Governments And Local Authorities	137.59	2.00	15.31	10.10	10.01	0	175.00
Secured On Real Estate	2.45	11.41	12.02	23.62	328.88	12.00	390.38
Short-Term Exposures	7.78	0	0	0	0	0	7.78
Sovereigns	0	89.44	25.14	49.26	323.04	0.13	487.00
Supra	96.42	0	141.48	22.50	347.72	0	608.12
Securitisation	0	0	0	14.88	85.19	0.01	100.09
Total Standardised approach	**407.50**	**175.50**	**235.54**	**176.91**	**1,643.73**	**688.55**	**3,327.73**
TOTAL EXPOSURE	**2,196.52**	**1,886.95**	**2,125.40**	**1,448.03**	**9,557.12**	**3,813.84**	**21,027.86**

This table shows that 36% of the total risk exposure does not exceed five years, and 10% of it is of very short term, below three months.
Over the longer term, 45% of the total risk exposure exceeds five years. This represents long-term bonds to sovereigns, retail banking mortgage activity and the financing of real estate project.

Exposures classified as “no defined maturity” represent 18% of the total exposure and are essentially composed of:
- facilities for the corporate exposure class
- consumer facilities for retail exposure class (e.g. overdrafts, debit accounts and lombard credits)
- nostri accounts with Central Banks for the Central Governments and Central Banks exposure class.

3.3 Forbearance, impairment, past due and provisions

3.3.1 Definitions

BIL records allowances for impairment losses when there is objective evidence that a financial asset or group of financial assets is impaired as a result of one or more events occurring after initial recognition and is evidencing (a) a decline in expected cash flows and (b) an impact on estimated future cash flows that can be reliably estimated.

3.3.1.1 Financial assets measured at amortised cost

BIL first assesses whether objective evidence of impairment exists individually for financial assets. If no such evidence exists, the financial assets is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment.

Determination of the impairment

• Specific individual impairments: If an objective evidence exists individually on a significant asset classified as loans or other receivables or financial assets classified as held-to-maturity, the amount of impairment on specifically identified assets is calculated as the difference between the carrying amount and the estimated future cash flows being the present value of estimated future cash flows.

• Specific collective impairments for mass products: If the objective evidence is identified individually for insignificant assets or collectively for a group of assets with similar risk characteristics, specific impairments is recorded on these identified group of assets.

• Collective impairments: Collective provisions are calculated for counterparties for which no objective evidence of impairment exist but for which the Bank knows that from a statistical point of view losses may have occurred unless those losses have not yet been identified.

The Bank considers the following events as impairment triggers according to IAS 39:

- Significant financial difficulty of the issuer or obligor;
- A breach of contract, such as a default or delinquency in interest or principal payments;
- The lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- It becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- The disappearance of an active market for that financial asset because of financial difficulties; or
- Observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
  - Adverse changes in the payment status of borrowers in the group (eg an increased number of delayed payments or an increased number of credit card borrowers who have reached their credit limit and are paying the minimum monthly amount); or
  - National or local economic conditions that correlate with defaults on the assets in the group (eg an increase in the unemployment rate in the geographical area of the borrowers, a decrease in property prices for mortgages in the relevant area, a decrease in oil prices for loan assets to oil producers, or adverse changes in industry conditions that affect the borrowers in the group).

In addition, the Bank will also consider the levels of and trends in delinquencies for similar financial assets.

In order to adopt a prudent approach, the Bank consider all individual factor as a trigger event.

Accounting treatment of the impairment

BIL recognises changes in the amount of impairment losses in the consolidated statement of income and reports them as "Impairment on loans and provisions for credit commitments". The impairment losses are reversed through the consolidated statement of income if the increase in fair value relates objectively to an event occurring after the impairment was recognised.

When an asset is determined by management to be uncollectable, the outstanding specific impairment is reversed via the consolidated statement of income under the heading "Impairment on loans and provisions for credit commitments" and the net loss is recorded under the same heading. Subsequent recoveries are also accounted for under this heading.

3.3.1.2 Available-for-sale financial assets

BIL recognises the impairment of available-for-sale (AFS) assets on an individual basis if there is objective evidence of impairment as a result of one or more events occurring after initial recognition.

Determination of the impairment

• Quoted equities: The potential need of impairment is analysed based on an impairment test which consists of identifying cases where the net carrying amount is higher than the net present value.

• Unquoted equities: The potential need of impairment on participations is reviewed based on a comparison between the purchase cost and the estimated fair value obtained through latest annual accounts available of the entity (for consolidated participations) and/or any other information that can help evaluating the participation such as latest securities exchanges, internal memorandum on valuation,…(for non-consolidated participations).

• Quoted/unquoted bonds: The potential need of impairment is analysed based on (i) the same impairment test described for the quoted equities above and, in some cases, (ii) an impairment test based on the evolution of the fair value referring to the credit spread.
• Private equity instruments: the potential need of impairment is analysed based on (i) the net asset value of reported by the fund/company, and (ii) an utility value calculated by the Credit Risk department.

Accounting treatment of the impairment

When AFS financial assets are impaired, the AFS reserve is recycled and these impairment losses are reported in the consolidated statement of income as "Net income on investments". Additional decline in fair value is recorded under the same heading for equity securities.
When an impairment loss has been recognised on bonds, any subsequent decline in fair value is recognised under "Net income on investments", if there is objective evidence of impairment. In all other cases, changes in fair value are recognised in "Other comprehensive income".
Impairments on equity securities cannot be reversed in the statement of income due to later recovery of quoted prices.

3.3.2 Information on forborne exposure

Since July 2013, as requested by CSSF Circular 12/552, BIL has defined and integrated into its guidelines the notion of "forbearance". Credit files considered as being "forborne" are those for which restructuring measures have been granted due to the deterioration of the creditworthiness of the debtor. These measures include, in particular, the granting of extensions, postponements, renewals or changes in credit terms and conditions, including the repayment plan. Once these criteria are met, the credit files are flagged as being restructured and are added to a list that is closely monitored by the "Gestion Intensive et Particulière" team.
This notion of forbearance has moreover evolved according to the EBA final draft implementing technical standards on forbearance and non-performing exposures published in July 2014. BIL group has launched a process to adapt its internal forbearance definition in order to fully comply with that suggested by the EBA. Specifically, analyses have been led internally on individual credit files, with the aim of defining and identifying relevant operational criteria for the forbearance classification.
From an accounting perspective, impairment events include significant financial difficulties of the obligor and the granting of a concession by the lender to the borrower that the lender would not otherwise consider due to the borrower's financial difficulty. The granting of a forbearance measure is likely to constitute an impairment trigger, meaning that the loan should be assessed for impairment either individually or as part of a collective assessment.
At the end of 2014, forborne exposures reached a total amount of EUR 197 million (including 12 million of given banking guarantees).

3.3.3 Information on non-performing exposures

According to EBA definition, non-performing exposures correspond to files classified in default, or in pre-litigation (past due period > 90 days) or all files from counterparties whose pre-litigated exposure represent at least 20% of their total exposure.
Exposures in respect of which a default (CRR) is considered to have occurred and exposures that have been found impaired (IFRS) are always considered as non-performing exposures.
The global non-performing exposures ratio reached 3.48% at the end of 2014 [1].

1 *FINREP source*

3.3.4 Impaired and past due exposures by large category of product

The following table shows the amount of past due exposures and the specifically impaired exposures at year-end.

31/12/14	Past due but not impaired assets			Carrying amount of individually impaired financial assets	Guarantees held for past due or individually impaired assets and debt instruments
Loans and advances (at amortised cost)	≤ 90 days	>90 days ≤180 days	>180 days		
Central Governments and Central Banks	0	0.50	0	0	0
Institutions	0	0.01	0	0	0
Corporates - Other	84.04	45.75	96.10	228.61	295.15
of which: SME	*30.75*	*28.26*	*7.57*	*0*	*56.78*
Retail	69.21	33.83	47.56	85.67	154.34
TOTAL	**153.25**	**80.09**	**143.66**	**314.28**	**449.49**

Neither the AFS nor the HTM portfolios contained past due or impaired assets.

3.3.5 Impaired and past due exposures by geographical area

The following table shows the amount of past due credit risk exposures broken down by geographical area.

	31/12/13					
	Past due financial assets (not impaired)			Past due financial assets (impaired)		
	≤ 90 days	> 90 days	Total	≤ 90 days	> 90 days	Total
Euro zone	157.45	202.64	360.09	1.47	138.56	140.03
Rest of Europe	11.28	8.49	19.76	0	31.65	31.65
Rest of the world	4.03	5.2	9.22	0	87.96	87.96
USA & Canada	0.04	0.08	0.12	0	0.04	0.04
TOTAL	**172.8**	**216.41**	**389.2**	**1.47**	**258.22**	**259.69**

	31/12/14					
	Past due financial assets (not impaired)			Past due financial assets (impaired)		
	≤ 90 days	> 90 days	Total	≤ 90 days	> 90 days	Total
Euro zone	150.43	210.07	360.5	3.62	141.15	144.78
Rest of Europe	1.93	5.25	7.18	0.3	30.08	30.38
Rest of the world	0.86	8.42	9.28	0	100.51	100.51
USA & Canada	0.02	0.02	0.04	0	0.02	0.02
TOTAL	**153.25**	**223.75**	**377**	**3.92**	**271.76**	**275.68**

3.3.6 Provisions for impaired exposures to credit risk by type of asset

The following table shows the amount of provisions for impaired exposures to credit risk broken down by type of asset at year-end 2014 and for comparison at year-end 2013.

	As at 31/12/13	Utilisa-tion	Allow-ances	Write-backs	Other adjust-ments	As at 31/12/14	Recoveries recorded directly in profit and loss	Charges recorded directly in profit and loss
Specific allowances for financial assets individually assessed for impairment	**-249.74**	**9.66**	**-39.87**	**16.60**	**-13.59**	**-276.94**	0	-6.42
Loans and advances to customers	-230.60	6.25	-36.19	16.60	-12.07	-256.01	0	-6.42
Central Governments and Banks	-3.30	2.11	0	1.19	0	0	0	-2.11
Institutions	0	0	0	0	0	0	0	0
Corporates - Other	-175.57	1.92	-24.26	8.80	-11.95	-201.06	0	-1.92
Retail	-51.72	2.22	-11.93	6.61	-0.13	-54.95	0	-2.38
Financial assets available for sale	-19.14	3.41	-3.68	0	-1.51	-20.93	0	0
of which fixed income instruments	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*
of which equities and other variable-income instruments	*-19.14*	*3.41*	*-3.68*	*0.00*	*-1.51*	*-20.93*	*0*	*0*
Allowances for incurred but not reported losses on financial assets and specific allowances for financial assets collectively assessed for impairment	**-20.10**	0	**-17.54**	**11.12**	**0.00**	**-26.53**	0	0
Debt securities								
Loans and advances	-20.10	0	-17.54	11.12	0.00	-26.53	0	0
TOTAL	**-269.84**	**9.66**	**-57.41**	**27.72**	**-13.59**	**-303.47**	**0.00**	**-6.42**

The other adjustments correspond to exchange rate variations over the period affecting provisions recognised in other currencies as well as the deconsolidation of entities.

3.4 Advanced Internal Ratings Based approach (A-IRB)

The exposure data included in the quantitative disclosures is that used for calculating the Bank's regulatory capital requirements. In what follows and unless otherwise stated, exposures will thus be expressed in terms of Exposure-at-Default (EAD).

3.4.1 Competent authority's acceptance of the approach

In a letter sent on December 21, 2007 by the former Belgian regulator (the Banking, Finance and Insurance Commission), Dexia SA was authorised to use the advanced internal rating-based (A-IRB) approach for the calculation and reporting of its capital requirements for credit risk from January 1, 2008.
This acceptance was applicable to all entities and subsidiaries consolidated within the Dexia group, which are established in a member state of the European Union and are subject to the Capital Requirement Directive, which includes BIL.

Following its former holding company's dismantlement, BIL group has decided to keep the A-IRB approach for the assessment of the credit risk related to its main counterparties, as agreed in 2012 with the Luxemburgish regulator (CSSF).

3.4.2 Model management and global governance

3.4.2.1 Parameters

Internal rating systems have been set up to evaluate the three Basel credit risk parameters: Probability of Default (PD), Loss Given Default (LGD) and Credit Conversion Factor (CCF). For each counterparty type to which the advanced method is applicable, a set of three models, one for each parameter, has been or will be developed as part of the roll-out plan.
The PD models estimate the one-year probability of default of given obligors. Each model has its own rating scale and each rating on the scale corresponds to a probability of default used for regulatory and reporting purposes. The correspondence

between the rating and PD for each scale is set during the calibration process, as part of the model development, and is reviewed and adjusted during the yearly backtesting, when applicable. The number of ratings on each scale depends on the characteristics of the underlying portfolio (the number of counterparties, their homogeneity, whether it is a low default portfolio or not) up to a maximum of 17 non-default classes. In addition, each scale has been attributed two internal default classes (named D1 and D2).

The LGD models estimate the ultimate loss incurred on a facility of a defaulting counterparty before taking the credit risk mitigants into account. The unsecured LGD depends on different factors such as the product type, the level of subordination or the rating of the counterparty.

CCF models estimate the portion of off-balance sheet commitments that would be drawn before a counterparty goes into default.

In addition to the calculation of the regulatory risk-weighted assets, internal estimates of Basel parameters are increasingly used within BIL group in the decision-making process, credit risk management and monitoring, as well as provisioning assessment.

3.4.2.2 Segmentation and principles used for estimating the PD, LGD and CCF

BIL group uses a wide range of models to estimate PD and LGD in respect of the following types of counterparty.

Segmentation

- Sovereigns

The scope of the model encompasses sovereign counterparties, defined as Central Governments, Central Banks and all debtors whose liabilities are guaranteed irrevocably and unconditionally by Central Governments or Central Banks.

In addition, in-depth analysis of some public sector counterparties shows that they share the same credit risk as the "master" counterparties to which they are assimilated (usually local authorities or sovereigns). They are consequently attributed the same PD and LGD as their "master" counterparties.

- Project finance (specialised lending) [1]

This model is applied to all segments of BIL's project financing activity. The specialised lending portfolio is a subgroup of the corporate portfolio which has the following characteristics: the economic objective is to finance or acquire an asset; the flows generated by this asset are the sole or practically the sole source of repayment; this financing represents a significant debt in respect of the liabilities of the borrower; the main distinguishing criterion of risk is essentially the variability in flows generated by the financed asset, rather than the borrower's ability to repay.

- Banks

The scope of the model encompasses worldwide bank counterparties, defined as legal entities that have banking activities as their usual profession. Banking activities consist of the receipt of funds from the public, credit operations and putting these funds at customers' disposal, or managing means of payment. Bank status requires a banking licence granted by the supervisory authority.

- Corporates

Two models have been designed for corporate and mid-corporate counterparties:

Corporates

The scope of the model encompasses worldwide corporate counterparties. BIL defines a corporate as a private or a publicly traded company with total annual revenue higher than 50 million (250 million if Belgium and Luxembourg companies) or belonging to a group with total annual revenue higher than 50 million that is not a bank, a financial institution, an insurer or a public/private satellite.

Mid-corporates

This model is approved in accordance with the A-IRB approach for mid-corporates from Belgium and Luxembourg. BIL defines a mid-corporate as a private company with total revenue lower than 50 million (250 million if Belgium and Luxembourg companies) and belonging to a group with consolidated total revenue lower than 50 million and with total assets higher than 2 million that is not a bank, a financial institution, an insurer or a public/private satellite.

- Retail

Retail – individuals

These models are applied to retail customers (individuals). Individuals are defined as retail counterparties not engaged in a self-employed activity or a liberal profession (i.e. doctors, lawyers, etc.) and are not linked to the activity of a legal entity.

Retail – small professionals

These models are applied to small professional retail customers defined as individuals engaged in a self-employed activity or a liberal profession, or small companies generating revenue lower than a certain threshold (0.25 million).

Retail – small companies

These models are applied to small companies that are defined as companies generating revenue higher than a certain threshold (0.25 million), but which are still considered as retail counterparties based on certain criteria (i.e. not considered as mid-corporate or corporate counterparties). However, where these companies have a credit exposure higher than 1 million, they will be considered as non-retail counterparties from a regulatory reporting point of view.

1 *Please note that, early 2015, BIL has requested to switch from the A-IRB to the Standardised approach for the assessment of credit risk related to these counterparts. This decision has been motivated by the low material exposure the Bank has on these.*

- Equity and securitisation transactions

No internal model has been developed specifically for equity or securitisation transactions.

