# Risk Management

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## Internal Capital Adequacy Assessment

*December 31st 2017*

Eurobanco

*Eurobanco Bank Ltd.*
*30/06/2018*

## TABLA DE CONTENIDOS

# 1. Summary

Eurobanco Bank Ltd. was incorporated as a limited liability company under the laws of the Commonwealth of The Bahamas, with its registered offices at Caves Professional Centre, at Caves Village, Suite 12, West Bay St. & Blake Rd., Nassau - Bahamas. The license to carry on banking and trust business was obtained on May 25, 1992. The Bank is also licensed under the Securities Commission of The Bahamas with the following categories (i) Dealing in Securities as Agent, (ii) Arranging Deals, (iii) Managing Securities, and (iv) Advising on Securities.

The objectives of the Bank are unrestricted and include the business of banking and all kinds of financial investments, commercial, trading and other transactions.

Eurobanco Bank Ltd.'s operations mainly comprise cash management, custody services, execution of customers trading orders in publicly offered corporate and sovereign debt securities, financing transactions, and investments with its own capital in low-risk financial assets with quotation in international markets.

Eurobanco Bank Ltd. is registered on the Security Commission of The Bahamas (according to Section 22 of the Security Industry Act, 1999) as Broker Dealer Class II to develop managing securities activities.

Eurobanco Bank Ltd. is part of CMF Group. The Bank is controlled by Banco CMF S.A., a bank incorporated under the Argentine law.  Banco CMF S.A. owns 99% of the share capital of Eurobanco Bank Ltd since November of 1997.

Eurobanco Bank Ltd. owns 100% of Lemitel S.A., which provides BackOffice, EDP, and Administration services, exclusively to Eurobanco. Lemitel S.A. is under the supervision of the Central Bank of the Republic of Uruguay.

Eurobanco Bank Ltd. has adopted its parent Company (Banco CMF S.A.) Corporate Governance Principles and its Risk Management Framework.

This report has been submitted for the consideration of the Risk and Credit Committee and subsequently treated and approved by the Board of Directors of the Bank on June 28, 2018.

## 1.1. Entity's Risk Profile

Eurobanco Bank Ltd. is part of the CMF Group, and as such complements its business, offering its clients (companies and individuals) an international network for their business.

As its parent company, Eurobanco Bank Ltd. is specialized in the wholesale corporate business, focused on medium and large companies, with a conservative risk profile. Its efforts are focused on offering personalized and differential services that they cannot receive in other financial institutions in the market.

Its business model, wholesale bank, by definition has the strength to be a more flexible organization in the face of changing scenarios, with low fixed costs and more flexibility for changes than larger institutions. Its main weakness is concentration.

The Board of Directors is in charge of identifying and monitoring the risks that affect business, as well as the effects of these risks on the Bank's financial statements. The Risk & Credit Committee is in charge of defining and supervising the implementation of policies to monitor the most significant risks.

The main risks affecting the operations of Eurobanco Bank Ltd are as follows:

- Credit Risk

  The risk level has been defined as low, according to Eurobanco Bank Ltd.'s business strategies. The Bank maintains a limited loan portfolio.

  Eurobanco Bank Ltd.'s client portfolio is mainly focused on providing credit assistance to medium and large companies according to Latin America standards.

  The Bank monitors the credit risk by establishing the credit limits to be granted to individual customers, customers by group and by industry through the "Large Exposures Policy". It also periodically assesses the portfolio of credits and related guarantees to record the loan loss reserves. Historically, the Bank has not had any material credit problems.

  The probability of default of the total portfolio at 12/31/2017 was 0%, as was the debtor portfolio and the non performing portfolio.

  At the same date, Eurobanco Bank Ltd. had an allowance for doubtful accounts of USD 119,693. -, which reached to cover 1% of the total portfolio.

- <u>Liquidity Risk</u>

  The concentration of funding sources is a feature of the Entity. At December 31, the Bank's top 10 clients accounted for 88% of the total deposit portfolio.

  Eurobanco Bank Ltd. monitors expected cash outflow on a daily basis. Its policy throughout the year has been to ensure liquidity by maintaining sufficient high quality liquid assets at all times to cover expected net cash outflow. The Bank’s liquidity policy is very conservative, keeping a very high correlation of cash and short-term investments with its deposits and permanently monitoring changes therein. This risk results from the maturity gap, where assets are less liquid than liabilities.

- <u>Interest Rate Risk</u>

  Eurobanco Bank Ltd. monitors this risk through the analysis of current and future changes in the rates of different financial assets and liabilities performed by the Risk & Credit and Assets & Liabilities Committees.

- <u>Market Risk</u>

  The Bank's risk profile for financial instruments on and off the balance sheet is conservative, with a relatively low level of tolerance compared to the rest of the risks to which it is exposed.

  The Bank classifies exposures to market risk into either trading or non–trading portfolios and manages each of those portfolios separately. The market risk for the trading portfolio is managed and monitored based on a Value–at–Risk (VaR) methodology that reflects the interdependency between risk variables. Non–trading positions are managed and monitored using other sensitivity analyses.

  The Board of Directors' policy is that market volatility cannot materially affect the valuation of its investments, quantitatively limiting the share of listed fixed-interest securities in total assets, and selecting them based on their credit quality and maturity.

  As of December 31, 2017, Eurobanco Bank Ltd. had a portfolio of public and private securities of USD 24,4 million.

- <u>Operational Risk</u>

  Eurobanco Bank Ltd.’s Board of Directors considers Operational Risk as the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. Operational risk includes, among others, Technology risk, Legal risk, People risk, and Compliance risk.

The bank has a strong internal control culture. It develops its operations within the framework of updated procedures, with clear assignment of responsibilities and segregation of duties.

The board of Directors can not expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the bank is able to manage them.

The identification and control of these risks is managed by the Audit and Compliance Committee. Controls over these risks include effective segregation of duties, access, authorization and reconciliation procedures, staff education and process assessment, including the use of internal audit.

The bank's Audit & Compliance Committee carries out regular reviews of all operational areas to ensure operational risks are being properly controlled and reported to the Executive Committee.

Exposure to operational risk is medium, so that permanent awareness-raising processes are carried out for officials.

Historically the Entity has not been exposed to severe events related to this type of risk.

## 1.2. Capital Planning and Stress Testing

Eurobanco Bank Ltd. has adopted the stress testing methodology of its parent company, Banco CMF S.A., which is proportional to its size, risk profile and relative importance in the financial system and the nature and complexity of its operations. Last review and approval of the methodology by Banco CMF S.A.'s Board of Directors was on April 27, 2018.

The stress tests were designed to alert the Entity's Management and Board of Directors about unexpected results related to a variety of risks to which it is exposed, and in order to provide a magnitude of the amount of capital needed to address them and thus avoid unwanted consequences on customers, shareholders, employees and related third parties.

In the definition of stress scenarios, situations considered as adverse and extreme, but possible, are identified. The stress scenarios are defined taking into account the specific vulnerabilities of the business structure of the Entity sharpen by external factors (market).

Based on this analysis, the stress scenario was developed for the year ended December 2018. Eurobanco Bank Ltd has issued two one-year scenarios, both based on an increase of interest rate of 25bp quarterly. During the third quarter, a strong fall in market prices of bonds and shares happens what generates a “fly to quality” effect, from emergent markets to better qualified ones.

This scenario has an effect on the market value of financial instruments that are at fair market value, in which an increase in market rates implies a decrease in the price of the same financial instruments, generating a corresponding devaluation and losses.