Main principles used for estimating the PD, LGD and CCF

- Main principles used for estimating the PD

Types of counterparty	Through-the-cycle models	Time series used	Internal/external data
Sovereigns	Models are forward looking and through the cycle. They are designed to be optimally discriminative over the long term. The through-the-cycle aspect of the rating is also addressed in a conservative calibration of the PD.	> 10 years	External
Banks		> 10 years	External
Corporates		> 10 years	Internal + external
Specialised lending		6 years	Internal
Mid-corporates		6 years	External + internal
Retail		> 5 years	Internal
Equity	Mix of single risk weight and PD/LGD approach.	N/A	N/A
Securitisation	Standardised approach.	N/A	N/A

- Main principles used for estimating the LGD

Types of counterparty	Main hypotheses	Time series used	Internal/external data
Sovereigns	Expert score function based on Fitch country loss risk methodology and internal expert knowledge to distinguish between high and low loss risk.	> 10 years	Internal + external
Banks	Statistical model derived from the LGD corporate model which includes additional risk factors specific to banking counterparties (country of residence, business profile, etc.).	> 10 years	Internal + external
Corporates	Statistical model based on external rating agencies loss data. The LGD is based on counterparty rating, exposure seniority level, geographical region and macroeconomic factors.	> 10 years	Internal + external
Specialised lending	This model is of the 'Workout LGD' type: the LGD computation was developed according to the Bank's workout data on internal project finance default facilities over a 10-year period. Cash flows are estimated on the basis of the historical recovery process, and the LGD is computed using discounted cash flows.	10 years	Internal
Retail and mid-corporates	The retail LGD model is based on statistical estimates of prior LGD and haircuts to compute LGD in line with the comprehensive CRM technique as part of the A-IRB approach.	> 5 years	Internal
Equity	Mix of single risk weight and PD/LGD approach.	N/A	N/A
Securitisation	Standardised approach.	N/A	N/A

- Main principles used for estimating the CCF

Regarding CCF models, a roll-out plan has been communicated to the regulators in 2015 in order to develop the corresponding internal models. Currently, BIL group uses CCF defined under the Foundation approach .

3.4.2.3 Model management process and internal governance

BIL has set up an internal organisation adequately scaled and skilled to allow the introduction, monitoring, maintenance and progressive development of the A-IRB framework. This is reflected in a well-defined process, which is described below.

Credit Risk Control Unit (CRCU)

The CRCU is responsible for the oversight of the IRS and for the proper application of the current framework. The CRCU is run by the Risk Controlling team. CRCU activities fall into two main categories:

- **Model validation**, which is aimed at controlling the adequacy of rating models to the level of risk the Bank is exposed to. In particular, this team:
  - controls the consistency of the assumptions and methodological choices made during the model development steps of the model lifecycle
  - performs backtesting and/or benchmarking on a regular basis and at least annually to control model performance as well as the appropriateness and soundness of the model assumptions over time
  - ensures that the rating models have been properly implemented and that appropriate testing has been carried out.
- **Rating systems quality control**, which is aimed at ensuring that the ratings allocated are consistent with the internal rating procedures. In particular, this team ensures:
  - the accuracy of data used in the rating process
  - that rules on which the rating models are based are adhered to
  - that the ratings and the related data are properly disseminated within the different internal systems
  - that overrides are clearly justified and documented.

Model Management Unit (MMU)

The Model Management Unit (MMU) is run by the IRS Modelling and Integration team. This team is responsible for the development, the implementation and the management of all the rating models under the scope of the current framework.

Credit Risk Management Unit (CRMU)

The Credit Risk Management Unit (CRMU) is run by the Country and Bank Analysis team and the Retail, Mid-Corp, Corp and Private Bank Analysis team. The Credit Risk Management department and, more precisely, the credit risk analysts are the main users of the IRS; they are responsible for the assessment and monitoring of credit risk. Specifically regarding the model management framework, CRMU is in charge of assessing the ratings of the Bank’s counterparties (i.e. PD) as well as their corresponding exposure facility type (i.e. LGD and CCF) and of documenting these results in the context of the loan approval process (i.e. mention on the “Fiche de Décision Crédit”).

As a key member of the Default Committee, this unit is actively involved in default decisions and monitoring.

Moreover, credit analysts bring qualitative input to the model development stage and during backtesting and stress testing exercises.

Audit

As part of its audit plan for the Bank, the Internal Audit function reviews whether the Bank’s control systems for internal ratings and related parameters are sufficiently robust. The main objective of the review is to ensure compliance with the legal and regulatory requirements related to the credit risk modelling framework and the effective assessment and management of all risks/weaknesses. In particular, internal audit may review Credit Risk Control Unit activities, ensuring that the oversight process is properly managed.

3.4.2.4 Committees

Several committees have been established to consolidate the credit risk model management framework and to provide adequate follow-up and decisions.

Internal Rating System Performance Committee (IRSPC)

The Internal Rating System Performance Committee (IRSPC) looks after all matters related to the regulatory Basel III Pillar 1 credit rating models and corresponding rating tools.

Rating Committee (RC)

The objective of the Rating Committee is to discuss and make decisions about the following topics:

- rating methodology
- rating system framework
- rating process reviews.

Risk Policy Committee (RPC)

The Risk Policy Committee (RPC) is responsible for the implementation and the maintenance of the risk governance framework within the Bank. In particular, the RPC is tasked with ensuring that the policies and procedures related to risk concerns are comprehensive and consistent.

Default Committee

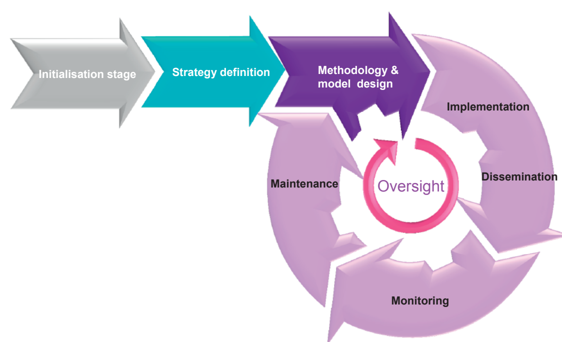
For BIL and its main subsidiaries and branches, this committee examines each case of default, classifies it (distinguishing between “true default” and “technical default”), assigns counterparties default level D1 or D2 according to general default indicators and parameters specific to each customer segment, and decides on the reclassification as a non-default counterparty.

Escalation Committee

When cases are discussed during IRSPC meetings, disagreements may arise between the MMU, CRCU or CRMU, leaving the case without decision. These cases are then submitted to Escalation Committee for a final decision.

3.4.2.5 Model management process

The lifecycle of a model can be summarised as follows:



Initialisation stage

The scope of credit risk models is supposed to be modified in accordance with business changes; new models or model changes could thus be required over time.
New model development requests are submitted to the IRSPC, which centralises and documents them and takes a decision on their relevance.
If the decision is to develop a model, the change request is handled by the MMU.

Strategy definition

Once the IRSPC has decided that a new model should be developed or reviewed, a pre-analysis is performed by the MMU.
Based on the results of this analysis, a strategy will be proposed by the MMU and submitted to the IRSPC. At this stage, validation of the strategy is required. Depending on the prescribed strategy, the CRCU and/or Model Validation team should provide their opinion.

Methodology and model design

The MMU is responsible for the definition and the implementation of the approach used for the model design. The model choice is left to the discretion of the MMU.
At the end of this stage, a model vetting review should be performed prior to the internal implementation of the new model. Model vetting consists of a detailed review of the model methodology, the modelling assumptions and the data and programmes on which the model is based. This review is under the responsibility of CRCU, which can conduct the review itself or delegate it externally.

Implementation and dissemination

Once the methodology of the model has been validated, its technical implementation is performed. The technical implementation is based on a business requirement definition (BRD) which is defined by or under the responsibility of the MMU. Acceptance of the rating tool should be validated by the IRSPC.

Model monitoring

In order to ensure that the model provides the same level of performance over time, two sets of controls are performed. One regards the ability of the model to provide accurate and conservative predictions, while the other is aimed at ensuring the reliability of the rating and the related data.

- Quantitative validation

The quantitative validation of a rating model consists of performing a set of tests (i.e. backtesting).
In addition, a benchmarking analysis can be performed to compare internal estimates with figures across banks and/or with external benchmarks (e.g. external ratings, vendor models, or models developed by supervisory authorities).
Quantitative validation is performed once the year by the CRCU (Model Validation team) and their results are assessed by the IRSPC. A set of recommendations will be drafted if issues are identified. The conclusion of the backtesting can lead to a recalibration or review of the model if its performance does not reach the expected level.
In this case, the model review follows the same steps as those of the development of a new model (methodology and model design/implementation and dissemination/model monitoring).

- Backtesting

The primary purpose of credit risk model backtesting is to ensure the adequacy of the Bank's regulatory capital with regard to the credit risks to which it is exposed. Since capital adequacy relies on internally estimated credit risk factors (PD, LGD and EAD), the Bank has to provide evidence that its risk assessment is accurate or at least sufficiently conservative.
A second purpose of backtesting is the evaluation of the predictive power of the rating system and the assessment of its capacity to detect reduced performance at an early stage. Reduced performance of the rating system as a decision-making tool may expose the Bank to model risk by impacting the risk assessment of the defined risk buckets, and consequently reduce the Bank's profitability. The performance is tracked by analysing the ability to predict defaults and losses, by discriminating between high and low risk, and by analysing the stability of IRS results.
The backtesting process relies on three kinds of assessment:

- Calibration: calibration is used to assess the accuracy of the risk factor estimate. In the context of rating systems, it denotes the mapping of the probability of default (PD) to the rating grades. A rating system is well calibrated if the estimated PDs deviate only marginally from the actual default rates. The predicted LGD or CCF is compared to the actual loss rate or proportion of used facilities respectively.
- Discriminatory power: the discrimination of rating systems denotes their ex-ante capability to identify borrowers that are in danger of defaulting. Thus, a rating system with maximum power would be able to predict all borrowers that subsequently default. In practice, however, such perfect rating systems do not exist. A rating system is said to have high discriminatory

power if default rates are distributed and ordered consistently across the rating scale and if these default rates are significantly different. The "good" grades subsequently turn out to contain only a small percentage of defaulters and a large percentage of non-defaulters, with the opposite applying to the "poor" grades.
- Stability: the stability analysis concerns the population and its data characteristics, and the assumptions used to design the model. Its purpose is to ensure that the model inputs remain consistent with the original model specifications, that the economic environment or the changes in the Bank's activity do not affect the performance of the model, and that the possible drift of the model output distribution is not explained by a change of the model behaviour or population.

Prior to the dismantling of Dexia group, the backtesting of models was performed by its Modelling team. In view of the size and particular characteristics of the BIL credit portfolio, backtesting approaches have been reviewed and tailored to BIL concerns, especially the limited volume of internal data. BIL-specific backtesting was applied for the first time in 2013. On the whole, the results of backtesting performed on the BIL portfolio are in line with the results of previous backtesting exercises performed by Dexia group. The calibration of risk parameters appears as globally conservative for the main portion of the credit portfolio.

- Stress testing

Pillar 1 stress tests are defined within the Basel requirement framework. They provide an assessment of the risk parameter levels (weighted risk, expected loss and realised loss) and the related deviations during periods of stress.
The different stress tests impact either the quality of the portfolio as a whole or the risk parameters. They are organised as follows:
- Sensitivity stress tests: the sensitivity of the weighted risks and expected and realised losses in relation to changes in explanatory risk parameters (PD, LGD, CCF).
- Scenario stress tests: the impact of unlikely but plausible scenarios on the weighted risks and expected and realised losses. These scenarios can be macroeconomic or expert-based and are checked via the benchmarking of the hypotheses when possible.

Sensitivity tests and scenario-based stress tests are performed for the main internal rating systems (IRS).

- Quality control

Quality control consists of the operational validation of the IRS. It is aimed at ensuring the reliability of the ratings and the data involved in the rating process. In particular, quality control encompasses:
- rating process oversight
- rating dissemination through the Bank's different systems, by ensuring that the ratings are recorded and updated consistently and according to the expected frequency
- default and loss management.

Quality control reviews are performed once a year, or more frequently if required, and their results are discussed at meetings of the Rating Committee. In the event of problems or anomalies, recommendations are issued or corrective measures are requested.

Model maintenance

Model management is an iterative process used to ensure the consistency and the objectivity of risk assessments over time. The process may be improved or updated.
The MMU is in charge of collecting the change requests and providing an opinion regarding the relevance and the feasibility of the demand. The change requests (including the rationale for the request, the possible ways of fulfilling the request, the benefit that the request would bring versus the expected cost) are discussed during meetings of the IRSPC, which decides whether or not to proceed with the request.

Model management oversight and validation process

Model management oversight relies on a set of controls and validations throughout the model management process. The table below summarises the steps for this oversight process.

Oversight	Description	Owner	Decision-maker	Frequency
Model development and update decision	All new model developments or model updates have to be validated on the basis of a documented request.	Member of IRSPC	IRSPC	Each time a new model or updated is requested.
Decision on a change in the rating process	All changes in the rating process are to be discussed and validated.	Credit Risk Management Unit or Model Management Unit	RC – Operational changes IRSPC – Methodological changes	Each time a change in rating process is requested.
New model or model update vetting	When a new model is developed, a comprehensive review must be performed in order to validate the accuracy of 1) the model methodology and underlying assumptions, 2) the data and the programmes used in the development and 3) the mathematical foundation of the model.	Model Validation (review could be performed by an external vendor)	IRSPC	Each time a new model is developed or updated.
Oversight	**Description**	**Owner**	**Decision-maker**	**Frequency**
Validation of rating tool implementation	When a new rating application is implemented or developed, a comprehensive set of tests should be performed in order to ensure the consistency and the reliability of the ratings. These tests relate to programming and data flow. Validation should be based on the documented testing results.	Model Management Unit	IRSPC	Each time a new rating application is developed or updated.
Validation of the operational rating process	The reliability and consistency of the rating process is controlled on a regular basis in order to ensure an appropriate level of rating quality.	Quality Control Unit	RC	At least once a year per IRS.
Quantitative model validation	The ability of the model to provide an appropriate assessment of risk is controlled on a regular basis through the backtesting process.	Model Validation	IRSPC	At least once a year per IRS.
IRS compliance audit	A comprehensive review ensures the compliance of IRS with regulatory requirements, especially regarding the robustness of the oversight process	Internal Audit	Internal Audit	At least once a year.

Business integration of internal estimates

Internal estimates of Basel parameters are increasingly used within BIL group, and cover a large number of applications in addition to the calculation of the regulatory capital requirements. They are notably used in the following areas:

- **Decision-making process**

Basel II parameters are the key elements considered by the Credit Committee in assessing the opportunity to accept or reject a transaction. Basel II parameters are thus integrated into the credit files to assess credit proposals.

- **Credit risk management and monitoring**

Basel II parameters are actively used for the individual monitoring of distressed transactions and counterparties by the Default Committee.

The counterparty internal ratings, the LGD, the level of expected loss and the risk weighted assets are the key Basel II parameters used for internal reports or specific analysis, with the aim of improving credit risk management best practices.

- **Provisioning methodology**

IFRS loan-loss provisioning can occur on an individual or on a collective (portfolio) basis. Specific analysis of significant and impaired assets is necessary to calculate the so-called "specific" loan-loss provision. All the other assets, such as individually non-significant loans and individually significant but non-impaired loans, are subject to a portfolio approach to loan-loss provisioning.

Both Basel III and IFRS agree, in essence, in their international focus and their general goal to provide market participants and supervisory authorities with transparent and precise information. Consequently, many of the requirements and sources of data are similar under IFRS and Basel III.

Therefore, Basel III parameters can serve as a starting point to calculate loan loss provisions and are adapted in order to fulfil

the IFRS requirements. This is especially the case for collective provisioning approaches.

3.4.2.6 Model approval process

In the context of the Capital Requirement Regulation, the use of internal models for the assessment of the Risk Weighted Assets requires preliminary approval by the competent authority before effective implementation. According to the steps of the model life cycle, this approval can be required for one of the following cases:

- A new model is developed for a specific portfolio (Methodology and Model Design).
- An existing model is extended to a specific portfolio (Methodology and Model Design or Model Maintenance).
- Changes are applied to existing model covering a specific portfolio (Model Maintenance).

For the first case, the permission of the competent authority is systematically required. However, in the two other cases, this permission is required depending on the materiality of the extension or the change:

- Material extensions and/or changes require permission from the relevant competent authorities.
- Other less material extensions and/or changes require notification to the competent authorities. Two cases should be considered:
  - extensions and/or changes that require notification before their implementation
  - extensions and/or changes that require notification after their implementation.

The assessment of the materiality of the extensions or changes relies on the EBA/RTS/2013/06 [1] as transposed by the EU in its corresponding delegated regulation.

The rules defined below are the internal transposition of this framework and attempt to keep their main principles.

Materiality is firstly assessed quantitatively:

- Extensions or changes are considered as material when the overall Risk Weighted Asset of BIL group decreases of more than 1.5% or when Risk Weighted Asset related to the range of application of a considered IRS decreases of more than 15%.
- Extensions or changes are considered as not material but should be notified before implementation when the Risk Weighted Asset related to the range of application of a considered IRS decreases of more than 5% and less than 15%.
- Other impacts on Risk Weighted Assets should be notified after implementation.

In addition to those quantitative criteria, qualitative criteria should also be considered to assess the materiality of changes and/or extensions of internal approaches.

The materiality and the classification of changes and/or extensions are discussed during the IRSPC which states in which category the change should be classified. According to this, the appropriate communication stream with the regulatory authority is then applied.

3.4.3 Average PD, LGD and risk weight by asset class and obligor grade

The following table shows the total EAD, undrawn commitments, exposure-weighted average PD, LGD and CCF and exposure-weighted average risk weights broken down by exposure class and obligor grade at year-end 2014. The exposure is calculated using the advanced method.