Assuming that this situation of market volatility is not expected to reverse in the short term, Eurobanco Bank Ltd. decides to strongly reduce its position of financial instruments at market value during the second half of the year to mitigate the effect of the fall of its price.

It’s also estimated that the cost of funding will increase slightly and, in order to maintain its liquidity and fidelity of depositors.

The main difference between the two Scenarios is that in Scenario 2, Eurobanco Bank Ltd. decides to take advantage of the increasing market volatility so it increases its trading revenues.

Due to Eurobanco Bank Ltd. high liquidity levels, the liquidity, operations, and solvency of the Entity would not be affected in the scenario described.

The stress tests are carried out by Eurobanco Bank Ltd. as minimum with annual frequency, in coordination with the operational management of the Entity and supervised by the Board of Directors. Once the scenarios have been developed, the tests carried out and the corresponding contingency plans designed, they are subject to the analysis and validation of the Risk and Credit Committee, and finally approved by the Executive Committee.

## 1.3. Action Plan

Eurobanco Bank Ltd., as was mentioned before, has adopted Banco CMF S.A.'s Risk Management Framework.

In the mid-term, Eurobanco plans to develop its own risk management framework, under the guidelines of its parent company's Risk Management Policy.

Among the initiatives foreseen for the mid-term are the following:

- Develop formal Frameworks for the management of the main risks of Eurobanco Bank Ltd., including:
    - Market Risk;
    - Liquidity Risk;
    - Interest Rate Risk;
    - Credit Risk;
    - Concentration Risk;
    - Operational Risk, including Technology Risk; and
    - Reputational Risk.
- Expand Eurobanco's Risk Indicator dashboard;
- Improve capital calculation models.
- Develop a self-assessment of information technology risks.

# 2. Corporate Governance, Risk Management and Internal Audit

## 2.1. Corporate Governance

Eurobanco Bank Ltd.'s Board of Directors is fully aware of the importance for Financial Institutions of adopting principles of Corporate Governance to guide the behavior of its corporate bodies in the best interest of the Bank, its shareholders, depositors, customers, employees and public.

The Board of Eurobanco Bank Ltd., as part of CMF Group, has adopted and implemented its parent company's Corporate Governance values and principles since November 20th, 2012.

The definitions of the Corporate Governance Guidelines implemented by the Bank are adequate to its profile, complexity and economic importance.

The Board and Management have the necessary information for planning and controlling the risk management process at Eurobanco Bank Ltd. They rely on a structure of Committees that facilitates the timely treatment of risks and decision making.

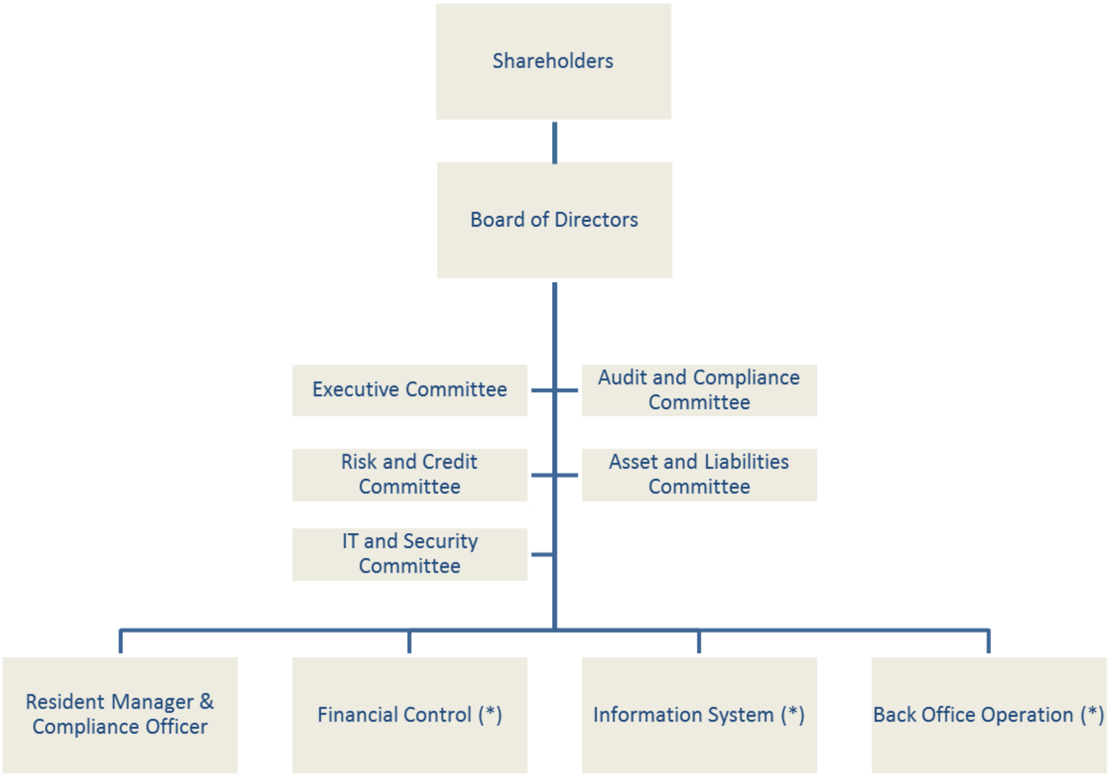
Eurobanco Bank Ltd. has an organizational structure with few hierarchical levels, according to the size of the Bank, which guarantees an agile decision making process. The fulfillment of the budgeted objectives is monitored in the Executive Committee meetings.

Eurobanco Bank Ltd. is aware that good Corporate Governance practices must be driven from the highest level of the organization, in order to flow to its lowest hierarchical level.

Annually, the Board of Directors of Eurobanco Bank Ltd. issues a "Corporate Governance Certification", in which it evaluates the level of implementation and compliance with Corporate Governance principles within the Bank, and in particular, its function as Government, regarding the implementation and compliance of the mentioned principles and the Risk Management Policy.

### 2.1.1. Description of the Entity's Organization

The chart in force in the Entity as of December 31, 2017 was as follows:




(*) Functions outsourced with Lemitel S.A. (Eurobanco Bank Ltd' subsidiary)

The entity is managed by a Board of Directors composed of five titular members; one of them is a RNED (Resident Non-Executive Director). The number of members is proportionally set according to the size, complexity, economic importance and risk profile of the Bank.

Eurobanco Bank Ltd. has five specialized Committees to advise Board of Directors. These Committees have a clear definition of their objectives, responsibilities and working procedures. All committees document the issues discussed and their decisions in acts.

The Committees in force as of December 31, 2017 were as follow:

**<u>Executive Committee</u>**

The Executive Committee manages matters that require the Board´s review, but arise between full Board meetings. It can relieve the full Board of the responsibility of detailed review of information and operational activities. Generally, all major functions of the organization will be subject to review and approval by the committee and the work of the other Board committees will be coordinated by it.

**Committee Members**

The Committee is composed by:

- José A. Benegas Lynch – Director
- Miguel Tiphaine – Director
- Esther Benitez - Resident Manager

**Attributions and Responsibilities**

- To take cognizance of the issues dealt with by the Entity Committees and to approve or rectify the decisions made by them.
- Approve financial statements and quarterly reports
- Maintain constant communication with Central Bank Of The Bahamas' officers.
- Approve Eurobanco Bank Ltd.'s reports that must be presented to the Control Entities (Central Bank of The Bahamas, Securities Commission of the Bahamas, etc.)

## Compliance and Audit Committee

The Compliance and Audit Committee oversees senior management's activities, through the Compliance Officer, to ensure that the organization is in compliance with all laws, regulations, guidelines, other regulatory and supervisory requirements, accepted business practices and ethical standards. Also, the committee provides direct oversights of the organization's internal and external audit functions, supervising the quality and integrity of all external financial reporting, and assisting the Board in providing an independent review of the effectiveness of the reporting process and internal control system.

**Committee Members**

The Committee is composed by:

- Ricardo Orgoroso – Director
- Esther Benitez - Resident Manager
- Ramiro Argonz – Assistant Resident Manager
- Andrea Azeez – Resident Non – Executive Director
- Cora Braña - INED

When internal audit tasks are delegated to other independent professionals, a top-level responsible from the professional association shall be a member of this Committee.

### Attributions and Responsibilities

- Monitor the proper functioning of the internal control systems defined in the Entity, through its periodic evaluation
- Contribute to the improvement of the effectiveness of internal controls
- Acknowledge the planning of the external auditors
- Review and approve the reports issued by the Internal Audit
- Consider the external and internal auditors' issues related to the internal control weaknesses, as well as the corrective actions implemented by the Management
- Maintain constant communication with Central Bank Of the Bahamas' officers in charge of Eurobanco's supervision.
- To acknowledge the annual financial statements and the external auditor's reports issued on them, as well as all other relevant accounting information
- Consider any other matter delegated by the Board of Directors.

## Asset and Liability Committee

The Asset and Liability Committee oversees the organization’s operations related to interest rate risk, market risk and liquidity risk. In particular, ensures that the organization has adequate funds to meet its obligations. Other functions of the committee are dependent on the organization’s lines of business and asset/liability mix.

### Committee Members

The Committee is composed by:

- José A. Benegas Lynch – Director
- Miguel Tiphaine – Director
- Esther Benitez - Resident Manager

### Attributions and Responsibilities

- Generate periodic information on the evolution of business in financial matters of the Entity;
- Analyze the international and domestic macroeconomic situation and the microeconomic situation of the financial system;

- Implement the strategies approved by the Board related to liquidity, market, and interest rate risks, as well as the most significant policies and practices to protect financial strength;
- Monitor changes in markets to assess how they affect the Entity's financial objectives.

## Risk and Credit Committee

The Risk and Credit Committee provides general oversight of senior manager's activities in managing the overall range of risk to which the organization is subject. It monitors and reports to the full Board in the process of risk identification, measurement, monitoring and control. Also, ensures that the organization's credit policies are adequate and activities related to extending credit, in all forms and types, are conducted in accordance with established policies and relevant laws, regulations, guidelines, accepted business practices and ethical standards. It also serves a vital role in monitoring credit quality throughout the organization and ensures that the management of the credit process is appropriate and effective. It may also participate in evaluating certain credit applications and making significant credit decisions.

### Committee Members

The Committee is composed by:

- Ricardo Orgoroso – Director
- Alberto Llambí Campbell - Director
- Esther Benitez - Resident Manager

### Attributions and Responsibilities

- Implement credit policies approved by the Board of Directors;
- Decide on the acceptance or not of a client;
- Assign the limits of credit assistance with the different modalities for the operation of clients within the limits defined by the Board of Directors, and the Central Bank Of the Bahamas;
- Recognize and understand the risks associated with current operations and those that may arise from new initiatives
- Propose improvements to the Risk Management framework;
- Analyze the measurement of the risks identified, verifying compliance with the policies, the limits set and the economic impact of the risks.

- Decide the actions necessary for the implementation of the corrective measures required in case of deviations from the risk tolerance levels, as well as possible exceptions
- Follow up on exposures to risks. Compare such exposures against risk limits approved by the Board of Directors.
- Report to the Board of Directors the results of its assessments on the Bank's exposure to risk
- Supervise the processes of determination of Economic Capital;
- Review the capital self-assessment report (ICAAP), prior to submitting it for approval by the Board of Directors

## IT and Security Committee

The IT and Security Committee is in charge of the definitions about IT infrastructure and technology and information security.

**Committee Members**

The Committee is composed by:

- José A. Benegas Lynch – Director
- Marcos V.F. Prieto – Director
- Esther Benitez  - Resident Manager
- Pablo M. Righi – IT Administrator
- Cora Braña – INED

**Attributions and Responsibilities**

- Monitor the proper functioning of the IT environment, and contribute to its improvement.
- Acknowledge the Information Technology and Systems Plan
- Review and approve the strategies, policies, processes and resources related to Systems, Technology and Security, within the framework of the business objectives of Eurobanco Bank Ltd.
- Define the strategy to be implemented for the logical and physical control of the information assets and ensure the availability, reliability and confidentiality of those assets
- Define critical and confidential operations for the Bank
- Establish mechanisms for the administration and control of security over logical and physical access to its different technological environments and information

resources, in accordance with the value, confidentiality, and criticality of the resources to be protected
- Acknowledge and supervise the administration of the main problems and incidents of Information Security
- Review the reports issued by the auditors related to Information Technology, Systems and Information Security in the different areas of the Bank, and ensure the execution of corrective actions aimed at solving or minimizing identified weaknesses.

### 2.1.2. Board of Directors´ responsibilities related to Risk Management, internal control and capital adequacy

It is important to highlight the importance of the Board of Directors, the organization's governing body in implementing good Corporate Governance practices, which guides the structure and functioning of its Committees in the best interest of the Bank and related third parties.

The members of the Board of Directors have the necessary knowledge and skills to clearly understand their responsibilities in the exercise of an independent decision-making process regarding the administration areas and external interests within the framework of Good Corporate Governance, in order to act with loyalty and with the diligence of a good businessman in the affairs of the Bank.

In this order, the Board of Directors has the authority to manage the Bank's business, define the overall business strategy, establish policies to meet corporate objectives, instruct management, and ensure that Entity activities comply with levels of security and solvency, to ensure liquidity and to comply with the laws and other regulations in force. The Board of Directors is also responsible of defining the risk appetite and the risks to be assumed by the Entity; approving and supervising the procedures for conducting daily operations; approve and control the implementation of the Corporate Governance Guidelines; promote and periodically review the Entity's general business strategies and policies, and control the management.

For each of the risks considered significant for the Entity, indicators, limits and operating thresholds have been defined, which are monitored by the Risk and Credit Committee and the Executive Committee with a minimum monthly frequency based on the "Risks Management Dashboard". The mentioned Committees analyze the deviations and their justifications, taking corrective measures in case it is necessary.

## 2.2. Risk Management

Eurobanco Bank Ltd. has an effective process of risk identification, measurement, control and monitoring, implemented through periodic reports analyzed by the management and the Committees competent in the matter, with the direct participation of the Board of Directors.

The Board monitors the risk of business operations on an ongoing basis. Risk management strategies are approved by the Board of Directors.

It implements risk management processes, which are periodically revised and updated according to the changes in the risk profile of the Bank and of the market.

The Board of Directors has adopted the policies and procedures for risk management defined and approved by its parent company, and must ensure that appropriate operating limits are established, which must be reviewed and updated in the event of changes in the entity's risk appetite.

Eurobanco Bank Ltd. adopts the necessary measures to monitor and control all significant risks consistently with the strategy and policies approved by the Board of Directors.

### 2.2.1. Risk culture: main guidelines for its management

The Risk Management Policy adopted and implemented by Eurobanco Bank Ltd. clearly defines and establishes guidelines for risk management.