1 On the conditions for assessing the materiality of extensions and changes of internal approaches when calculating own funds requirements for credit and operational risk in accordance with Articles 143(5) and 312(4)(b) and (c) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR).

	Obligor Grade	Total exposure	Undrawn Commit-ment	Off-balance sheet exposure after CCF application	EAD	Average PD weighted by EAD	Average LGD weighted by EAD	Average CCF weighted by EAD	Average RW weighted by EAD	Provisions	EAD pro-forma 31/12/13
Central Governments and Central Banks	AAA+ to AA-	3,917.04	146.86	75.68	3,841.36	0%	5.98%	48.47%	0.00%	0	4,421.08
	A+ to A-	531.51	0	0	531.51	0.06%	24.08%	0%	15.59%	0	569.62
	BBB+ to BBB-	698.43	0	0.01	698.42	0.23%	34.61%	0%	39.21%	0	467.20
	Other	0.78	0	0	0.78	30.87%	5.00%	0%	27.82%	0	1.09
Central Governments and Central Banks	**TOTAL**	**5,147.76**	**146.86**	**75.68**	**5,072.07**	**0.04%**	**11.82%**	**48.46%**	**7.04%**	**0**	**5,458.98**
Corporates - other	AAA to AA-	158.80	0	0.00	158.80	0.03%	1.74%	0.00%	0.70%	0	12.13
	A+ to A-	365.05	88.69	67.09	297.96	0.07%	18.94%	24.35%	7.99%	0	352.82
	BBB+ to BBB-	849.44	210.44	141.33	708.10	0.46%	33.16%	32.84%	55.63%	0	446.33
	Default	20.82	0.58	0.32	20.50	100.00%	18.59%	45.45%	0%	9.53	2.20
	Other	504.88	190.15	118.04	386.84	5.14%	36.45%	37.92%	79.26%	0	231.37
Corporates - other	**TOTAL**	**1,898.99**	**489.86**	**326.78**	**1,572.20**	**2.79%**	**27.91%**	**33.29%**	**46.14%**	**9.53**	**1,044.85**
Corporates - SME	A+ to A-	130.68	50.94	29.06	101.62	0.09%	19.51%	42.94%	12.16%	0	83.96
	BBB+ to BBB-	523.91	234.85	143.19	380.72	0.58%	15.63%	39.03%	24.01%	0	408.97
	Default	86.42	4.07	2.64	83.77	100.00%	8.14%	35.12%	0%	35.34	77.70
	Other	1,188.35	319.58	189.96	998.38	6.57%	5.42%	40.56%	13.38%	0	1,083.96
Corporates - SME	**TOTAL**	**1,929.35**	**609.45**	**364.86**	**1,564.50**	**9.69%**	**8.97%**	**40.13%**	**15.17%**	**35.34**	**1,654.59**
Corporates - specialised lending	Other	5.02	0.13	0.07	4.96	3.95%	25.80%	50.00%	73.43%	0	3.83
Corporates - specialised lendin	**TOTAL**	**5.02**	**0.13**	**0.07**	**4.96**	**3.95%**	**25.80%**	**50.00%**	**73.43%**	**0**	**3.83**
Equity	AAA+ to AA-	0	0	0	0	0%	0%	0%	0%	0	0.00
	A+ to A-	0	0	0	0	0%	0%	0%	0%	0	2.39
	BBB+ to BBB-	7.37	0	0	7.37	0.18%	90.00%	0%	135.26%	0	65.65
	Default	**0**	**0**	**0**	**0**	**0%**	**0%**	**0%**	**0%**	**0**	**0.00**
	Other	4.98	0	0	4.98	94.20%	11.11%	0%	265.47%	0.35	1.43
Equity	**TOTAL**	12.35	0	0	12.35	38.12%	58.17%	0.00%	187.80%	0.35	69.47
Institutions	AAA+ to AA-	574.40	104.73	83.29	491.10	0.03%	10.41%	20.47%	5.25%	0	509.72
	A+ to A-	2,294.70	4.73	2.37	2,292.34	0.06%	12.68%	50.00%	6.63%	0	1,397.21
	BBB+ to BBB-	426.77	0.91	0.46	426.32	0.34%	8.21%	49.84%	14.59%	0	605.89
	Default	0.01	0.01	0	0.01	100.00%	66.96%	50.00%	0.00%	0	0
	Other	158.72	1.18	0.58	158.13	1.61%	7.24%	50.76%	22.63%	0	157.84
Institutions	**TOTAL**	3,454.60	111.57	86.70	3,367.90	0.16%	11.53%	22.29%	8.19%	0	2,670.66

	Obligor Grade	Total exposure	Undrawn Commit-ment	Off-balance sheet exposure after CCF application	EAD	Average PD weighted by EAD	Average LGD weighted by EAD	Average CCF weighted by EAD	Average RW weighted by EAD	Provisions	EAD pro-forma 31/12/13
Retail - other non-SME	AAA+ to AA-	23.95	16.31	8.24	15.72	0.04%	26.41%	49.51%	3.47%	0	12.59
	A+ to A-	425.44	193.30	111.17	314.27	0.10%	11.45%	42.49%	2.86%	0	322.37
	BBB+ to BBB-	744.92	238.26	168.11	576.82	0.49%	10.47%	29.44%	7.53%	0	748.38
	Default	213.73	10.35	6.09	207.64	100.00%	23.41%	41.11%	0.00%	100.46	314.22
	Other	1,656.43	189.24	111.37	1,545.06	5.32%	8.21%	41.15%	12.73%	2.42	1,630.82
Retail - other non-SME	**TOTAL**	**3,064.47**	**647.46**	**404.97**	**2,659.50**	**11.02%**	**10.38%**	**37.45%**	**9.39%**	**102.88**	**3,028.39**
Retail - other SME	A+ to A-	0.33	0.12	0.06	0.27	0.12%	13.36%	50.00%	4.01%	0	0.09
	BBB+ to BBB-	28.34	11.86	8.58	19.76	0.77%	12.88%	27.68%	12.31%	0	48.95
	Default	10.19	0.18	0.15	10.05	100.00%	12.54%	16.90%	0.00%	5.50	31.26
	Other	138.75	35.20	28.15	110.60	9.74%	12.64%	20.03%	21.43%	0	234.72
Retail - other SME	**TOTAL**	**177.61**	**47.36**	**36.94**	**140.67**	**14.91%**	**12.67%**	**22.01%**	**18.59%**	**5.50**	**315.03**
Retail - secured by real estate non-SME	AAA+ to AA-	0	0	0.00	0	0.00%	0.00%	0%	0.00%	0	0.74
	A+ to A-	734.84	11.67	6.98	727.85	0.10%	10.52%	40.17%	2.63%	0	621.73
	BBB+ to BBB-	1,714.20	17.26	10.35	1,703.85	0.51%	10.38%	40.05%	8.45%	0	1,525.59
	Default	166.86	0.38	0.19	166.67	100.00%	11.22%	50.00%	0.00%	25.18	59.48
	Other	1,640.27	40.16	22.26	1,618.01	6.89%	11.35%	44.56%	32.12%	0	1,041.91
Retail - secured by real estate non-SME	**TOTAL**	**4,256.17**	**69.47**	**39.78**	**4,216.38**	**6.82%**	**10.81%**	**42.73%**	**16.19%**	**25.18**	**3,249.46**
Retail - secured by real estate SME	BBB+ to BBB-	5.63	1.62	1.08	4.55	0.78%	12.90%	33.71%	12.65%	0	4.44
	Default	3.67	0.31	0.15	3.51	100.00%	12.50%	50.00%	0.00%	0.72	1.44
	Other	73.06	7.31	4.93	68.13	7.74%	12.86%	32.53%	25.02%	0	14.96
Retail - secured by real estate SME	**TOTAL**	**82.36**	**9.24**	**6.16**	**76.20**	**11.57%**	**12.84%**	**33.32%**	**23.13%**	**0.72**	**20.84**
TOTAL		**20,028.67**	**2,131.40**	**1,341.95**	**18,686.73**					**179.50**	**17,516.09**

3.4.4 Advanced retail exposure by type of product and obligor grade

The following tables provide an analysis of the retail segment exposures broken down by loan types and expressed in EAD under the A-IRB approach.

	31/12/13					
	AAA to AA-	A+ to A-	BBB+ to BBB-	Other	Default	Grand Total
Consumer loans	0.88	140.65	379.27	876.65	253.11	1,650.56
Credit cards	7.76	25.39	23.51	11.95	0.17	68.78
Investment loans	0.18	13.13	19.61	95.74	5.03	133.69
Leasing	0.29	0.90	17.71	41.79	0.28	60.96
Lombards	0.00	0.00	0.00	138.93	0.35	139.28
Mortgage loans	2.06	678.06	1,669.59	1,347.32	79.41	3,776.45
Others	0.34	69.36	149.51	227.83	32.32	479.36
Straight loans		0.25	0.49			0.74
Student loans	0.16	6.68	24.82	15.39	1.39	48.44
Treasury Loans/ Facilities	1.67	36.99	71.03	175.92	34.33	319.94
TOTAL	**13.33**	**971.40**	**2,355.55**	**2,931.52**	**406.40**	**6,678.21**

	31/12/14					
	AAA to AA-	A+ to A-	BBB+ to BBB-	Other	Default	Grand Total
Consumer loans		156.09	345.99	1,259.80	256.30	2,018.18
Credit cards	13.65	43.22	41.07	21.96	0.31	120.19
Investment loans		10.38	33.46	62.44	5.56	111.83
Leasing	0.34	1.37	35.55	39.64	0.45	77.36
Lombards		16.23	49.63	241.12	16.96	323.94
Mortgage loans	0.97	744.04	1,762.95	1,516.51	91.62	4,116.09
Others	0.76	73.07	157.55	283.30	33.68	548.36
Straight loans			9.93	12.59		22.52
Student loans		5.84	25.73	15.49	1.67	48.73
Treasury Loans/ Facilities		2.86	4.82	28.83	0.69	37.20
TOTAL	**15.72**	**1,053.09**	**2,466.69**	**3,481.68**	**407.24**	**7,424.41**

The overall exposure by rating increased between 2013 and 2014. The Bank continued to develop its credit business which led to an increase of 370 million in consumer loans exposure and of 340 million in mortgage loan exposure.

3.5 Standardised approach

3.5.1 Introduction

As previously stated, BIL group uses the A-IRB approach to calculate its regulatory capital requirements. Nevertheless, the Bank applies the standardised approach for some portfolios corresponding to cases specifically authorised by regulation such as:

- small business units with non-material exposures
- portfolios without enough data to build a sound model
- portfolios for which BIL has adopted a phased roll-out of the A-IRB approach.

As requested by the regulator, more than 85% of the exposures are treated under the A-IRB approach.

3.5.2 External credit assessment institutions (ECAI)

The standardised approach provides weighted risk figures based on external ratings. In order to apply the standardised approach for risk weighted exposure, BIL group uses the external ratings assigned by the following rating agencies: Standard & Poor's and Moody's.

The rating used for regulatory capital calculation is the lower of the two ratings. If no external rating is available, the standardised approach provides specific risk weights defined by the regulator (depending on the counterparty type).

Credit rating agencies and credit quality step under the standardised approach

Standard & Poor's	Moody's	Regulatory credit quality step
AAA to AA-	Aaa to Aa3	1
A+ to A-	A1 to A3	2
BBB+ to BBB-	Baa1 to Baa3	3
BB+ to BB-	Ba1 to Ba3	4
B+ to B-	B1 to B3	5
CCC+ and below	Caa and below	6
NR	NR	7

Risk weights are mainly determined in relation to the credit quality step and the exposure class.

3.5.3 Standardised exposure-at-default and average risk weights

The following table shows the EAD under the standardised approach, before and after credit risk mitigation, broken down by asset and external rating classes. It also indicates the corresponding weighted average risk weights, the undrawn commitment amounts and the exposure of debtors in default (for which the amount of provisions is given by the impaired exposure).

31/12/14	Obligor Grade	Exposure before CRM (EAD)	exposure after CRM	Average RW weighted by EAD	Undrawn Commitment	Impaired Exposure	EAD pro-forma 31/12/13
Collective Investment Undertakings	A+ to A-	0	0	0%	0	0	0
	No External Rating	0	0	0%	0	0	3.19
Collective Investment Undertakings		**0**	**0**	**0%**	**0**	**0**	**3.19**
Corporates	AAA to AA-	0	0	0%	0	0	0.00
	A+ to A-	24.10	24.10	50.00%	0	0	8.24
	BBB+ to BBB-	0.00	0.00	100.00%	0	0	0.00
	No External Rating	719.32	719.32	100.00%	145.93	0.25	585.67
Corporates		**743.42**	**743.42**	**98.38%**	**145.93**	**0.25**	**593.91**
Covered Bonds	AAA to AA-	60.25	60.25	10.00%	0	0	60.54
Covered Bonds		**60.25**	**60.25**	**10.00%**	**0**	**0**	**60.54**
Equity	No External Rating	4.95	4.95	227.35%	0	7.50	1.00
Equity		**4.95**	**4.95**	**227.35%**	**0**	**7.50**	**1.00**
High Risk Exposures	No External Rating	30.02	30.02	150.00%	0	9.79	60.54
High Risk Exposures		**30.02**	**30.02**	**150.00%**	**0**	**9.79**	**60.54**
Institutions	AAA to AA-	1.35	1.35	20.00%	0	0	0.00
	A+ to A-	0.16	0.16	50.00%	0	0	0.16
	BBB+ to BBB-	0.28	0.28	50.00%	0	0	0.49
	BB+ to B-	0	0	0%	0	0	0
	No External Rating	0.14	0.14	100.00%	0.20	0	3.46
Institutions		**1.93**	**1.93**	**32.60%**	**0.20**	**0**	**4.11**
Multilateral Development Banks	No External Rating	86.72	86.72	0%	0	0	30.51
Multilateral Development Banks		**86.72**	**86.72**	**0%**	**0**	**0**	**30.51**
Other	AAA to AA-	39.06	39.06	0%	0	0	43.59
	No External Rating	330.18	330.18	88.22%	0.44	0	350.08
Other		**369.24**	**369.24**	**78.89%**	**0.44**	**0**	**393.67**
Past Due	Below B-	0	0	0%	0	0	0.01
	No External Rating	19.34	19.34	110.36%	0	71.57	15.88
Past Due		**19.34**	**19.34**	**110.36%**	**0**	**71.57**	**15.90**
Public Sector Entities	AAA to AA-	128.31	128.31	20.00%	19.57	0	78.45
Public Sector Entities		**128.31**	**128.31**	**20.00%**	**19.57**	**0**	**78.45**
Retail	No External Rating	0.38	0.38	75.00%	0.12	0	0.18
Retail		**0.38**	**0.38**	**75.00%**	**0.12**	**0**	**0.18**
Regional Governments And Local Authorities	A+ to A-	10.10	10.10	20.00%	0	0	0.00
	BB+ to B-	15.83	15.83	20.00%	0	0	15.83
	No External Rating	148.89	148.89	20.00%	0	0	2.80
Regional Governments And Local Authorities		**174.82**	**174.82**	**20.00%**	**0**	**0**	**18.63**
Secured On Real Estate	AAA to AA-	9.15	9.15	100.00%	0	0	10.05
	No External Rating	376.19	203.39	75.96%	7.30	0	367.42
Secured On Real Estate		**385.33**	**212.53**	**76.53%**	**7.30**	**0**	**377.47**
Securitisation	AAA to AA-	100.07	100.07	20.00%	0	0	0
	No External Rating	0.01	0.01	1,250.00%	0	0	0
Securitisation		**100.08**	**100.08**	**20.17%**	**0**	**0**	**0**
Short-Term Exposures	A+ to A-	7.79	7.79	20.00%	0	0	0
Short-Term Exposures		**7.79**	**7.79**	**20.00%**	**0**	**0**	**0**
Sovereigns	AAA to AA-	431.87	431.87	0%	64.55	0	274.73
	A+ to A-	0	0	0%	0	0	60.66
	BBB+ to BBB-	11.00	11.00	0%	0	0	0
	BB+ to B-	0.13	0.13	0%	0	0	0.02
Sovereigns		**443.01**	**443.01**	**0%**	**64.55**	**0**	**335.41**
Supra	AAA to AA-	567.81	567.81	0%	0	0	608.24
Supra		**567.81**	**567.81**	**0%**	**0**	**0**	**608.24**
	TOTAL	**3,123.41**	**2,950.61**		**238.15**	**89.11**	**2,581.75**

3.6 Credit risk mitigation techniques

3.6.1 Description of the main types of credit risk mitigants (CRM)

Basel regulation recognises three main types of CRM:
- collateral
- guarantees and credit derivatives
- netting agreements (applicable to on-balance sheet and off-balance sheet netting agreements – see below).

Main types of collateral

Collateral is represented by financial products or physical assets used to hedge exposures. BIL group manages a wide range of collateral types. From a regulatory point of view, three main categories of collateral exist:
- pledges of financial assets – cash, blocked accounts, term deposits, insurance contracts, bonds and equity portfolios
- pledges of real estate (residential mortgages, commercial mortgages)
- pledges of commercial assets (e.g. transfer of receivables).

Main types of guarantees

Guarantees refer to personal guarantees, first demand guarantees and support commitments.

Main types of netting agreements

A netting agreement is a technique for mitigating credit risk. Banks have legally enforceable netting agreements for on-balance sheet exposures (loans and deposits) and off-balance sheet exposures (derivatives) for which they may calculate capital requirements on the basis of net credit exposures subject to specific regulatory conditions.

3.6.2 Policies and processes

Collateral and Guarantees/Credit Derivatives

Within BIL, managing the CRM involves the following tasks:
- analysis of the eligibility of all CRM under the standardised and advanced approaches
- collateral valuation in mark-to-market
- description of all CRM characteristics in BIL group's risk systems, such as:
    - mortgages – rank, amount and maturity
    - financial collateral – valuation frequency and holding period
    - guarantees/credit derivatives – identification of the guarantor, analysis of the legal mandatory conditions, check as to whether the credit derivative covers restructuring clauses
    - security portfolio: description of each security.

Periodic review of the descriptive data.

At an operational level, different IT tools are used to manage collateral. These IT tools are used to record any relevant data needed to identify collateral characteristics, eligibility criteria and estimated value, in accordance with the Basel framework.

On- and off-balance sheet netting

The regulator is in charge of granting banks authorisation to use netting agreements according to certain eligibility criteria which are different for on-balance sheet and off-balance sheet netting agreements.

BIL group does not make use of on- or off-balance sheet netting for regulatory purposes, except for over-the-counter (OTC) derivative products.

For these products, internal policies document the eligibility criteria and minimum requirements that netting agreements need to fulfil in order to be recognised for regulatory purposes under the Basel framework.

Appropriate internal procedures and minimum requirements have been implemented in the internal risk management process.

Information about market or credit risk concentrations

Concentration risk is related to a concentration of collateral in one issuer, country, industry or market. As a result, credit deterioration might have a significant impact on the overall value of collateral held by the Bank to mitigate its credit exposure.

Since BIL is a commercial and private bank, most of its credit risk mitigants are linked to mortgage loans and leveraged loans (categorised as Lombard loans and investment lines of credit by BIL).

- Mortgages

As a major Luxembourg-based bank, BIL makes a substantial contribution to the financing of local projects involving both residential and commercial real estate. As such, it is inevitably dependent on the effect Luxembourg's economic growth may have on the large amount of mortgages it takes as collateral for loans granted.

However, the Bank has strong governance and specific guidelines in place in order to adequately cover the risks involved in the granting of loans to its retail and corporate customers and to diversify the range of collateral it takes as a guarantee. This involves the approval of commitment/credit committees based on credit applications proposed by front officers, for which credit analysts give their opinion. This opinion takes into account the quality of the debtor through its rating, revenues, indebtedness level and repayment capacity, as well as the quality of the asset pledged as collateral for which a conservative loan-to-value ratio is assigned.

The Bank as well as the national regulator are well aware of this exposure and carefully monitor the concentration risk through regular reports and monitoring of limits on real estate exposure.

• Financial collateral

Among its range of services to wealthy customers, the Bank proposes Lombard loans and investment lines of credit. These are granted against the pledge of eligible financial assets for which cover values are assigned by the Credit Risk team reflecting the quality, liquidity and volatility of the underlying collateral. As part of their contractual obligations and in order to limit the concentration risk within individual portfolios, customers using these kinds of facilities must not only maintain adequate cover values for their loans at all times, but are also required to comply with an obligation of diversification of their collateral portfolios.

Exposure and collateral values are continuously monitored to ensure the proper application of these instructions, and margin calls or close-out procedures are enforced when the market value of collateral falls below a predefined trigger level.

3.6.3 Basel III treatment

BIL group recognises the mitigation impact of netting agreements (subject to eligibility conditions), by applying the netting effect of these agreements to the calculation of the EAD used to compute its risk weighted assets.

For guarantees and credit derivatives, BIL recognises the impact by substituting the PD, LGD and risk weight formula of the guarantor to those of the borrower (i.e. the exposure is considered to be directly to the guarantor) if the risk weight of the guarantor is lower than the risk weight of the borrower.

For collateral (both financial and physical), BIL methodology relating to eligible CRM is based on the Basel III approach.

• Standardised exposures

Eligible CRM (after regulatory haircuts) are directly taken into account when calculating the EAD (deduction).

• A-IRB approach exposures – Two methodologies may be applied:

- CRM are incorporated into the calculation of the LGD based on internal loss data and A-IRB approach model calculations.
- CRM are not incorporated into the LGD computed by the model. The impact of each individual CRM is taken into account in the LGD according to each transaction.

3.6.4 Exposure covered by CRM by exposure class

This section provides an overview of the EAD covered by Basel III-eligible CRM (after regulatory haircuts) broken down by exposure class at year-end 2013 and 2014. The amounts shown in the table below take netting agreements into account and include collateral values for reverse repo transactions.

31/12/13	Financial Collateral	Guarantee	Physical collateral	Repo	EAD collateralised or guaranteed	EAD NOT collateralised and NOT guaranteed	TOTAL EAD	Cover percentage
IRB approach								
Central Governments and Central Banks	0.01	689.60	0	0	689.61	4,769.36	5,458.98	12.63%
Corporates - Other	21.02	12.57	90.06	0	123.66	921.19	1,044.85	11.83%
Corporates - SME	2.97	13.60	0.50	0	17.06	1,637.53	1,654.59	1.03%
Corporates - Specialised Lending	0	0	0	0	0	3.83	3.83	0%
Equity	0	0	0	0	0	69.47	69.47	0%
Institutions	376.58	130.94	0	363.02	870.55	1,800.12	2,670.66	32.60%
Retail - Other non-SME	382.96	0	0.21	0	383.17	2,645.22	3,028.39	12.65%
Retail - Other SME	0.89	0.05	0.02	0	0.97	314.06	315.03	0.31%
Retail - Secured by real estate non-SME	0.78	0	0	0	0.78	3,248.68	3,249.46	0.02%
Retail - Secured by real estate SME	0.00	0	0	0	0	20.84	20.84	0%
Total IRB approach	**785.22**	**846.76**	**90.79**	**363.02**	**2,085.80**	**15,430.30**	**17,516.09**	**11.91%**
Standardised approach								
Collective Investment Undertakings	0	0	0	0	0	3.19	3.19	0%
Corporates	0	0	0	0	0	593.91	593.91	0%
Covered Bonds	0	0	0	0	0	60.54	60.54	0%
Equity	0	0	0	0	0	1.00	1.00	0%
High Risk Exposures	0	0	0	0	0	60.54	60.54	0%
Institutions	0	0	0	0	0	4.11	4.11	0%
Multilateral Development Banks	0	0	0	0	0	30.51	30.51	0%
Other	0	0	0	0	0	393.67	393.67	0%
Past due	0	0	0	0	0	15.90	15.90	0%
Public Sector Entities	0	0	0	0	0	78.45	78.45	0%
Retail	0	0	0	0	0	0.18	0.18	0%
Regional Governments and Local Authorities	0	2.80	0	0	2.80	15.83	18.63	15.03%
Secured On Real Estate	0	0	219.26	0	219.26	158.21	377.47	58.09%
Sovereigns	0	60.66	0	0	60.66	274.75	335.41	18.09%
Supra	0	0	0	0	0	608.24	608.24	0%
Securitisation	0	0	0	0	0	0	0	0%
Total Standardised approach	**0**	**63.46**	**219.26**	**0**	**282.72**	**2,299.03**	**2,581.75**	**10.95%**
TOTAL	**785.22**	**910.23**	**310.05**	**363.02**	**2,368.52**	**17,729.33**	**20,102.83**	**11.78%**

31/12/14	Financial Collateral	Guarantee	Physical collateral	Repo	EAD collateralised or guaranteed	EAD NOT collateralised and NOT guaranteed	TOTAL EAD	Cover percentage
IRB approach								
Central Governments and Central Banks	0.01	536.56	0	0	536.58	4,535.50	5,072.07	10.58%
Corporates - Other	41.20	12.01	255.36	0	458.57	1,113.63	1,572.20	29.17%
Corporates - SME	20.22	24.89	827.43	0	872.54	691.96	1,564.50	55.77%
Corporates - Specialised Lending	0	0	0	0	0	4.96	4.96	0%
Equity	0	0	0	0	0	12.35	12.35	0%
Institutions	190.62	130.57	0	1,561.68	1,732.86	1,635.03	3,367.90	51.45%
Retail - Other non-SME	962.26	0	0	0	962.26	1,697.24	2,659.50	36.18%
Retail - Other SME	11.92	0.04	0	0	11.96	128.71	140.67	8.50%
Retail - Secured by real estate non-SME	33.14	0	941.5	0	974.65	3,241.73	4,216.38	23.12%
Retail - Secured by real estate SME	0.06	0	74.8	0	74.83	1.36	76.20	98.21%
Total IRB approach	**1,259.44**	**704.07**	**2,099.08**	**1,561.68**	**5,624.26**	**13,062.46**	**18,686.73**	**30.10%**
Standardised approach								
Corporates	0	0	0	0	0	743.42	743.42	0%
Covered Bonds	0	0	0	0	0	60.25	60.25	0%
Equity	0	0	0	0	0	4.95	4.95	0%
High Risk Exposures	0	0	0	0	0	30.02	30.02	0%
Institutions	0	0	0	0	0	1.93	1.93	0%
Multilateral Development Banks	0	0	0	0	0	86.72	86.72	0%
Other	0	0	0	0	0	369.24	369.24	0%
Past Due	0	0	0	0	0	19.34	19.34	0%
Public Sector Entities	0	0	0	0	0	128.31	128.31	0%
Retail	0	0	0	0	0	0.38	0.38	0%
Regional Governments And Local Authorities	0	0	0	0	0	174.82	174.82	0%
Secured On Real Estate	0	0	172.80	0	172.80	212.53	385.33	44.84%
Short-Term Exposures	0	0	0	0	0	7.79	7.79	0%
Sovereigns	0	91.54	0	0	91.54	351.47	443.01	20.66%
Supra	0	0	0	0	0	567.81	567.81	0%
Securitisation	0	0	0	0	0	100.08	100.08	0%
Total Standardised approach	**0**	**91.54**	**172.80**	**0**	**264.34**	**2,859.07**	**3,123.41**	**8.46%**
TOTAL	**1,259.44**	**795.61**	**2,271.88**	**1,561.68**	**5,888.60**	**15,921.53**	**21,810.13**	**27.00%**

An increase, compared to 2013, is notable among repurchase agreements (repo). The three main repurchase agreements are composed of a long-term and two short-term repurchase agreements with European counterparties, for a total of 1,190 million out of 1,560 million.

3.7 Counterparty risk

3.7.1 Management of counterparty risk

A counterparty risk attached to derivatives exists in all over-the-counter (OTC) transactions such as interest rate swaps, foreign exchange swaps, inflation or commodity swaps and credit default swaps.

To reduce counterparty risk, OTC derivatives are in most cases concluded under a master agreement (i.e. the International Swap and Derivative Association – ISDA) taking account of the general rules and procedures set out in the credit risk policies of the Bank. Collateral postings for derivative contracts are regulated by the terms and rules stipulated in the credit support annex (CSA) negotiated with the counterparty.

These terms may depend on the credit ratings of the counter-parties. The impact of potential downgrades is managed by the Bank.

All OTC transactions are monitored within the credit limits that are set up for each individual counterparty, and are

subject to the general delegation rules. Sub-limits may be put in place for each type of product.

3.7.2 Exposure to counterparty risk

The following table shows the gross EAD for the derivative contracts, the netting agreements and the amount of collateral received, and the net EAD (after taking into account the impact of netting agreements and collateral posting).

	31/12/13	31/12/14
Gross EAD	720	525
Netting agreements	242	195
Eligible collateral	377	197
Net EAD	101	133
Total RWA	47	55
Capital requirement	4	4

The derivatives exposure decreased in gross EAD by 195 million explained by termination of transactions with Dexia group and by the interest rate evolution. The amount of collateral and the effect of the netting agreements have been reduced accordingly.
The table below shows the breakdown of the net EAD (after applying the effects of netting and collateral agreements), broken down by type of derivative at year-end 2013 and 2014.

	Net EAD	
Type of derivative	31/12/13	31/12/14
Equity	4	22
Foreign exchange	57	57
Interest rate	41	54
TOTAL	101	133

3.8 Equity exposure

3.8.1 Accounting rules

IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Quoted market prices on an active market for identical instruments are to be used as fair value, as they are the best evidence of the fair value of a financial instrument. If a financial instrument is not traded on an active market, valuation models can be used. The objective of a valuation model is to determine the value that is most representative of fair value under current market conditions.
The Bank's valuation techniques maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The valuation model should take into account all factors that market participants would consider when pricing the financial instrument. Measuring the fair value of a financial instrument requires consideration of current market conditions. To the extent that observable inputs are available, they should be incorporated into the model.

• **Financial assets and liabilities measured at fair value are categorised into one of the three fair value hierarchy levels**
The following definitions used by the Bank for the hierarchy levels are in line with IFRS 13 rules
- Level 1: quoted prices (unadjusted) on active markets for identical assets and liabilities
- Level 2: valuation techniques based on inputs other than quoted prices included within Level 1 that are observable, either directly or indirectly
- Level 3: valuation techniques for which significant inputs are not based on observable market data.

• **Financial instruments measured at fair value for which reliable quoted market prices are available**
If the market is active, market prices are the most reliable evidence of fair value and therefore shall be used for valuation purposes. The use of market prices quoted on an active market for identical instruments with no adjustments qualifies for inclusion in Level 1 within the IFRS 13 fair value hierarchy, contrary to the use of quoted prices on inactive markets or the use of quoted spreads.

• **Financial instruments measured at fair value for which no reliable quoted market prices are available and for which valuations are obtained by means of valuation techniques**
Financial instruments for which no quoted market prices are available on an active market are valued by means of valuation techniques. The models used by the Bank range from standard market models (discount models) to in-house developed valuation models. In order for a fair value to qualify for Level 2 inclusion, observable market data should mainly be used. The market information incorporated in the Bank's valuation models is either directly observable data (prices) or indirectly observable data (spreads), and or own assumptions about unobservable market data. Fair value measurements that rely significantly on own assumptions qualify for Level 3 disclosure.

3.8.2 Equity exposures by type of asset and calculation process

The following table shows the amount of exposure to equities included in the banking book broken down by accounting class and level at year-end 2014 and for comparison at year-end 2013. It provides an analysis of the fair value of financial instruments measured at fair value after their initial recognition, grouped in three levels from 1 to 3, according to the degree of observability of the fair value.

Assets	31/12/13 Level 1	Level 2	Level 3	Total	31/12/14 Level 1	Level 2	Level 3	Total
Financial assets designated at fair value - equities	0	0	0	0	0	0	0	0
Financial assets available for sale - equities **	113.57	1.06	28.02	142.65	75.15	5.75	33.39	114.29
TOTAL	**113.57**	**1.06**	**28.02**	**142.65***	**75.15**	**5.75**	**33.39**	**114.29**

* *In the Pillar 3 2013, the total equity exposures reached 171 million. After an accounting reclassification of Europay Luxembourg and Societé de Bourse de Luxembourg from financial investments category to investment in associates category, the adjusted total equity exposure in 2013 amounted 143 million.*
** *Excludes variable securities recorded at cost (amounted to EUR 8.4 million as at December 31, 2013).*

3.8.3 Equity exposures by type of market and Basel III approach

The following table shows the EAD for equities not included in the trading book, broken down by type of market and by Basel II treatment.
Equities for which BIL's stake exceeds 10% are not included in these figures, since they are deducted from own funds for the calculation of the regulatory solvency ratio.

Type of market	31/12/13 EAD	31/12/13 RWA	31/12/14 EAD	31/12/14 RWA
Private Equity	78	94	43	50
Recognised Market	65	88	7	10
Unrecognised Market	10	10	4	8
Basel treatment				
ADV	69	97	12	23
STD	84	95	42	45
TOTAL	**153**	**192**	**54**	**69**

3.8.4 Gains or losses on equity

3.8.4.1 Realised gains or losses arising from sales and liquidations

The following table shows the cumulative realised gains or losses arising from sales or liquidations, impairments allowances and write-backs in 2014 and 2013.

	31/12/13	31/12/14
Financial assets designated at fair value - equities	5.68	0.00
Financial assets available for sale - equities	-1.14	18.42
TOTAL	**4.54**	**18.42**

3.8.4.2 Unrealised gains or losses included in own funds

The total unrealised gains or losses related to equity instruments amounted to 86 million as at December 31, 2014.

	31/12/13	31/12/14
Financial assets available for sale - equities	82.40	85.76
TOTAL	**82.40**	**85.76**

Amounts are net of tax.