There are formal frameworks, processes and procedures –actions and responsibilities- for the management of each of the relevant risks, to identify, measure, mitigate and monitor all significant risks to which the bank is exposed to.

In that sense, the Board of Directors is responsible for having an effective, consistent and documented effective surveillance framework to identify, measure, mitigate and monitor significant risks in a timely manner, and to assess the adequacy of its capital and liquidity according to its risk profile.

Management is responsible for implementing the strategy, policies and practices for risk management, approved by the Board of Directors, as well as implementing processes to identify, measure, mitigate and monitor each of the significant risks in a timely manner and assess the adequacy of its capital and liquidity according to the Bank’s risk profile.

The scope of each of the risk management system, is defined according to the risk profile, dimension, economic importance, nature and complexity of related operations.

Monthly, Eurobanco Bank Ltd. issues the “Risk Management dashboard” (consolidated risk report), which includes Eurobanco’s Key Risk Indicators comparing them with its limits and thresholds, analyzing the deviations and proposing alternative solutions or justifying the variations regarding the events occurred during the period.

### 2.2.2. Specific aspects of each risk

#### 2.2.2.1. Credit Risk

**Credit Risk**

Credit risk arises from the possibility that debtors cannot bear the repayment of financing facilities granted on a timely basis. Credit limits to each client are established through a credit risk analysis, which assigns a risk qualification to each counterparty.

The credit quality review process allows the Bank to evaluate the possible loss as a result of the risks to which it is exposed and to take the necessary measures. The process of quality review starts from the first contact of the potential client with the Entity.

In this first instance, the client's file is prepared and a general risk assessment is carried out, in which the client's level of risk is identified. In case the client is eligible for credit, the Risk and Credit Committee analyses the client credit application and sets the limits for the Credit Agreement to operate with Eurobanco Bank Ltd. and with CMF Group.

Once a Credit Agreement is approved, the Administration area, prior to the disbursement of a loan, performs an analysis of compliance with the guidelines related to fractioning, concentration and related parties exposures. In case of discrepancies, the Risk and Credit Committee is advised to carry out a new evaluation.

On a frequent basis, depending on the risk level of the client, the Administration area of Eurobanco Bank Ltd. conducts a review and update of the general risk profile of the client. In cases of high risk clients, the review will be quarterly. For all other clients, the review will be carried out annually. At the end of each year, the entire portfolio has been reviewed.

Eurobanco Bank Ltd. considers that the follow-up of early debtors is a determining factor in the possibility of recovering credits that could generate future losses. That is why it uses an integrated system for credit administration, which records the collection of debt and tracks the days of delay in payments.

The monitoring of collections of individual credits is carried out by the Operations area, since the officers issue the list of the day's maturities, from which they monitor the days of delay, by means of telephone calls and courier mail seeking compliance of payments agreed at the time of origination. The fluid relationship of officers with the Entity's clients is the key to the achievement of early debt settlement goals.

The complete information of the recoveries by each credit, allows to evaluate the sufficiency of the general loan loss reserve and the economic capital to face the underlying risk of each one of them.

The credit policies are described in the Entity's procedures manual, including the analysis, controls and authorization levels required for the approval of a credit agreement. As well as all procedures and controls regarding the monitoring and cancellation of credits, including recovery in the event of default.

The entire credit risk management process is carried out through the centralized application system.

Eurobanco Bank Ltd’s monitors portfolio default probability (probability of default), non-performing loans coverage, total loan loss reserves, non-performing loans, average delay days, level of guaranteed loans, concentration levels and fractioning on a monthly basis. This analysis is documented in the Risk Management Dashboard, which is analyzed in the Risk and Credit Committee.

Eurobanco Bank Ltd. annually performs stress tests which are analyzed by the Risk and Credit Committee and approved by the Executive Committee.

Credit risk management is considered a mature discipline within the structure of Eurobanco Bank Ltd.. Historically, Eurobanco Bank Ltd. has not suffered significant losses due to credit risk.

## Residual Risk

Residual risks are those arising from credit risk hedging techniques, when, for example, it is not possible to take possession of an asset received as collateral, there is a denial or delay in payment by the guarantor or the documentation of the assets taken out as collateral is defective. In these cases, Eurobanco Bank Ltd. reduces its exposure to residual credit risk since it has defined strict processes and controls at the time of evaluation and follow-up of the life cycle of the guarantees that covers each credit operation. The Risk & Credit Committee is involved in the evaluation of the guarantee.

Eurobanco Bank Ltd. holds liquid guarantees deposited within the same institution.

## Concentration Risk over Loan Portfolio

Concentration risk is defined as exposures or groups of exposures with similar characteristics which may generate:

- Significant losses which may affect the financial entity's solidity or ability to maintain the main operations, or
- A significant change in the entity's risk profile.

The concentration of risk in assets is mainly due to common or correlated risk factors that, in periods of stress, can have an adverse effect on the solvency of debtors, counterparties and / or guarantors.

Eurobanco Bank Ltd. has implemented a credit concentration risk management process which includes the strategy, policy, practices, procedures, organizational structure and responsibilities for an adequate management of this risk. The process implemented is proportional to the size of the Entity and to the nature, complexity and volume of its credit operations.

The effects of concentration in Assets have an impact mainly on the Bank's solvency, since significant losses could be generated by not having sufficiently diversified its risk and therefore could threaten the viability of its business plan and its projections for the medium and long term.

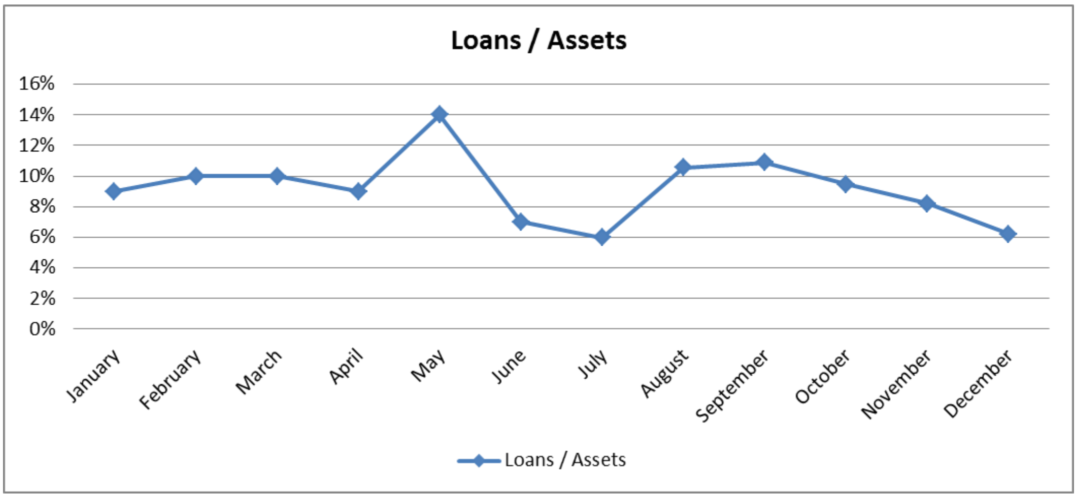
The credit concentration in Eurobanco Bank Ltd. is bounded within the limits of fractioning and concentration of credit risk defined by the Central Bank of the Bahamas. Those limits are monitored by the Administration area and the Risk and Credit Committee.