3.9 Securitisation exposures

3.9.1 Introduction: Theoretical considerations on securitisation

The following disclosures refer to traditional securitisations held in the banking book and regulatory capital on these exposures calculated according to the Basel III standardised approaches to securitisation exposures.
BIL's role in the securitisation process is that of investor since it has acquired EUR 100 million of ABS on a total portfolio of EUR 4.91 billion. BIL has exclusively securitisation exposures in the banking book referencing different types of underlying assets including residential mortgage-backed security and auto loans.
A traditional securitisation is a financial transaction or mechanism that takes the credit risk associated with an exposure or pool of exposures and divides it up into transferable tranches with the following characteristics:

- Payments in the transaction or mechanism are dependent upon the performance of the securitised exposure or pool of exposures.
- The subordination of tranches determines the distribution of losses during the life of the transaction or mechanism. A distinction is made between the *Equity* tranche (first-loss tranche), which is the riskier tranche, the *Mezzanine* tranche and the *senior* tranche. The *senior* tranche will be defined as BIL solely bought ABS with such a tranching.
  The senior tranche can be defined as any tranche that is neither a first-loss nor a mezzanine tranche. Within the senior tranches, the super senior tranche is the top tranche in the priority of payments, without taking into account for these purposes any amounts owed under interest rate or currency derivatives, brokerage charges or similar payments.

3.9.2 Management of the Bank's securitisation activity

The only activity in securitisation is done through investments in the banking book of the Bank. The Bank has no role of originator or sponsor of securitised deal.

To invest in securitised assets, the Bank complies to the strict investment guidelines that were approved by the Board of Directors. These guidelines stipulate that:

- Exposures on securitised assets could not exceed 10% of total size of portfolio.
- The Weighted Average Life (WAL) of each exposure must not exceed 5-year at the time of the trade.
- The evolution of the WAL must be followed on a monthly basis. If the WAL exceeds 5-year during the life of the issue, a specific investment committee is organised to make a decision on the future of the exposure.
- For any securitised asset in the portfolio, the portfolio manager will review the trustee reports once it is published and communicate it to the Credit Risk department.
- In the case the portfolio manager is uncomfortable with the published figures due to a weak performance of the pool, he will present the situation to the Investment Committee, which decides whether the exposure has to be sold or to be monitored further.

In 2014, the Bank has implemented to following investment strategy in securitised products:

- Invest only in senior tranche of ABS
- Limit the total invested amount to 150 million with a minimum rating of AA-
- Limit the WAL to 5-year
- Invest principally in ECB-eligible paper, if the paper is not ECB-eligible, a significant spread differential should reward for the additional risk
- In terms of geographical exposure, the investment is mainly concentrated in core-countries, peripheral countries could be envisaged only if the spread premium compared to other asset types is significant for a comparable level of risk.
- Investments in securitised assets must comply to Art 405 & 406 of the CRR to ensure a preferential risk-weighting under the standard method.

On December 31, 2014, the total EAD for securitised products amounted to 100 million for ten exposures. The exposure could be split as follows:

Chart 1: Breakdown by country of Risk (by EAD)

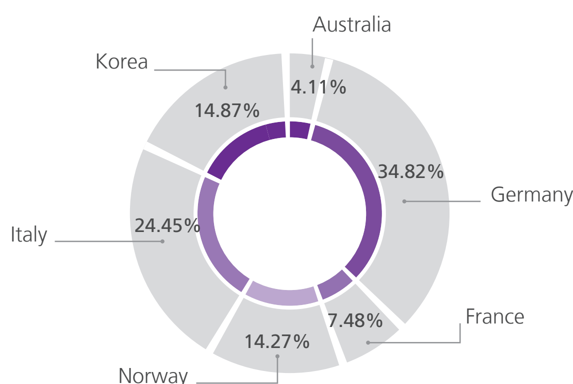
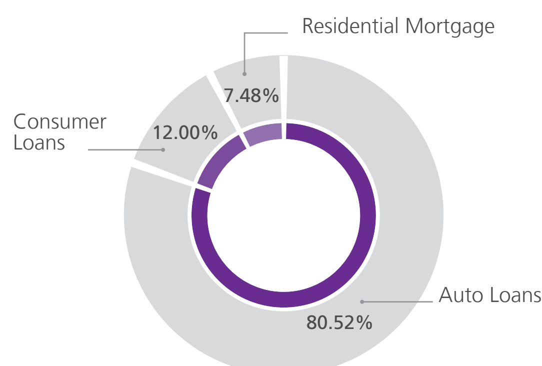


Chart 2: Breakdown by type of assets (by EAD)



Most of the securitisation exposures are eligible to HQLA for the LCR calculation.

3.9.3 Securitisation accounting policies

Currently, the Bank does not own any securitisation for which it would be originator/initiator. Therefore, policies as described in the CRR 449 J are not deemed necessary at this stage.
Indeed, the Bank owns securitisations (ABS, MBS etc.) that it has acquired and not originated. These types of securitisation are classified in the portfolio of the Bank as available-for-sale securities. Therefore, the accounting treatment as explained in IAS 39 applies.
The Bank recognises AFS securities initially at fair value plus transaction costs. Interest is recognised based on the effective interest rate method and recorded under "Net interest income".
The Bank subsequently measures AFS financial assets at fair value.
Unrealised gains and losses arising from changes in the fair value of financial assets classified as AFS are recognised within equity, under the heading "Gains and losses not recognised in the consolidated statement of income". When securities are disposed of, or impaired, BIL recycles the related accumulated fair value adjustments in the consolidated statement of income as "Net income on investments".
BIL recognises the impairment of available-for-sale (AFS) assets on an individual basis if there is objective evidence of impairment as a result of one or more events occurring after initial recognition.
When AFS financial assets are impaired, the AFS reserve is recycled and these impairment losses are reported in the consolidated statement of income as "Net income on investments".

3.9.4 Breakdown of securitisation exposures

The following table shows the securitisation positions purchased in the banking book at year-end 2014:

	Investor
Traditional securitisations	**Purchased positions**
Residential mortgages	8.31
Consumer loans	12.00
Auto loans	83.69
TOTAL	**104.00**

This table shows the securitisation breakdown by weighted risk in the banking book of the Bank at year-end 2014:

	EAD (Standard)					RWA				
Traditional securitisations	**≤20% RW**	**>20% to 50% RW**	**>50% to 100% RW**	**>100% to 1250% RW**	**1,250% RW**	**≤20% RW**	**>20% to 50% RW**	**>50% to 100% RW**	**>100% to <1,250% RW**	**1250% RW**
Residential mortgages	7.48					1.50				
Consumer loans	12.01					2.40				
Auto loans	80.58					16.12				
TOTAL	**100.07**	**-**	**-**	**-**	**-**	**20.01**	**-**	**-**	**-**	**-**

This table represents the breakdown of securitisation exposures by rating class at year-end 2014:

Rating used in RWA calculations	EAD (Standard)	RWA
AAA	75.60	15.12
AA+	24.47	4.89
TOTAL PORTFOLIO	**100.07**	**20.01**

And finally, this table shows the breakdown of securitisation exposures by valuation method at year-end 2014:

Valuation method	EAD (Standard)	RWA
Market	69.29	13.86
Expert	30.78	6.16
TOTAL PORTFOLIO	**100.07**	**20.01**

4. Market risk

Market risk is the risk of losses resulting from adverse movements of market risk parameters (e.g. interest rate risk, equity price risk and foreign exchange risk):

• The interest rate risk consists of a general interest rate risk, resulting from global market fluctuations, and a specific interest rate risk. The latter, also called 'credit spread risk', arises from variation of the credit spread of a specific signature within a rating class.

• The risk associated with the equity price represents the risk arising from the reduction in value of the Bank's equity positions.

• The foreign exchange risk represents the potential decrease in value due to currency exchange rate movements.

Assets & Liabilities Management covers all the banking book's structural risks, namely interest rate risk, foreign exchange risk and liquidity risk.

Liquidity risk measures BIL's ability to meet its current and future liquidity requirements, both expected and unexpected, whether or not the situation deteriorates.

Counterparty risk measures on a daily basis BIL's exposure to an external counterparty.

4.1 Market risk governance

4.1.1 Organisation

The Financial Risk Management department is split into three teams:

• Banking & Counterparty Risk Monitoring

This team is in charge of monitoring counterparty limits, margin calls for collateral management purposes, banking book activity and liquidity risk. It also implements the new regulatory ratios (LCR, NSFR, liquidity monitoring tools etc.).

• Treasury and Financial Markets (TFM) Risk Monitoring

This team's main tasks are the implementation and monitoring of the financial risks attached to financial market activities (fixed income, forex, structured products and brokerage), the calculation of BIL group Value-at-Risk (VaR), the detection of suspicious transactions and the reconciliation of positions and profit and loss (P&L).

• End User Integration (EUI) and Market Data Management

This team is in charge of the maintenance and the development of market risk data as well as dealing with dedicated reports and systems.

4.1.2 Policy and committees

In order to manage market and ALM risks in an efficient manner, BIL group has defined a framework based on the following:

• A comprehensive risk measurement approach, which is an important part of BIL's risk profile monitoring and control process,

• A sound set of limits and procedures governing risk-taking: The system of limits must be consistent with the overall risk measurement and management process, and be proportionate to the capital position. These limits are set for the broadest scope possible,

• An efficient risk management structure for identifying, measuring, monitoring, controlling and reporting risks: BIL's development of a general risk management framework is suited to the type of challenges it faces. This approach offers an assurance that market risks have been managed in accordance with BIL's objectives, strategy and risk appetite.

Financial Risk Management (FRM) oversees market risk under the supervision of the Management Board and specialist risk committees. On the basis of its global risk management approach, FRM is responsible for identifying, analysing, monitoring and reporting on risks and results (including the valuation of assets) associated with financial market activities.

The policies, directives and procedures documenting and governing each of the activities are defined within BIL and applied to all of the Bank's entities:

• Head Office FRM teams define risk measurement methods for the whole group, as well as reporting and monitoring the risks of the activities they are responsible for, at a consolidated level.

• Head Office and local FRM teams follow day-to-day activity, implement policies and directives, monitor risks (calculation of risk indicators, control limits and triggers, frame new activities/new products and so on) and report to their own Management Board, as well as to their local supervisory bodies.

• The ALM Committee (ALCo) decides on the structural balance sheet positioning regarding interest rates, foreign exchange rates and liquidity profile. It defines and revises market risk limits.

• FRM, in its day-to-day activity, is supported by two operational committees: The MOC (Monthly Operational Committee) and the OR&NPC (Operational Risk and New Products Committee), which are detailed in Operational Risk section hereafter.

4.1.3 Risk measurement

• The Bank has adopted sensitivity and VaR measurement methodologies as key risk indicators. Risk sensitivity measurements reflect the balance sheet exposure to a parallel movement of 1% on the yield curve. VaR measures the maximal expected potential loss that can be experienced with a 99% confidence interval, within a 10-day holding period.

BIL applies sensitivity and VaR approaches to accurately measure the market risk inherent in its various portfolios and activities:

• General interest rate risk and currency risk are measured through historical VaR.

• Trading portfolio equity risk is measured through historical VaR.

• Non-linear risks are measured through historical VaR.

• Specific interest rate risk (spread risk) is measured through sensitivities.

As a complement to VaR measures and income statement triggers, the Bank applies a broad range of other measures aimed at assessing risks associated with the various business lines and portfolios (nominal limits, maturity limits, market limits, sensitivity to various risk factors etc.).

4.2 Market risk exposure

4.2.1 Treasury and Financial Market

The use of VaR in relation to interest rates and foreign exchange rates (excluding ALM) is shown in the table below. BIL group's average VaR was 2.40 million in 2014, compared with 4.99 million in 2013.

		2013							
VaR (10 days, 99%)		**IR[1] & FX[2] (trading and banking)[3]**				**EQT trading[4]**			
		Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
By Risk factor	Average	5.81	4.59	5.13	4.39	0.01	0.02	0.01	0.00
	Maximum	8.47	6.26	6.09	5.19	0.02	0.03	0.02	0.02
Global	Average	4.99							
	Maximum	8.48							
	End of period	4.61							
	Limit	8.00							

		2014							
VaR (10 days, 99%)		**IR & FX (trading and banking)**				**EQT trading**			
		Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
By Risk factor	Average	4.45	2.97	1.57	0.70	0.00	0.00	0.01	0.00
	Maximum	5.45	3.99	2.46	0.96	0.01	0.02	0.01	0.03
Global	Average	2.40							
	Maximum	5.45							
	End of period	0.45							
	Limit	8.00							

Prior to 2012, spread risk for the capital markets activity was measured using a VaR methodology. This measurement was replaced by a sensitivity calculation at the end of 2012. As at December 31, 2014, the spread sensitivity (+1bp) amounted to EUR -15,525 for a limit set at EUR -60,000.

4.2.2 Asset & Liability Management (ALM)

The role of ALM in terms of interest rate risk management is to reduce the volatility of the income statement, thereby safeguarding the gross income generated by the business lines.

The sensitivity of the net present value of ALM positions to a change in interest rates is currently used as the main indicator for setting limits and monitoring risks.

As at December 31, 2014, ALM sensitivity amounted to 61 million (versus 29 million as at December 31, 2013).

This change is mainly due to the cautious rate approach currently adopted by BIL that aims to avoid negative impacts in the event of an interest rate hike.

The limit of interest rate sensitivity for a 100 bp parallel shift was 81 million as at December 31, 2014 (versus 95 million as at December 31, 2013). This limit is reviewed in accordance with the Bank's regulatory own funds.

1 IR: interest rate
2 FX: foreign exchange
3 IR & FX: excluding Asset & Liability Management (ALM)
4 EQT: equity

4.2.3 Investment portfolio

The interest rate risk of the investment portfolio is either managed by the Treasury or the ALM departments, depending on various criteria (e.g. maturity, sector).
The investment bond portfolio had a total nominal exposure of 4.91 billion as at December 31, 2014 (versus 4.63 billion as at December 31, 2013). The majority is classified in the AFS portfolio (4.75 billion as at December 31, 2014, vs. 4.59 billion as at December 31, 2013) while the remainder is classified in the HTM portfolio (158 million as at December 31, 2014).
As far as the AFS classified bond portfolio is concerned, the sensitivity of the fair value (and the AFS reserve) to a one basis point widening of the spread was -2.7 million (compared with -2.5 million per basis point as at December 31, 2013).

	Notional amount		Rate bpv		Spread bpv	
Investment portfolio	**31/12/13**	**31/12/14**	**31/12/13**	**31/12/14**	**31/12/13**	**31/12/14**
Treasury	2,378	2,322	-0.19	-0.15	-0.84	-0.81
ALM	2,248	2,588	-0.64	-0.23	-1.68	-2.00
TOTAL	**4,626**	**4,910**	**-0.83**	**-0.38**	**-2.52**	**-2.80**

4.2.4 Model management

4.2.4.1 Backtesting

Backtesting exercises are performed in order to check the reliability of VaR figures.
BIL has adopted hypothetical backtesting as its main indicator, which takes into account different potential scenarios (incorporating changes in all market data, in interest rates only, in exchange rates only and in equity prices).
The backtesting process provides the Financial Risk Management department with a number of exceptions representing the number of losses exceeding their corresponding VaR figures. In 2014, the hypothetical backtesting calculated on the trading portfolio revealed no downward exception for interest rate and currency risks attesting to the quality of the tools in place.

4.2.4.2 Systems and controls

On a daily basis, FRM calculates, analyses and reports on the risks and results at a consolidated level.
All market activities are backed by specific guidelines describing the objectives, the authorised products, sensitivity, VaR and/or outstanding limits, etc.
The systems and controls established inside the Bank are described in various procedures to ensure a comprehensive framework is in place to support those responsible for managing market risks.

4.3 Liquidity risk

The liquidity management process is based on covering funding requirements with available liquidity reserves. Funding requirements are assessed prudently, dynamically and comprehensively by taking existing and planned on- and off-balance sheet asset and liability transactions into consideration. Reserves are constituted from assets eligible for refinancing with the Central Banks to which BIL has access (Banque Centrale de Luxembourg and Swiss National Bank).
Regular information channels have been established for management bodies. A daily report is sent to the CEO, the CRO, ALM Committee members, Risk Management, Cash & Liquidity Management and the TFM teams. An analysis of the balance sheet changes (customer deposits, etc.) is presented and discussed during the ALM Committee meetings.

4.3.1 Risk measurement

The internal liquidity management framework includes indicators enabling the assessment of BIL's resistance to liquidity risk. These indicators include liquidity ratios, which compare liquidity reserves to liquidity deficits[1]. All these indicators are assessed according to a variety of scenarios, in the major currencies. These ratios are sent to the CSSF and to the BCL, on a weekly basis.

1 Referred to as the "base case ratio"

4.3.2 Risk exposure

In line with the 2013 year-end situation, BIL presented a significant liquidity surplus throughout 2014.

Additional funding needed to reach 100% of the base case ratio	2014	Q1	Q2	Q3	Q4
	Estimated - 1 month				
Average	-4,664	-4,953	-4,796	-4,456	-4,452
Maximum	-5,116	-5,116	-4,911	-4,645	-4,565

The negative amount of additional funding needed to reach 100% of the base case ratio shows that the Bank presents a surplus of liquidity.

From a commercial balance sheet point of view, the Bank has observed a progressive increase in its customer deposits and a moderate growth in its loan portfolio.
This excess cash has been partially invested through the Bank's bond portfolio (Liquidity buffer). This portfolio is mainly composed of central bank eligible bonds which are also compliant with Basel III requirements, i.e. LCR and NSFR. Please also note that the Bank's LCR has met the fully phased threshold of 100% as at end 2014.

4.3.3 Asset encumbrance

In line with the guidelines established by the EBA in 2014, the concept of asset encumbrance includes both assets on the balance sheet, contributed as guarantee in operations to obtain liquidity, as well as those off-balance sheet ones received and re-used with a similar purpose, as well as other assets associated with liabilities for different funding reasons.

As at December 31, 2014, 1,838 million of BIL group's balance sheet assets were encumbered, partly offset by 969 million of collateral received. Asset encumbrance arises mainly from securities collateral pledged against secured funding and collateral swaps. BIL funds a portion of assets via repurchase agreements, securities lending and a participation in ECB TLTRO[1]. Collateral swaps, which also explain the major part of collateral received, aims to capture profit opportunities from the exchange of securities without downgrading the quality of securities portfolio. Additionally, encumbered loans correspond to cash collateral posted.
The amount of central bank's eligible assets among unencumbered assets (4,515 million[2]) results from a prudent liquidity risk management, particularly in the perspective of entry into force of LCR as from October 1, 2015. From this standpoint, BIL group ensures to maintain a sufficient level of potentially unencumbered assets.

4.3.3.1 Assets

The following table describes the unencumbered and encumbered assets as the end of 2014.

	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets		Fair value of unencumbered assets
				of which: central bank's eligible	
ASSETS OF THE REPORTING INSTITUTION	**1,838.41**		**18,446.37**	**3,940.13**	
Loans on demand	0		1,301.95	0	
Equity instruments	0		114.34	0	292.15
Debt securities	1,316.97	1,317.30	4,482.40	3,940.13	4,391.09
Loans and advances other than loans on demand	521.44		11,320.32	0	
Other assets	0		1,227.37	0	

1 *Targeted longer-term refinancing operations*

2 *3,940 million of assets + 575 million of collateral received*

4.3.3.2 Collateral received

The following table details the collateral received by the Bank related to the unencumbered and encumbered assets as the end of 2014.

	Fair value of encumbered collateral received or own debt securities issued	Unencumbered		
		Fair value of collateral received or own debt securities issued available for encumbrance		Nominal amount of collateral received or own debt securities issued not available for encumbrance
			of which: central bank's eligible	
COLLATERAL RECEIVED BY THE REPORTING INSTITUTION	**0**	**968.81**	**575.21**	**6,920.34**
Loans on demand	0	240.11	240.11	240.10
Equity instruments	0	0.00	0.00	0.00
Debt securities	0	728.70	335.10	325.63
Loans and advances other than loans on demand	0	0	0	0
Other collateral received	0	0	0	6,354.60
OWN DEBT SECURITIES ISSUED OTHER THAN OWN COVERED BONDS OR ABSs	**0**	**25.64**	**0**	**25.29**

4.3.3.3 Sources of encumbrance

As the end of 2014, the following table details the breakdown of encumbered assets, collateral received and associated liabilities.

	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
CARRYING AMOUNT OF SELECTED FINANCIAL LIABILITIES	**1,298.34**	**1,111.12**
Derivatives	711.93	521.44
Deposits	586.41	589.67
Debt securities issued	0	0
Other sources of encumbrance	728.70	727.30
TOTAL SOURCES OF ENCUMBRANCE	**2,027.04**	**1,838.41**

4.4 Assessment of the regulatory capital requirement

The Bank no longer applies the internal VaR model to calculate the regulatory capital requirement for general interest rate risk and currency risk within trading activities.
From 2013 onward, all market risks are treated under the Basel III standardised approach. The table below presents the Bank's regulatory capital required broken down by risk type for both year-end 2013 and 2014.

		31/12/13		31/12/14	
Method	**Type of risk**	**RWA**	**Capital requirement**	**RWA**	**Capital requirement**
Standardised	Interest rate risk	64	5	70	6
	Foreign exchange risk	8	1	17	1
	Position Risk on equities	47	4	49	4
TOTAL		**119**	**10**	**136**	**11**

5. Operational risk

Operational risk is the risk of losses stemming from inadequate or failed internal processes, people, systems or external events. This definition includes legal risk, but excludes strategic risk. It also excludes losses resulting from commercial decisions.

5.1 Operational risk governance

5.1.1 Organisation

The Operational Risk Management unit encompasses the management of corporate operational risks, Insurances Reinsurance as well as Security risks (i.e. prevention and regulation).

- *Corporate Operational Risk* (COR) is in charge of the description of the Bank's internal operational risk management framework and its implementation and application throughout BIL group. In addition, COR is in charge of recording operational incidents, implementing Key Risk Indicators, supervising the Risk and Control Self-Assessment (RCSA) performed by each Business Line/branch/subsidiary, and following the resulting action plans. COR also provides quarterly reports to the Operational Risk and New Products Committee. These reports can be used to review changes in the Bank's risk profile and to take measures needed to reduce risk.
- Based on the risk profile of the Bank, the *Insurance & Reinsurance team* develops and ensures the adequacy (i.e. establishment of new insurance policies and/or update of existing policies) of the (re)insurance policy and (re)insurance system within the Bank and its branches/subsidiaries. This team also provides a centralised management of (re)insurance contracts and acts as single point of contact for our brokers, insurance companies and others insured bodies.
- The *Security Risk Prevention team* is in charge of ensuring Information Security by defining the access rules to information in accordance with the Security Policy of the Bank, securing access to information by implementing tools and defining access granting procedures, and addressing the new challenges (i.e. reorganisation, restructuring, expansion etc.) of the Bank by working to adapt its management system of access to information. This team is also responsible for analysing the risks related to the availability of critical activities (i.e. BIA [1], RTO [2], RPO [3]) and considering the strategy reducing these risks to an acceptable level through the development, testing and maintenance of a Business Continuity Plan.
- The *Security Risk Regulation team* ensures the analysis of risks related to the availability, confidentiality and integrity of information and the strategy, actions and projects to reduce these risks to an acceptable level. Moreover, this team is also in charge of the management of security governance (i.e. roles, responsibilities, committees, processes), the development and maintenance of information classification, the strengthening of the awareness of employees with security requirements, the management of security incidents related to information, the organisation of the Crisis Committee and Security Committee and the implementation and monitoring of its related decisions, the execution of controls to ensure compliance with the Security Policy and, finally, some aspects of the legal and regulatory compliance related to information security issues.

5.1.2 Policies & committees

BIL group's operational risk management framework relies on strong governance, with clearly defined roles and responsibilities.

Policies

BIL group's Operational Risk Management Policy involves identifying and assessing the existing risks and checks in place on a regular basis in order to ensure that the acceptance level defined for each activity is respected. If this is not the case, corrective measures must be taken to permit the return to an acceptable situation. This framework is implemented through a prevention policy, particularly with regard to information security and business continuity and, whenever necessary, through the transfer of the financial consequences of certain risks through insurance.

In terms of operational risk, BIL group's management has validated the Operational Risk Global policy, which was implemented through the application of guidelines (guidelines for reporting operational incidents and guidelines for conducting a risk and control self-assessment (RCSA)).

In terms of Security Risk, including business continuity management, BIL group's Management Board has validated and implemented an Information Security Policy. This document and its related instructions, standards and practices are intended to secure BIL's information assets. Security programs and responsibilities (a Chief Information Security Officer supervising BCM, Asset Management, Identity & Access Management, IT Security and Physical Security) have been set up in order to let all the business lines operate within a secure framework.

Committees

The following committees are responsible for operational risk (including Security Risk) at BIL:

- The Operational Risk and New Products Committee (OR&NPC) is in charge of monitoring operational risk at BIL. To this end, the committee makes decisions on risks that have been identified and analysed as well as on suitable measures to be taken in order to improve weak processes; it also monitors any action taken. This committee is responsible for approving RCSA. It also supervises the launch of new products and examines their operational aspects, making decisions on any project that could have an operational impact on BIL activities.

1 *Business Impact Analysis*
2 *Recovery Time Objective*
3 *Recovery Point Objective*

• The Security Committee (SC) is mandated by the Management Board to oversee the risks to BIL's information security and to that of its subsidiaries and branches, as well as all risks relating to the loss of the confidentiality, availability or integrity of the Bank's information assets. It is also in charge of monitoring security incidents involving BIL, making decisions on any project with the potential to have an impact on the security of BIL's information assets and ensuring that the implementation and support of a global Business Continuity Plan (BCP) follows the strategy defined by the BIL Management Committee.

• The Crisis Committee, is a crisis management body governed by the Chief Information Security Officer (CISO). This committee, as its name indicates, is called upon in the event of a crisis situation which could affect BIL operations and, therefore, present an operational risk (damage to reputation, opportunity loss, financial loss, client withdrawals, etc.). The Crisis Committee is chaired by BIL's Chief Risk Officer (CRO) and includes key players, ensuring risks are assessed and this type of situation is managed responsibly.

The Operational Risk Department participates to the MOC (Monthly Operational Committee) when the subject has operational risks aspects.

5.1.3 Risk measurement

The operational risk framework is based on the following elements:

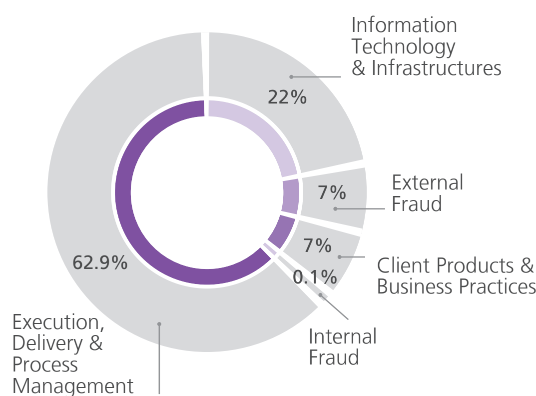
- efficient data collection
- self-assessment of risks
- corrective and preventive action plans
- development, implementation and follow up of Key Risk Indicators.

Operational risk event data collection

According to the Basel Committee, the systematic recording and monitoring of operational incidents is a fundamental aspect of risk management: "Historical data on banking losses may provide significant information for assessing the Bank's operational risk exposure and establishing a policy to limit/ manage risk."

Regardless of the approach used to calculate capital (standardised or advanced measurement approaches), data collection is required. Having a relevant procedure in place ensures that BIL complies with the Basel Committee's requirements (guidelines for reporting operational incidents). At the same time, the recording of incidents provides information that may be used to improve the internal control system and determine the operational risk profile.

A breakdown of incidents by event type is shown in the chart below.



The results for 2014 of the recording of operational incidents are presented in the above pie chart.

Execution, Delivery & Process Management represents 63% of the total amount of incidents. Losses related to these incidents are usually due to human errors. Defining an action plan for this kind of error is usually not necessary except if the error comes from the misunderstanding of procedures, documents or rules to be followed.

The second most important category with 22% of the total amount of incidents is *Information, technology and Infrastructure*. Most of these incidents concern IT failures that generally do not generate direct financial losses. The impacts are generally expressed in man-days lost.

The incidents in the category *Damage to asset and Public Safety* are covered by Insurance.

Concerning external frauds occurring in 2014, the Bank recorded 9 frauds and 62 fraud attempts. The amount could be sometimes very high and the Bank does not expect a decrease of the attempts. During 2014, the operational risk department worked around several axis to fight against fraud attempts (new procedure/rules for transfers, blocking of the communication channels to instruct, to raise the employees awareness, systematic analyse of the modus operandi of the fraudsters) in order to recognise a fraud attempt and to react quickly and in a better way.

In terms of reporting, an exhaustive monthly document is produced for each line manager (head office, subsidiaries and branches). It covers all incidents that have arisen in their business over the previous month, based on reports filed. Recipients analyse the report and verify that all incidents brought to their attention have been included.

COR also presents a report on operational risk report to OR&NPC at the end of each quarter.

Self-assessment of risks and associated controls

A risk and control self-assessment (RCSA) is performed in order to identify the most significant risk areas for the Bank. This assessment provides a good overview of the various activities and existing checks and can lead to the definition of mitigation actions. The results of the assessment are reported

to Management during meetings of the Operational Risk and New Products Committee.

Definition and follow-up of action plans

As part of operational risk management, corrective action plans linked to major risks and events must be monitored closely.
Two types of action plan are managed through operational risk management:

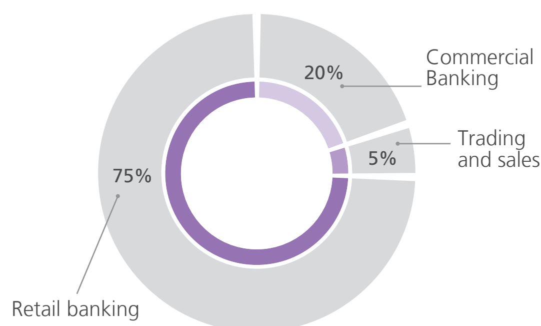
- Action plans – Incidents: following a significant incident, the management may implement action plans,
- Action plans – RCSA: in the event of unacceptable risk exposure, the management may identify action plans.

5.2 Calculation of the regulatory capital requirement

BIL applies the Basel III standardised approach to calculate regulatory capital for operational risk. This approach consists in applying a percentage (called the "beta factor", ranging from 12% to 18%) to an appropriate activity indicator calculated for each of the eight business lines defined by the Basel Committee (i.e. corporate finance, commercial banking, retail banking, trading and sales, asset management, agency services, retail brokerage, payment and settlement).
The relevant indicator is defined by the regulator and is based on the gross operating income of the underlying business, using an average over the past three years. The calculation is updated at the end of each year. The capital requirement for operational risk was 55.34 million at year-end 2014, as compared with 55.72 million at year-end 2013.

	Beta Factor	Adjusted Gross Operating income	Capital Requirement 2014	Capital Requirement 2013
Commercial banking	15%	73.89	11.08	10.54
Trading and sales	18%	13.85	2.49	3.01
Retail banking	12%	348.04	41.76	42.18
TOTAL		**435.12**	**55.34**	**55.72**

The chart below presents the breakdown by business lines (according to Basel definitions) of the capital requirement for operational risk as at December 31, 2014.



6. Remuneration policies and practices

6.1 Determination of the Identified Staff

BIL group has performed a detailed analysis in order to identify its members of staff whose professional activities have a material impact on BIL group's risk profile, referred to as the "Identified Staff".

This analysis has been performed in collaboration with HR, Risk Management and Compliance.

More precisely, BIL group has updated the list of Identified Staff that had already been drawn up – on the basis of the analysis of job functions and responsibilities as prescribed mainly by the CEBS Guidelines on Remuneration Policies and Practices and CSSF Circulars 10/496 and 11/505 - with regard to the new requirements detailed in the Commission Delegated Regulation EU 604/2014 on the identification of categories of staff whose professional activities have a material impact on an institution's risk profile.

BIL group updates the list of Identified Staff at least on an annual basis.

6.1.1 Proportionality principle at the level of Identified Staff

BIL group applies the principle of proportionality as defined by the CRD III, the CRD IV, the CEBS guidelines and the CSSF Circular 11/505.

More precisely, BIL group has applied (and will continue to apply unless the CSSF issues a new guidance on the application of the proportionality principle) the proportionality principle to its Identified Staff members who have less material impact on BIL group's risk profile and who have an annual variable remuneration that is inferior or equal to EUR 100,000.

In this context, the following specific remuneration requirements are neutralised for the Identified Staff for whom the proportionality principle is applied:

- requirement to pay out a part of the variable remuneration in instruments and, de facto, the related instrument retention obligations
- requirement to pay out a part of the variable remuneration through a deferral scheme and, de facto, the related ex-post risk adjustment obligations (malus).

6.2 Determination of the Relevant Persons

In addition, as per Circular CSSF 14/585 transposing the European Securities Markets Authority's (ESMA) guidelines on remuneration policies and practices (MiFID), BIL group has identified the list of the so-called Relevant Persons, i.e. "*persons who can have a significant influence on the service provided or corporate behaviour of the firm, including persons who are client-facing front-office staff, sales force staff, and/or other staff indirectly involved in the provision of investment and/or ancillary services whose remuneration may create inappropriate incentives to act against the best interests of their clients. This includes persons who oversee the sales force (such as line managers) who may be incentivised to pressurise sales staff, or financial analysts whose literature may be used by sales staff to induce clients to make investment decisions. Persons involved in complaints handling, claims processing, client retention and in product design and development are other examples of 'relevant persons'. Relevant persons also include tied agents of the firm.*"

The list is drawn and yearly reviewed by HR and Compliance. BIL group had already adopted before the implementation of Directive 2004/39/CE in 2007 and still maintains measures enabling to effectively identify where the Relevant Persons might fail to act in the best interests of clients and to take remedial action. In addition, organisational measures adopted in the context of the launch of new products or services appropriately take into account the remuneration policies and practices and the risks that these products or services may pose in terms of conduct of business and conflicts of interests.

6.3 Performance assessment

6.3.1 Performance management system

6.3.1.1 Main characteristics of the system

Within BIL group and subject to minor local adjustments, all members of staff are assessed once a year on the basis of targets set at the beginning of each calendar year.

An evaluation of a whole year's work is carried out and targets are set for the following year. During such annual assessments, employees are provided with an appraisal of their work. Providing feedback to employees contributes to motivating employees and to enhancing BIL group performance in many ways, as well as:

- guaranteeing equity and internal consistency
- promoting internal mobility
- attracting and enhancing loyalty
- granting a fair bonus
- concentrating on collective efforts and achieving BIL group corporate objectives.