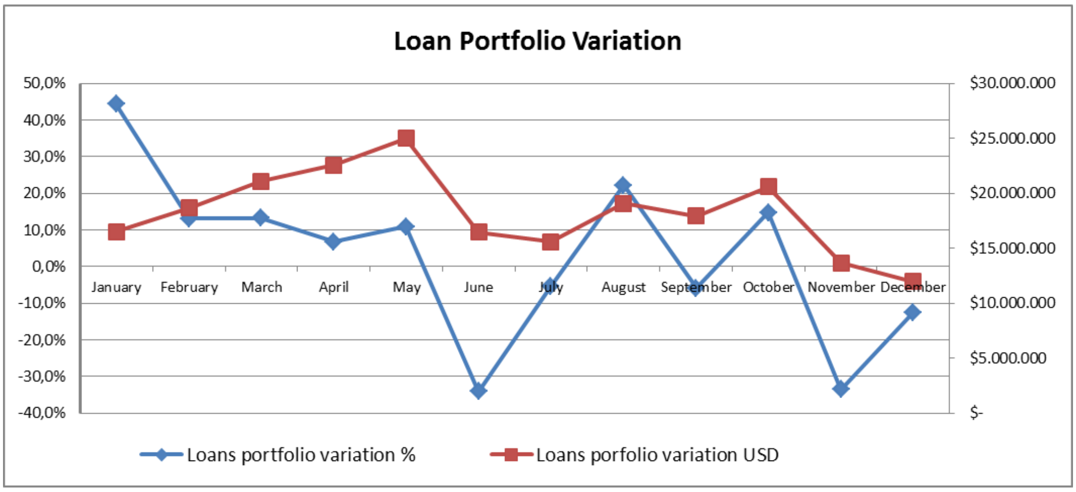
Economic capital calculation models have been defined to cover possible effects on the Bank's solvency arising from the concentration of loans. These models apply in case loan portfolio exceeds 25% of the total assets of Eurobanco Bank Ltd..

Monthly, Eurobanco Bank Ltd. monitors Key Risk Indicators regarding credit concentration. This analysis is documented in the Risk Management Dashboard, which is analyzed in the Risk and Credit Committee.

Eurobanco Bank Ltd. annually performs stress tests which are analyzed and reviewed by the Risk and Credit Committee and approved by the Executive Committee.

The loan portfolio during year 2017 remained below 10% of the assets of Eurobanco Bank Ltd., except for 3 specific months. As Board of Directors has defined, loan portfolio is not considered a significant risk exposure if it does not exceed 25% of the Bank's assets.







During the entire period analyzed, the levels of the Guaranteed Loan portfolio compared to the Total Loan Portfolio remained above the limits established by the Board of Directors.

The indicators defined to monitor the Credit Risk and its limits and thresholds, including the concentration of the loan portfolio, are as follows:

| Credit | Bottom Limit | Top Limit | Threshold |
|---|---|---|---|
| Loans / Assets | 25% | | |
| Loan Portfolio variation | | | |
| PD (Default Probability) | | | |
| Loan Portfolio | | | |
| Coverage over non performing loans | 100% | | 10% |
| Allowance for doubtful accounts / Loan Portfolio | 1% | | 0% |
| Debt Loans / Loan Portfolio | | 10% | |
| Non performing Loans / Loan Portfolio | | 2% | |
| Days of average delay | | 30 | |
| Guaranteed loans / Loan Portfolio | 50% | | 10% |
| Single Exposure Limit | | | |
| Large Exposures by Client or Economic Group | N/A | 25% RPC | 0% |
| Related Party Limit | | | |
| Large Exposures to related parties | N/A | 15% RPC | 0% |
| Agregate Limit on Large Exposures | | | |
| Σ Large Exposures sin garantía preferida | N/A | 800% RPC | 0% |

### 2.2.2.2. Market Risk

Market risk is the risk that the fair value or future cash flows of financial instruments (on or off balance sheet) fluctuate due to changes in market variables with interest rates, exchange rates and bond and stock prices. The Entity has implemented a control and mitigation process of this risk.

Market risk includes exchange rate risk. This risk is defined as the risk that a financial instrument may fluctuate due to changes in the exchange rates.

The Bank's Trading Portfolio consists of positions in financial instruments incorporated into Eurobanco Bank Ltd.’s equity for the purpose of trading them or providing coverage to other elements of the portfolio.

A financial instrument may be assigned to the Trading Portfolio if its trading is free of any restriction or if it is possible to obtain full coverage of the Instrument.

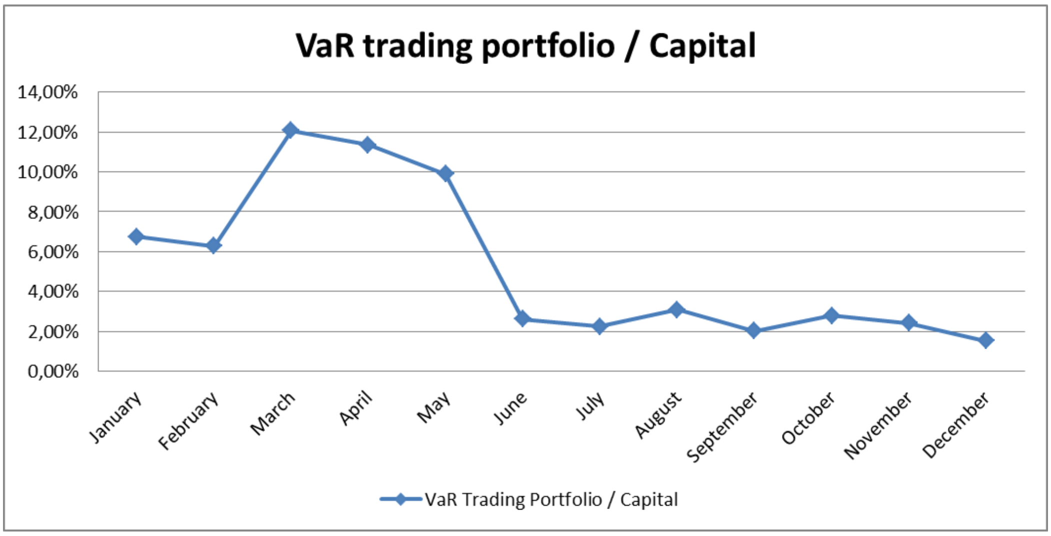
The Trading Portfolio is actively managed by Eurobanco Bank Ltd., under the guidelines and the Investment Strategy defined by the Board annually.

As a general principle, all financial instruments acquired will be incorporated into the Trading portfolio. The positions are valued on a daily basis at fair market values.

Eurobanco Bank Ltd. assumes a comprehensive risk strategy suited to its specific and particular business structure. In the global risk strategy, Eurobanco Bank Ltd. maintains a conservative policy, with historically adequate levels of efficiency. It has a leverage ratio in relation to the limits established by the Board of Directors, maintains good liquidity indicators, good performance and appropriate levels of profitability, in line with its historical performance.

The main tool used by Eurobanco Bank Ltd. for the calculation of economic capital by market risk is the VaR (Value at Risk) method. VaR is defined as the largest change that can be expected to occur statistically in a specific period given a certain confidence level. The parameters used to calculate the VaR are the following: 99% confidence level and 5 days holding period. The VaR also determine the Capital needs of Eurobanco Bank Ltd.
Market risk management is considered a mature discipline within the structure of Eurobanco Bank Ltd.. Historically, Eurobanco Bank Ltd. has not suffered significant losses due to market risk.

As of 12/31/2017, the evolution of the VaR relative to the Capital of Eurobanco Bank Ltd. was as follows:



As can be seen, the VaR of the bank's portfolio exposed to market risk during the period analyzed was very low, increasing in the first half of 2017 due to the decision to increase the securities position.

The indicators defined to monitor Market Risk, its limits and thresholds as of 12/31/2017 were as follows:

| Market Risk | Bottom Limit | Top Limit | Threshold |
|---|---|---|---|
| Trading Portfolio / Capital | | 200% | |
| Portfolio VaR / Capital | | 10,00% | |

#### 2.2.2.3. Operational Risk

Operational risk is the risk of loss arising from failure in internal processes, human error, information systems, or external events. When controls fail, operational risks may have legal or regulatory implications or lead to financial loss. The Entity cannot expect to eliminate all operational risks, but to be in a position to manage the risks through a framework for identifying and controlling them, and also responding to these possible risks through appropriate corrective measures. Controls include effective separation of duties, conciliation procedures, appropriate authorizations and access, evaluation procedures and site training, including internal audit engagement.

The risk associated with information systems, information technology and related resources is part of the operational risk. The IT Risk Management plan will be a part of the Operational Risk Management plan.

Risk is inherent to the Entity's activities. It’s managed through an ongoing process of identification, measurement and control. Risk limits and other controls should be implemented in this process. Risk management is essential to the entity's continuous profitability and all of Entity’s employees are responsible for mitigating the risks related to its functions.

Eurobanco Bank Ltd. is working on defining a set of Key Risk Indicators (KRI) for the monitoring of Operational Risk. This process consists of identifying process risks, definition of KRIs, calibration, setting limits and thresholds, and subsequent inclusion in the Risk Management Dashboard.

#### 2.2.2.4. Interest Rate Risk

Interest rate risk arises from the possibility of changes in the Bank's financial condition as a result of fluctuations in interest rates, which may have an adverse effect on the Bank's net financial income and its economic value. The Board has established limits on interest rate gaps for specific periods. Positions are controlled daily.

The main Key Risk Indicators (KRI) used to monitor interest rate risk are based on the determination of “Interest Rate Gaps”, which is a simple and basic method focused on the analysis of the impact of possible changes in the levels of market interest rate on net financial income and expenses, considering one year analysis horizon. This analysis allows Eurobanco Bank

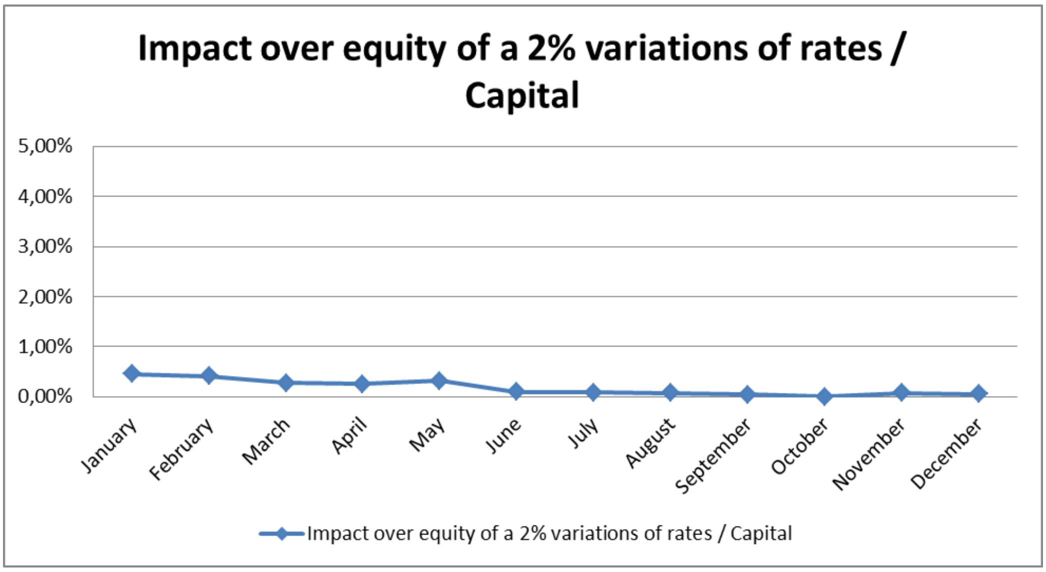
Ltd. to measure the impact of interest rate variation (+/- 200 bp) on Bank's Equity (Assets minus Liabilities subject to interest rate changes).

Monthly, Eurobanco Bank Ltd. monitors the KRIs regarding interest rate risk. This analysis is documented on the Risk Management Dashboard, which is presented in the Risk and Credit Committee.

Eurobanco Bank Ltd., annually performs stress tests which are analyzed and approved by the Risk and Credit Committee and approved by the Executive Committee.

Interest Rate risk management is considered a mature discipline within the structure of Eurobanco Bank Ltd.. Historically, Eurobanco Bank Ltd. has not suffered significant losses due to interest rate risk.

As of 12/31/2017, the evolution of the impact over equity relative to the Capital of Eurobanco Bank Ltd. was as follows:




The indicators defined to monitor the Interest Rate Risk, its limits and thresholds were as follows:

| Interest Rate Risk | Bottom Limit | Top Limit | Threshold |
|---|---|---|---|
| Impact over equity of a 2% variations of rates / Capital | | 10% | |

#### 2.2.2.5. Liquidity and Funding Concentration Risk

Liquidity risk represents the risk that the Bank cannot efficiently meet its payment obligations at the time of maturity under normal and stressful circumstances without affecting its daily operations or financial condition. To limit this risk, the Board of Directors has agreed on a variety of funding sources. In addition to its deposits, the management administers Eurobanco Bank Ltd’s assets considering liquidity and monitors the expected cash-flows.

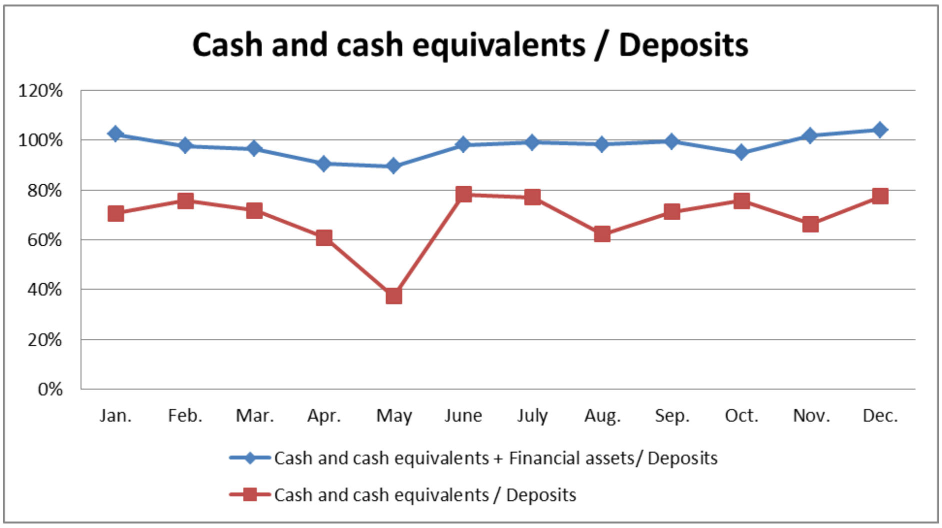
Historically, the bank's funding has been mainly comprised of deposits and, to a lesser extent, by cross-border loans and inter-bank loans.