The performance appraisal process is detailed in a practical guide provided to each appraiser and appraisee.

The assessment scale involves five ratings from "5" to "1":

- **Rating 5:** Corresponds to a very exceptional level of performance and is only attributed in the case where the member of staff has exceeded all their targets, constantly and throughout the year,
- **Rating 4:** Corresponds to an exceptional level of performance for which the member of staff has exceeded their targets,
- **Rating 3:** Corresponds to a very good level of performance for which the member of staff has reached all their targets,
- **Rating 2:** Corresponds to a poor level of performance for which the member of staff has not reached all their targets,
- **Rating 1:** Corresponds to a very poor level of performance for which the member of staff has not reached their targets at all.

6.3.1.2 Performance assessment process overview

The target-setting interview is the first meeting between the appraisers and their direct reports during which objectives are set for the year. The interview is recorded in writing in the first quarter of the year. In practice, performance assessments are generally conducted in December and January and goals settings for the following year are performed during the first quarter of each year.

During the second or third quarter, an optional second interview may take place to monitor the objectives and if need be to adapt them in relation to the evolution of the professional context.

At the end of the year, the appraisers hold the year-end assessment interviews and set the level of target achievement according to a specific scale. The rating will be used, among other factors, to determine the variable remuneration.

6.3.1.3 Link between remuneration and performance

BIL group aims to attract, retain and motivate highly qualified professionals in their respective domains. BIL group offers remuneration packages that, while in line with market practices, are competitive and attractive, both in terms of amounts and structure. An important element of the employees' remuneration packages is the variable component which is very much linked to the performance of the group or the entity, of the department and of the individual.

The rating given by the appraisers determines whether the staff member is eligible or not to variable remuneration:

- The staff member is eligible with a rating from "3" to "5".
- The staff member is in principle not eligible with a rating of "1" or "2".
- In the framework of its risk management approach, and in order to minimise behaviors that are inappropriate or incompatible with BIL group's long term goals and with customers' protection and satisfaction, objectives always have a qualitative component that fosters compliance with BIL Code of Ethics and values.

If the qualitative objectives are not met, the overall rating may not reach "4" or "5".

Furthermore, in accordance with its policy on variable remuneration, BIL group can decide, in case the performance of the staff member, the business unit or BIL group as a whole is not satisfactory, to lower or even to reduce to zero the variable remuneration.

6.3.2 Set up of objectives

Cascading common objectives from a top/down approach is a key factor to allow the group to achieve its strategic priorities. Objectives are set-up in order to ensure that individual performance and development is coherent with BIL group's ambition and future development. Hence objectives are linked to the role and function that the relevant employee holds within the organisation; such objectives are individual or collective and are based on quantitative as well as qualitative aspects.

Objectives are weighted by the direct manager and must respect the SMART principle, i.e. be *Specific*, *Measurable*, *Attainable*, *Relevant* and *Time-Bound*.

Variable compensation for performance should always have an individual component reflecting non-financial performance criteria, such as compliance with internal rules, risk standards and procedures, as well as compliance with the company's standards which govern relationships with clients and investors, as well as proper ethical behavior.

6.4 Remuneration structure & pay out modalities

6.4.1 Description of the remuneration structure and components

The principles set out below apply to all employees of BIL group.

However, since BIL group is active in multiple countries, it sometimes needs to align its practices with the local regulatory frameworks (e.g. labor, social security and tax laws, codes / rules / circulars issued by the local regulator, etc.) and with local remuneration market practices. Therefore, the structure and components of remuneration packages may slightly differ from one country to another. The remuneration at BIL group is structured around three pillars:

1. Fixed remuneration

Portion of the total remuneration periodically received in cash. It remunerates the competences of the staff members, is based on the role and experience of the staff member and is guaranteed irrespective of their performance. Fixed remuneration may be impacted by a Collective Agreement and is generally composed of the following elements:

- monthly salary
- additional monthly or fixed premium if provided by contract or a Collective Agreement
- mandatory additional premiums provided by a Collective Agreement.

2. Variable remuneration

Portion of the total remuneration received in cash (or cash and instruments for Identified Staff for whom proportionality cannot be applied) which is entirely at BIL group's discretion and is determined on the basis of individual and collective, financial and non-financial performance criteria. In particular it enables the interests of the employee to be aligned with those of BIL group.

3. Fringe benefits

All advantages received in kind by an employee in addition to his/her cash remuneration (such as company cars, pension schemes and loans). These benefits are non-discretionary and do not foster under any circumstances excessive risk-taking, but may be linked to hierarchical, advancement or seniority criteria. None of these benefits are linked to performance. They are part of the fixed remuneration (see above under 1). Fringe benefits depend on each entity's remuneration structure.

6.4.2 Staff identified as Material Risk Takers (MRT)

BIL has performed a detailed analysis in order to identify its members of staff whose professional activities have a material impact on BIL group's risk profile, referred to as the "Identified Staff".

This analysis has been performed in collaboration with HR, Risk Management and Compliance.

More precisely, BIL has updated the list of Identified Staff that had already been drawn up -on the basis of the analysis of job functions and responsibilities as prescribed mainly by the CEBS Guidelines on Remuneration Policies and Practices and CSSF Circulars 10/496 and 11/505- with regard to the new requirements detailed in the Commission Delegated Regulation EU 604/2014 (art.3, 4) on the identification of categories of staff whose professional activities have a material impact on an institution's risk profile (15 qualitative and 3 quantitative criteria).

The list of Identified Staff is fixed at 82 as of December 31, 2014 and detailed as follows:

MRT	82
Supervisory function	13 (from which 8 are not incl. in other position)
Management function	9
Asset Management	25
Corporate functions	19
Independant control functions	11
Investment Banking	5
Retail Banking	5

6.4.3 Variable remuneration principles & upper limits

Variable remuneration is allocated to staff members according to:

- the status of the employee (employee/manager/executive) and his/her job level
- the appraisal notes obtained through the performance assessment process on the basis of individual and collective, quantitative and qualitative performance criteria
- the average presence of the employee during a period of reference.

As far as the proportion of variable remuneration to fixed remuneration with regard to total annual remuneration of Identified Staff is concerned, these proportions are linked to the categories of Identified Staff as well as to the entities or countries where the entities are located.

As a general principle, and as per the CRD IV requirements, the variable component shall not exceed 100 % of the fixed component of the total remuneration. On an exceptional basis, a higher maximum level of the ratio between the fixed and variable components can be fixed but will in no case exceed 200 % of the fixed component. In such case, and to comply with the CRD IV requirements, the Board of Directors will submit to the Bank's shareholders a detailed recommendation describing the reasons for, and the scope of, the approval sought (incl. the number of staff affected, their functions and the expected impact on the requirement to maintain a sound capital base). The shareholders' decision has been taken at the General Meeting. The procedure for increasing the ratio (including the quorum and voting thresholds) as described in the CRD IV (and as they will be implemented in the Financial Sector Law) will be strictly followed. Copies of both the recommendation of the Board of Directors to the shareholders and the shareholders' decision will be provided to the competent regulators.

If one of BIL group's subsidiaries is located in other EU Member States which have chosen to set lower maximum percentages, the ratios defined in this Policy will no longer apply and the local requirements will be respected.

6.4.4 Variable remuneration principles for specific categories of staff

6.4.4.1 Non-executive directors

Non-executive directors receive no variable remuneration.

Non-executive directors' fixed remuneration for the exercise of their mandates is set as follows:

- The Ordinary General Meeting of BIL decides of the fixed remuneration of non-executive directors of BIL.
- The Ordinary General Meetings of the shareholders of the relevant subsidiaries of BIL define the fixed remuneration of their non-executive directors.

The Ordinary General Meeting of the shareholders of BIL, upon proposal of the Remuneration and Nominations Committee (RNC), decides each year on the remuneration of the Chairman, Vice-Chairman and the Members of the Board of Directors, including the remuneration of the Board Members which are appointed member of the specialised Board Committees.

6.4.4.2 Member of the Management Board of BIL group

The remuneration of the Member of Management Board (MMB) of BIL is defined by the Board of Directors, acting upon the recommendation of the RNC. The RNC may be assisted by independent external advisers who are experts in the field of remuneration, and by the Risk, Human Resources, Compliance, Legal & Tax departments of BIL group.

In order to offer remuneration which is in line with market practice, the RNC regularly orders a benchmarking study on the basis of which, if need be, it makes proposals to the Board of Directors to adapt the remuneration conditions of the MMB, including the variable components.

The remuneration (allowances or attendance fees) of MMB paid by a company in which the relevant member exercises a mandate in the name of, or on behalf of, BIL group is retro-ceded to BIL.

The MMB's fixed remuneration constitutes the basis on which the variable remuneration is calculated.

- Amount of variable remuneration

At the beginning of the year, objectives are set and a target bonus is agreed upon.

The variable remuneration that is paid may be more or less than the target bonus in case where the objectives have either been exceeded or have not been met.
Variable remuneration is in no way guaranteed. Variable remuneration remains discretionary and can be set to zero by the Board of Directors if the group / Business / Individual performances targets are not fulfilled.

- Composition of variable remuneration

The variable component consists of three elements, each assessed on the basis of quantitative or qualitative, financial or non-financial criteria:

1. Group component

This component is common to all MMBs. BIL group or an entity's specific situation can influence the determination of variable remuneration. It is calculated on the basis of the financial indicators agreed by the Board of Directors, acting upon the recommendation of the RNC.

2. Business component

The business component is analysed individually with respect to the targets set for MMBs for the coming year. The performance analysis will depend upon the manner in which the business or the support line has taken an active part in the achievement of the group target. This analysis will make it possible to make a difference between good and poor performance. The performance analysis will include the monitoring of the risk elements specific to MMB's activity line. All these performance indicators are communicated to the MMBs at the beginning of the year.

3. Individual component

The individual component is analysed separately with respect to the targets set for MMBs for the coming year, on the basis of qualitative criteria such as management skills, the manner in which the MMB has participated in the elaboration and/or the implementation of the transformation plan for his/her entity, support line or business line, and compliance with the values of the BIL group which, when setting targets, will need to be translated in concrete behaviours.
Below a certain result in the individual assessment, the entire variable remuneration amount may be set at zero. This decision is made by the Board of Directors, acting upon the recommendation of the RNC.

6.4.4.3 Members of Local Management Board [1]

For Members of Local Management Boards, variable remuneration components will not include any group Component and will only depend on business and individual components.

6.4.4.4 Senior executive staff

For senior executive staff, a target model bonus may be set-up. At the beginning of the year, objectives are set and a target bonus is agreed upon.
The variable remuneration may be more or less than the target bonus in case where the objectives have either been exceeded or have not been met.
Variable remuneration is in no way guaranteed. Variable remuneration remains discretionary and can be set to zero if the Group / Business / Individual performances targets are not fulfilled.

6.4.4.5 Management responsible for independent control functions (compliance, internal audit)

The control functions identified within BIL group are Human Resources, Risk Management, Internal Audit and Compliance. The performance analysis and the decision on the variable remuneration are performed in all independence for all control functions. More precisely, in order to avoid conflicts of interests, the performance indicators in control functions consist mainly of non-financial individual criteria and do not in any case contain financial criteria related to the entities they control.
As such, the performance is analysed on the basis of targets that are principally qualitative and specific to the function performed. In general, unless there is a reduction in the variable remuneration because of poor company results, the variable remuneration of control functions is irrespective of the group's economic results.
The remuneration of the Heads of control functions is directly overseen and determined by the RNC. Employees in control functions are not assessed on the performance of the entities they control, and the remuneration of these profiles is reviewed by the RNC.

6.4.5 Variable remuneration pay-out principles for Identified Staff

6.4.5.1 Procedure governing the payment of variable remuneration

BIL group applies the proportionality principle to its Identified Staff members who have a less material impact on BIL group's risk profile and who have an annual variable remuneration that is inferior or equal to EUR 100,000 ("Application of the principle of proportionality among the material risk takers within a single institution"). To the extent requirements related to deferral and payment in instruments have been neutralised for these Identified Staff members, the rules described below are applicable only to the Identified Staff members for whom the proportionality principle cannot be applied.

6.4.5.2 General rules for deferral

In order to link the variable remuneration of the Identified Staff members to the evolution of their performance and their potential future impact, performance is assessed over several years with respect to objectives / targets, taking into account the interests of BIL group over the long term. In that respect, the performance assessment is part of a multi-annual framework, thereby guaranteeing an assessment of long-term performance. As such, payment of a part of the variable remuneration is deferred and subject to the fulfilment of conditions described under 5.4.1.4 and 5.4.2. The deferred part will not be paid out in case these conditions are not met.

1 *Other than MMB at group level.*

6.4.5.3 Calculation of the deferred part of the variable remuneration

40% of the total variable remuneration is deferred over a period of three-year.

In the case where the variable remuneration is of a particular high amount, the portion of the variable remuneration that is deferred should be increased to 60%. Whether the variable component is considered as of a particular amount will be determined by reference to the regulator guidelines in relation to the same.

6.4.5.4 Terms of payment of the variable remuneration

- Principles applied to the non-deferred part

The non-deferred part related to performance year Y, i.e. 60% of the total variable remuneration, is paid during the first semester of Y+1:

➔ 50% (=30% of the total variable remuneration) in cash;

➔ 50% (=30% of the total variable remuneration) in the form of phantom shares, with a retention period of one year.

- Principles applied to the deferred part

➔ 50% of the deferred part (=20% of the total variable remuneration) is paid in cash in Y+2, Y+3 and Y+4, vesting on a pro rata basis.

➔ 50% of the deferred part (=20% of the total variable remuneration) is paid in the form of phantom shares in Y+2, Y+3 and Y+4, vesting on a pro rata basis.

6.4.5.5 Conditions of payment of the deferred element

Actual payment of the deferred part of the variable remuneration is subject to the fulfilment of the following conditions:

- Performance

BIL group is in a position to reduce part of, or all the variable remuneration that has not been paid out yet in case the sustainability of the performance of the institution as a whole, the business unit and / or the staff member is not in line with expectations. As an ex-post risk adjustment measure, malus will be used to reduce a part of, or all the deferred remuneration in order to take into account the potential negative underlying performance of BIL group as a whole, of the department or of the Identified Staff member.

- Existence of a professional relationship

There needs to be a professional relationship under a contract of employment or, as the case may be, a mandate as a director and/or as a member of the Management Board, linking the beneficiary to the BIL group on the date of payment. Notwithstanding this principle, if the contract is terminated by statutory or early retirement, or on BIL group's initiative on grounds other than serious misconduct, or by automatic termination of the employment contract in accordance with article L.121-4 of the Labour Code or by death, the beneficiary whose contract is terminated may, nonetheless, claim payment of the deferred parts, unless the assessment of his / her performance and BIL group performance during the 12 months prior to termination of the professional relationship has substantially deteriorated. The deferred parts of the variable remuneration will not be paid if the beneficiary leaves BIL group voluntarily or if there is a termination on the grounds of serious misconduct. Nevertheless, the Board of Directors reserves the right to adopt a more favourable position, on a case-by-case basis, upon recommendation of the RNC.

6.4.6 Specific provisions

6.4.6.1 Malus

A malus will be applied:

- In case of misbehaviour or serious error by the staff member (e.g. breach of code of conduct and other internal rules, especially concerning risks). If a malus is applied, all deferred but not yet vested bonus amounts (as well as the bonus amount for the current year) will be reduced in proportion to the severity and impacts of the error / misbehaviour.
- When BIL and/or the underlying BIL-entity suffers a significant downturn in its financial performance. If the performance for the year, assessed at group and entity level under review is more than 20% lower than those in place when the deferred bonuses were granted, these deferred bonuses will be reduced in proportion to the performance decrease, unless this decrease is fully independent of the strategy employed during the previous years.
- When BIL and/or the underlying BIL-entity in which the staff member works suffers a significant failure of risk management. If this is the case, all deferred, but not yet vested, bonus amounts (as well as the bonus amount for the current year) will be reduced in proportion to the severity and impacts of the failure.
- In case of significant changes in the institution's economic or regulatory capital base.

6.4.6.2 Clawback

Payment of variable remuneration is based on the premise that, during the period when the Identified Staff member was working within BIL group, he / she fully observed the law and the rules specific to the relevant entity as well as the values of BIL group.

In case fraud is observed after the award of variable remuneration, and in cases where the variable remuneration might have been granted on the basis of intentionally erroneous information, the Board of Directors reserves the right to claim the part of the variable remuneration which might already have been paid, or at least equivalent damages and interest, in cases where the Bank might have suffered significant harm.

6.4.6.3 Prohibitions of guaranteed variable remuneration

Variable remuneration is no way guaranteed. In very particular circumstances, the only exception relates to the recruitment of new staff members to whom variable remuneration might be guaranteed during the first year of employment.

6.4.6.4 Severance payments

Without prejudice to the application of the legal and regulatory provisions and agreements binding the relevant entity, payments associated with the early termination of an employment contract and/or a mandate as a member of the Management Board are designed not to reward failure.
There are no "Golden Parachute" in BIL group's policy.
BIL group will ensure that it does not pay severance amounts greater than applicable under the laws, regulations and collective bargaining agreements or exceeding the benefits generally fixed by the competent courts and tribunals.
The severance package should not only cover compensation for notice, or remuneration relating to the notice period, but should also cover any other payments made when ending the employment relationships.