The concentration of deposits is an Eurobanco Bank Ltd.’s characteristic given the type of business of the bank. The concentration of the Entity’s depositors could adversely impact on the liquidity of Eurobanco in the event of a crisis of confidence in the financial system that would lead to an exit of deposits or a lack of availability of credit.

The funding concentration is mitigated by the increase in the portion of its resources allocated to liquid assets. Eurobanco Bank Ltd.’s has defined that liquid assets (cash and cash equivalents) should be maintained above 60% of deposits.

As of 31 December 2017, the "cash and cash equivalents / deposits" KRI showed a result of 77,45%, above the minimum defined by the Board.

Eurobanco Bank Ltd. maintains a portfolio of diverse assets with a high capacity of commercialization. In case of an unforeseen interruption of cash-flows, the assets mentioned above can be liquidated easily.




The Key Risk Indicators performance throughout 2017 is above the limits defined by the Board of Eurobanco, in line with the strategy of maintaining a portfolio of high liquidity assets. However, in May, the KRI Cash and cash equivalent over deposits is out of limit. It was a particularly market situation in which Eurobanco decided to increase its trading portfolio. On the other hand, in that month, the KRI Cash and cash equivalents + financial assets over deposits showed a result of 90%.

Eurobanco Bank Ltd.'s Board of Directors and Management have always evaluated and controlled the risk of funding concentration, developing and implementing permanent strategies to mitigate it.

Eurobanco Bank Ltd. uses the Liquidity Gap to monitor the maturities of its active and passive portfolio. The Liquidity Gap is a method of projecting and allocating Bank's cash flows for assets, liabilities, equity concepts -such as dividends-, and off-balance-sheet operations -such as derivatives- to different horizons or time buckets. Based on this projection, the gap or mismatch between the different assets, liabilities and off-balance sheet accounts can be determined for each bucket. The analysis of mismatches between incoming and outgoing flows in the different buckets, allows determining the amount of funding required in each period. The gap can be analyzed individually (the one corresponding to a specific bucket), or the accumulated gap, which considers the sum of the previous gaps to be positive or negative.

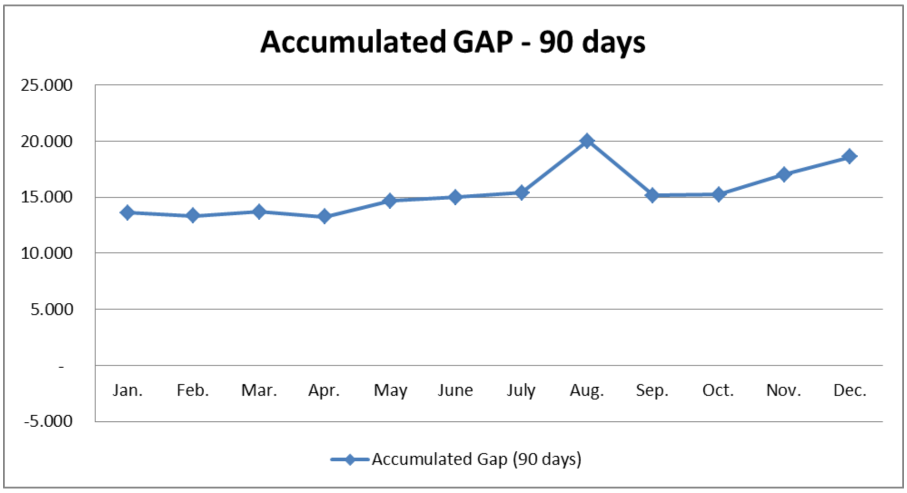
Likewise, indicators of the levels of liquid assets with respect to total deposits, concentration of deposits, and leverage levels are analyzed.

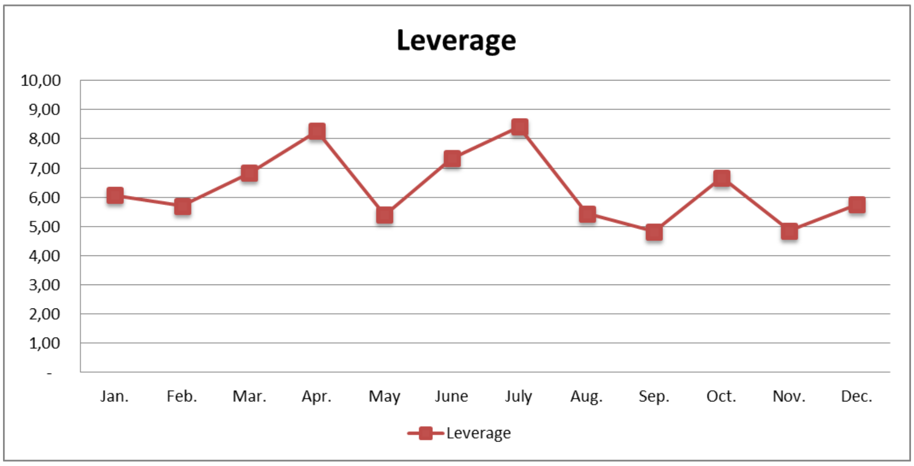
Monthly, Eurobanco Bank Ltd. monitors Key Risk Indicators regarding liquidity and funding concentration risk. This analysis is documented in the Risk Management Dashboard, which is analyzed in the Risk and Credit Committee.

Liquidity and Funding Concentration risk management is considered a mature discipline within the structure of Eurobanco Bank Ltd.. Historically, Eurobanco has not suffered significant losses, nor its solvency has been affected due to exposure to liquidity and funding concentration risk.

The behavior of the main indicators of liquidity and concentration of funding for 2017 can be seen in the following graphs:

The accumulated short term GAP at 90 days (assets minus liabilities) and the Leverage of the Entity can be seen in the following graphs:



The indicators defined to monitor the Liquidity Risk and Concentration of funding sources with their limits and thresholds were as follows:

| Liquidity risk | Bottom Limit | Top Limit | Threshold |
|---|---|---|---|
| Cash and Cash equivalents + Overnight + Securities / Deposits | 70% | | |
| Cash and Cash equivalents / Deposits | 60% | | |
| Deposits concentration (10 largest depositors) / Deposits | | 65% | 10% |
| Leverage | | 9.50 | |
| Leverage Ratio | | | |
| GAP accumulated over a 3-month horizon | - | | |
| GAP accumulated over a 6-month horizon | - | | |
| GAP accumulated | - | | |

### 2.2.2.6. Reputational Risk

Eurobanco Bank Ltd. understands reputational risk as the risk associated with a negative perception on the financial entity (whether this perception is founded or unfounded) by clients, counterparties, investors, debt holders, market analysts and other relevant market participants that could adversely affect their ability to maintain or generate a business relationship with Eurobanco, continue accessing to funding sources as well as could affect the Bank liquidity, in case public's confidence and Eurobanco Bank Ltd's ability to raise funds is diminished.

Eurobanco Bank Ltd. believes that reputational risk is highly correlated with the main risks to which the Bank is exposed (operational, liquidity, market, interest rate and credit). In other words, the risk of losses resulting from the lack of adequacy or possible failures in internal processes, the behavior of the Entity's own personnel or its information systems or external events could lead to the negative impact of the reputation of the Entity. On the other hand, an event that negatively affects the reputation could lead to events of credit, liquidity, interest rate or market risk.