6.4.6.5 Prohibition of personal hedging

All staff members are forbidden to use personal hedge or insurance strategies linked to remuneration or to responsibility in order to offset the impact of the ex-ante and ex-post risk alignment measures incorporated in the Policy.

6.5 Governance: roles and responsibilities in the design, implementation and on-going supervision of the remuneration policy

- Board of Directors

The Board of Directors is responsible for the design of the Policy principles and for the monitoring of the Policy's implementation, maintenance and review.
The Board of Directors also ensures to take into account all the adequate inputs provided by all relevant functions (i.e. Internal Audit, Compliance, Risk management, Human Resources). In addition, the Board of Directors is assisted in its tasks by the RNC, set up as a specialised Committee of the Board.
Finally, the Board of Directors ensures that the implementation of the Policy is reviewed on an annual basis at a minimum by RNC, which can be assisted, if so requested, by the Control Functions. Such central and independent reviews will assess whether the remuneration system (i) operates as intended and (ii) is compliant with the regulatory requirements.

- Remuneration and Nominations Committee

The role of the RNC is to assist and advise the BIL Board of Directors (hereafter, the "BoD"):
- on the appointment process and on the appointment/dismissal of
- the members of the BoD
- the members of BIL's Management Board
- on the evaluation process and the evaluation of the MMB
- on the definition of the remuneration package of the MMB and the BoD members
- on the definition and the annual review of a global remuneration policy of the Bank.

- Management Board Members

Notwithstanding the fact that the overall responsibility for the policy remains in the hands of the Board of Directors, it is important to note the active role of the Management Board of BIL group entities which ensures the operational implementation of the Policy throughout BIL group and takes appropriate measures to ensure that it is applied properly.

- Control Functions

The control functions (Internal Audit, Compliance, Risk management, Human Resources) are consulted in the framework of designing and controlling the remuneration policy. KPMG and Clifford Chance have assisted in the elaboration of the policy.

6.6 Disclosure

6.6.1 Internal disclosure

Employees of BIL group are informed through the intranet or by their hierarchy on the annual performance assessment and reward process and the main principles of this policy.
The discretionary nature of the variable remuneration is mentioned in the employment contracts.
BIL group informs its staff members appropriately and timely of any amendments to the policy which might affect them.

6.6.2 External disclosure

As set out in art. 450 (Part Eight) of EU Regulation 575/2013, BIL group makes available to the public information regarding its remuneration policy and practices for those categories of staff whose professional activities have a material impact on BIL group's risk profile (i.e. the Identified Staff). Such information can be found in BIL group's risk report.

6.7 Quantitative information

The table below shows data on remuneration for all staff and expressed in EUR.

Business areas:	MB Mana-gement function	Investment banking	Retail banking	Asset manage-ment	Corporate functions	Inde-pendent control functions	All other
Number of members (headcount)	9						
Total number of staff in FTE		**118.43**	**511.73**	**483.15**	**656.80**	**146.05**	**0**
Total remuneration (in EUR)	**8,569,374**	**11,713,640**	**36,468,293**	**54,072,977**	**50,742,913**	**13,135,810**	**0**
Of which: variable remuneration	**4,470,858**	**1,324,100**	**2,217,395**	**5,538,328**	**3,804,410**	**1,174,809**	**0**

The table below shows data on remuneration for all staff and expressed in EUR.

	Top Management	Other Identified Staff
Members (headcount)	**42**	**32**
Total fixed remuneration (in EUR)	**9,962,806**	**4,830,530**
Of which: fixed in cash	**9,962,806**	**4,830,530**
Of which: fixed in shares and share- linked instruments	**0**	**0**
Of which: fixed in other types instruments	**0**	**0**
Total variable remuneration (in EUR)	**6,507,298**	**1,127,735**
Of which: variable in cash	**5,113,182**	**1,127,735**
Of which: variable in shares and share-linked instruments	**0**	**0**
Of which: variable in other types instruments	**1,284,117**	**0**
Total amount of variable remuneration awarded in year N which has been deferred (in EUR)	**1,027,293**	**0**
Of which: deferred variable in cash in year N	**513,647**	**0**
Of which: deferred variable in shares and share-linked instruments in year N	**0**	**0**
Of which: deferred variable in other types of instruments in year N	**513,647**	**0**
Additional information regarding the amount of total variable remuneration		
Article 450 h(iii) CRR – total amount of outstanding deferred variable remuneration awarded in previous periods and not in year N	**2,643,597**	**0**
Total amount of explicit ex post performance adjustment18 applied in year N for previously awarded remuneration	**0**	**0**
Number of beneficiaries of guaranteed variable remuneration (new sign-on payments)		**4**
Total amount of guaranteed variable remuneration (new sign-on payments)		**477,193**
Number of beneficiaries of severance payments		**3**
Total amount of severance payments paid in year N		**2,083,777**
Article 450 h(v) – Highest severance payment to a single person		**1,828,125**
Number of beneficiaries of contributions to discretionary pension benefits in year N	**0**	**0**
Total amount of contributions to discretionary pension benefits in year N20	**0**	**0**
Total amount of variable remuneration awarded for multi- year periods under programmes which are not revolved annually	**0**	**0**

This table gives information on identified staff remunerated EUR 1 million or more in 2014:

Reporting under Article 450(1)(i) of Regulation (EU) No 575/2013	
Total remuneration - payment band (in EUR)	**Number of identified staff (headcount)**
1,000,000 to below 1,500,000	0
1,500,000 to below 2,000,000	0
2,000,000 to below 2,500,000	0
2,500,000 to below 3,000,000	0
3,000,000 to below 3,500,000	1
3,500,000 to below 4,000,000	0
4,000,000 to below 4,500,000	0
4,500,000 to below 5,000,000	0
5,000,000 to below 6,000,000	0
6,000,000 to below 7,000,000	0
7,000,000 to below 8,000,000	0
8,000,000 to below 9,000,000	0
9,000,000 to below 10,000,000	0
To be extended as appropriate, if further payment bands are needed.	

Appendix 1: Glossary

AFS Available For Sale
Non-derivative financial assets designated on initial recognition as available for sale or any other instruments that are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.

A-IRBA Advanced Internal Rating-Based Approach
Institutions using the IRB approach are allowed to determine borrowers' probabilities of default and to rely on own estimates of loss given default and EAD on an exposure-by-exposure basis. These risk measures are converted into risk weights and regulatory capital requirements by means of risk weight formulas specified by the Basel Committee.

BANK
Corresponds to Banque Internationale à Luxembourg, including branches and subsidiaries.

ALM Asset & Liability Management
Action – for instance in a financial institution or a corporate – of managing the net risk position between assets and liabilities, particularly with respect to imbalances generated by movements in interest rates, currencies and inflation, but also maturity mismatch, liquidity mismatch, market risk and credit risk.

CCF Credit Conversion Factor
The CCF is the ratio of the currently undrawn amount of a commitment that will be drawn and outstanding at default to the currently undrawn amount of the commitment. The extent of the commitment will be determined by the advised limit, unless the unadvised limit is higher.

CDS Credit Default Swap
Swap contract in which the buyer of the CDS makes a series of payments to the seller and, in exchange, receives a pay-off if a credit instrument (typically a bond or loan) undergoes a defined "credit event", often described as a default (failure to pay).

CRD Capital Requirements Directive
The Capital Requirements Directive (CRD) for the financial services industry introduces a supervisory framework in the EU that reflects the Basel II rules on capital measurement and capital standards.

CRM Credit Risk Mitigant
A range of techniques whereby a bank can, partially, protect itself against counterparty default (for example by taking guarantees or collateral, or by buying a hedging instrument).

CSSF Commission de Surveillance du Secteur Financier
The Commission de Surveillance du Secteur Financier is Luxembourg's regulator for financial institutions.

DTA Deferred Tax Asset
Deferred tax assets are created due to taxes paid or carried forward but not yet recognised in the income statement. Its value is calculated by taking into account financial reporting standards for book income and the jurisdictional tax authority's rules for taxable income.

EAD Exposure At Default
The EAD is used for calculating regulatory capital requirements including (1) potential future exposures resulting from future commitments, (2) netting arrangements and collateral agreements (3) after a possible substitution in the case of a personal guarantee.

ECAI External Credit Assessment Institutions
Under the Basel II agreement of the Basel Committee on Banking Supervision, banking regulators can allow banks to use credit ratings from certain approved credit rating agencies when calculating the risk weight of an exposure. Competent authorities will recognise an ECAI as eligible only if they are satisfied that its assessment methodology complies with the requirements of objectivity, independence, ongoing review and transparency, and that the resulting credit assessments meet the requirements of credibility and transparency.

EL Expected Loss
The amount expected to be lost on an exposure from a potential default of a counterparty or dilution over a one-year period.

FX Foreign Exchange
Transaction of international monetary business, as between governments or businesses of different countries.

HTM Held To Maturity
Non-derivative financial assets with fixed or determinable payments that an entity intends and is able to hold to maturity and that do not meet the definition of loans and receivables and are not designated on initial recognition as assets at fair value through profit or loss or as available for sale.

IAS International Accounting Standards
IAS stands for International Accounting Standards. IAS are used outside the USA, predominantly in continental Europe.

ICAAP Internal Capital Adequacy Assessment Process
The main objective of the Pillar 2 requirements is to implement procedures that will be more sensitive to an institution's individual risk profile. This is to be achieved through the implementation of internal processes (ICAAP).

IFRS International Financial Reporting Standards
International Financial Reporting Standards published by the IASB and adopted by most countries outside the USA. They have been designed to ensure globally transparent and comparable accounting and disclosure.

IR Interest Rate
Interest expressed as an annual percentage rate.

ISDA International Swap and Derivative Association

Trade organisation of participants in the market for over-the-counter derivatives. Its headquarters are in New York, and it has created a standardised contract (the ISDA Master Agreement) for derivatives transactions.

IT Information Technology
Study, design, development, implementation, support or management of computer-based information systems, particularly software applications and computer hardware. IT deals with the use of electronic computers and computer software to convert, store, protect, process, transmit and securely retrieve information.

JST Joint Supervisory Team
Joint Supervisory Teams (JSTs) are one of the main forms of cooperation between the ECB and the National Competent Authorities (NCA).

LGD Loss Given Default
The ratio of the loss on an exposure due to the default of a counterparty to the amount outstanding at default.

L&R Loans & Receivables
Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than held for trading or designated on initial recognition as assets at fair value through profit or loss or as available for sale.

NPE Non-Performing exposures
Non-Performing exposures are all credit lines considered 90 past due.

PD Probability of Default
The probability of default of a counterparty over a one-year period.

P&L Profit and Loss
The statement of income is a document showing all wealth-creating revenues and wealth-destroying charges. There are two major statement of income formats: the "by nature" statement of income format and the "by function" statement of income format. Also called: profit and loss account.

SSM Single Supervisory Mechanism
The Single Supervisory Mechanism (SSM) is the name for the mechanism which has granted the European Central Bank (ECB) a supervisory role to monitor the financial stability of banks based in participating states, starting from November 4, 2014. The main aims of the SSM are to ensure the safety and soundness of the European banking system and to increase financial integration and stability in Europe.

SRM Single Resolution Mechanism
A mechanism which establishes uniform rules and a uniform procedure for the resolution of credit institutions established in the banking union. The SRM is a necessary complement to the Single Supervisory Mechanism in order to achieve a well-functioning banking union.

RWA Risk Weighted Assets
Used in the calculation of risk-based capital ratios. This refers to the total assets calculated by applying risk-weights to the amount of exposure.

VaR Value at Risk
The VaR represents an investor's maximum potential loss on the value of an asset or a portfolio of financial assets and liabilities, based on the investment timeframe and a confidence interval. This potential loss is calculated on the basis of historical data or deduced from normal statistical laws.

Appendix 2: Risk Glossary

A key aim of risk management is to identify all risks the Bank is or will be exposed to.
The risks identified within the Bank fall into five main categories:

Credit risk

Credit risk includes:

• Solvency risk, which is the potential loss resulting from the decreased solvency of an obligor arising from credit migration and/or default events.
• Country risk, which is the potential loss due to local political or social actions, preventing an initially solvent obligor from fulfilling its payment obligations.
• Securitisation risk, which refers to the uncertainty relating to the economic substance of a transaction and its risk transfer level.
• Residual/recovery risk, which is the potential loss due to the decrease in value of risk mitigants, or resulting from the decreased solvency of guarantors.
• Settlement risk, which is the risk that a credit institution will deliver the sold asset or cash to the counterparty, and will not receive the purchased asset or cash as expected.
• Concentration risk, which refers to exposure(s) that may arise within or across different risk categories throughout an institution with the potential to produce: (i) losses large enough to threaten the institution's ability to maintain its core operations; or (ii) a material change in an institution's risk profile.
• Counterparty risk, which is the risk that a counterparty to a financial transaction fails to comply with the terms and conditions of the contract, potentially leading to financial losses. Counterparty risk includes the risk arising from credit value adjustment (CVA) and on revalued positions with the possibility of positive or negative fair value.

Operational risk

Operational risk corresponds to potential losses resulting from inadequate or failed internal processes, people and systems or from external events (spread over the other risks).
It includes the seven types of operational risk under Basel II: unauthorised activity and internal fraud risk; external fraud risk; employment practices and workplace safety risk; customer, product and business practice risk; damage to assets risk; business disruption and systems failures risk and execution, and delivery and process management risk. It also includes outsourcing risk, which is the risk arising from an arrangement of any form between a financial institution and a service provider by which the service provider compromises the continuity and the quality of a process, a service or an activity.

Market and ALM risk

Market and ALM risk refers to:

• Interest rate risk, which corresponds to the potential decrease of the Bank's value due to interest rate movements increasing the cost of interest rate liabilities or decreasing the value of interest rate assets.
• Price risk, which corresponds to the potential reduction in value of assets such as equity and real estate, funds, and derivatives pertaining to such assets
• Currency risk, which is the potential decrease of the Bank's value due to currency exchange rate movements changing the cost of currency-denominated liabilities or the value of such assets.
• Commodity risk, which is the risk of losses caused by changes in commodity prices.
• Inflation risk, which is the risk of losses on assets and liabilities caused by an adverse inflation rate.
• Spread risk, which is the potential decrease of the value of a portfolio due to the general fluctuations of the spread between the portfolio's yield and the risk free rate, when the portfolio's risk profile is unchanged.
• Liquidity risk, which is the risk that the Bank will not be able to meet both expected and unexpected current and future cash flow and collateral needs.
• Funding risk, which is the risk that the refinancing cost for BIL increases.
• Basis risk, which is the risk arising from an imperfect hedging strategy and/or a difference of reference on financial instruments.

Market risk is described in more detail in part 4.

Enterprise risk

Enterprise risk includes:

• Business and strategic risk, which refers to the decrease of profitability resulting from various endogenous or exogenous factors relating to the Bank (adverse business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment, economic downturn, etc.). This risk excludes financial risks for which the impact on profitability is independently assessed.
• Pension risk, which is the risk of losses resulting from an inadequate funding of pension obligations.
• Model risk, which refers to potential risk assessment errors resulting from an inadequate methodology and model, and/or data uncertainty or inappropriate use of models.
• Remuneration risk, which is the risk arising from bad practices which may gave staff incentives to pursue unduly risky practices, for example by undertaking higher risk investments or activities that provide higher income in the short run despite exposing the institution to higher potential losses in the longer run.
• Human resources risk, which can come from three main sources: human resources operating risk results from inadequate recruitment procedures for screening employees, inadequate training and change management programmes or poor succession planning policies; key-man risk measures the over-reliance on the skills of one or a few individuals which could affect the overall sustainability of the activity; people risk is the risk associated with inadequacies in human capital and the management of human resources, policies and processes, resulting in the inability to attract, manage, motivate, develop and retain competent employees, with a concomitant negative impact on the achievement of strategic group objectives.

- Legal and compliance risk, which is the risk arising from the necessity that the group conducts its activities in conformity with the business and legal principles applicable in each of the jurisdictions where the group conducts its business. It is the possibility that a failure to meet these legal requirements may result in unenforceable contracts, litigation, fines, penalties or claims for damages or other adverse consequences. It also includes tax risk, which is risk associated with changes in tax law and/or in the interpretation of tax law.
- Reputation risk, which is the potential decrease in the value of BIL arising from the adverse perception of the image of the financial institution on the part of customers, counterparties, shareholders, investors, regulators and other stakeholders
- Social and environmental risk, which are the risks that are due to the real or perceived negative impact of group business practices on a broad range of social matters related to employment, labour/management relations; occupational health and safety; training and education; diversity and equal opportunities and equal remuneration for women and men.
- Environmental risks, which are the risks that are due to the real or perceived negative impact of group business practices on a broad range of environmental matters related to energy and water consumption, emissions, production systems, biodiversity that could lead to climate change, resource scarcity and biodiversity loss.

Other risks

Behavioural risk (prepayment and outflow risks) refer to the potential change in exposure to interest rate and funding risks due to the uncertain behaviour of customers.