Consequently, and in order to strengthen its internal processes and mitigate the impact that failures could cause to the reputation of the bank, high levels of internal control over the processes, the performance of the staff of the Entity itself and/or their information systems, are in place.

Eurobanco Bank Ltd. promotes a preventive culture based on proactivity, regulatory compliance and an effective operational response. This culture tends to minimize those corporate behaviors that could damage the values and ethical principles in the development of the Bank daily activities, and consequently affect the reputation of the Entity.

Eurobanco Bank Ltd. takes into account reputational risk factors for measuring this risk that may be generated internally (from the organization's own behavior), or externally (originated in the environment where its business is developed).

The reputation of the organization may be affected by:

- External factors (aspects of the environment):
  - Compliance with the strategy and business plan: ability to adapt to changes in the market;
  - Compliance with the legal and regulatory framework: current regulation, modifications and new communications;
  - Relationship with regulatory organism and government agencies;
  - Market: changes in the macroeconomic situation, activity of the competitors, etc.;
  - Relationship with customers;
  - Disclosure of the bank's business information: own publications - market discipline, balance sheets, etc. - and of third parties - news published in the media, publications of regulators, etc.
- Internal factors (aspects specific to the entity):
  - Corporate Governance: projects and investments, developing and monitoring of planning and projections, organizational structure, Board of Directors and management engagement, etc.;
  - Compliance with obligations and commitments: liabilities, legal obligations, etc.;
  - Financial and accounting management: reliability and integrity of financial and accounting information;
  - Human Resource Management: Staff ethics and integrity, qualification level for tasks performed, etc.;

- Information Systems Management: monitoring the confidentiality, integrity, availability and security of the systems and the information.

Banco CMF S.A., as the parent company of CMF Group, has developed qualitative and quantitative risk models, which are fully integrated into reputational risk management framework. These models were developed on a consolidated basis. They are based on a reputational risk monitoring scheme that allows the Bank to know the public exposure level of the Group Companies (Banco CMF S.A., Eurobanco Bank Ltd., Metrocorp Valores S.A. and CMF Asset Management S.A.U.), Directors, Management and Employees, and to identify potential risks for reputation.

Based on the monitoring process, preventive actions may be taken and, in case of a reputational risk event, diminish the negative impact on the Bank's reputation and other risks.

#### 2.2.2.7. Strategic Risk

The strategic risk is the risk arising from an inadequate business strategy or an adverse change in the forecasts, parameters, objectives and other variables that support that strategy.

The Bank's business strategy is materialized in the “strategy and projections” issued by Eurobanco Bank Ltd. annually. The Bank monitors the level of compliance with the strategy defined by Board of Directors monthly by monitoring a series of Key Risk Indicators (KRI) that are representative of the strategy, and set the measure of the estimation for this risk. The Board has defined as significant an absolute deviation of 25% compared to the projected values thereof.

The monitored Key Risk Indicators are:

- Credit performance
    - Loans / Assets
    - Public Sector Loans / Loans
    - Government Securities + Public Sector Loans / Equity
- Liquidity Level
    - Deposits + Government Securities / Deposits
- Profitability and Solvency

- ROE
- Efficiency
  - Expenses / Financial Margin + Commissions
  - Fixed Assets / Shareholders' Equity
  - Total Expenses / Assets
- Indebtedness
  - Leverage (Liabilities / Net Equity)
  - Deposits / Liabilities
- Capital Planning
  - RPC
  - % of over-integration on demand

## 2.3. Internal Audit

### 2.3.1. Internal Audit tasks related to risk management

The Internal Audit function of Eurobanco Bank Ltd. (including the tasks performed by Lemitel SA) is carried out by the Internal Audit department of its parent company, Banco CMF SA, with standardized procedures and scopes, according to the complexity of the organizational structure of each entity of the group.

It is an independent area with direct reporting to the Audit Committee and, through it, to the Board of Directors of the Bank. It is formed by a Responsible and two analysts, one of them specialized in information systems auditing.

The Annual Internal Audit Plan includes the analysis of the compliance and the effectiveness of the procedures and controls implemented related to Corporate Governance and Risk Management, in a consolidated manner for all entities of the group. The review as of December 31, 2017 was carried out during December 2017 and January 2018.

The scope of the review carried out by the internal audit related to risk management for Eurobanco Bank Ltd. was as follows:

Corporate Governance:

- Effectiveness of the Corporate Governance Code and compliance with the annual review thereof by the Board of Directors;
- The Board effectively fulfills the duties assigned to it by the Code, the Statute and the laws;

- Effective functioning of the Committees, in accordance with the definitions of the Code and / or its Regulations;
- Compliance with monitoring established procedures and periodic reporting of compliance with Corporate Governance guidelines.

Risk Management:

- Existence of properly approved strategies, policies and procedures for the management of each of the relevant risks identified by the entity and the reasonableness of the established guidelines and their adequacy to the entity's size, complexity, economic importance and risk profile;
- Effective Conduct of Stress Testing in the Fiscal Year;
- Reasonability of the proposed stress scenarios and their conceptual and temporal scope, depending on the size, complexity, economic importance and risk profile of the Bank;
- Existence of a procedure for the monitoring and periodic reporting of the main risks. These procedures should be adequate according to the size, complexity, economic importance and risk profile of the Bank;
- Reports are based on reliable accounting and / or management information;
- Reported excesses and / or exceptions receive immediate attention and are properly approved;
- Compliance with definitions of the Central Bank Of the Bahamas related to the process of self-evaluation of the economic capital of the entity;
- Selective evaluation of the consistency of the data considered in the calculation of economic capital.

The Internal Audit report N° 32/2017, issued on February 23th, 2018, qualified as Satisfactory its evaluation regarding the compliance and the effectiveness of the procedures and controls implemented by CMF Group, with respect to Corporate Governance and Risk Management.

# 3. Economic Capital calculation models

## 3.1. Assessment of capital needs for Credit Risk

### 3.1.1. Credit Risk

Eurobanco Bank Ltd, has adopted a Credit Risk Capital calculation model that complies with minimum CBOB's requirements established on the "Guidelines for the Management of capital and the calculation of Capital adequacy". Such capital model is aligned with the guidelines applied by the Standardized Approach for calculating capital for credit risk under Basel III.

The calculation method consists of a capital reserve of an 8% over Risk Weighted Assets. In determining credit risk capital charges, Eurobanco Bank Ltd applies risk weights to both on-balance sheet and off-balance sheet exposures, defined by Central Bank of The Bahamas. The risk weights applied are as follows:

| Asset | Risk Weight |
|---|---|
| - Cash<br>- Claims collateralized with cash<br>- Government securities | 0% |
| - Exposures to Financial Institutions | 20% |
| - Loans fully secured by mortgages on residential property | 50% |
| - Securities | 75% |
| - Others | 100% |

Exposures are to be risk weighted net of specific provisions.

The calculation of the assets included in determining credit risk capital is made on the basis of the balances of those assets at the last day of each month. The calculation formula used is the following:

$$C_{RC}: (0{,}08 \text{ X } RWA) + INC$$

RWA: Risk Weighted assets net of specific provisions.

INC: Increase due to excess of regulatory limits.

As of December 31st 2017, Eurobanco Bank Ltd. has no overdue payment credits on its loan portfolio.

The estimated economic capital by credit risk as of 12/31/2017 was as follows (values in thousands of US Dollars):

| Entity | Economic Capital ('000) |
|---|---|
| Eurobanco Bank Ltd. | 4.237 |

### 3.1.2. Residual Risk

All credit granted by Eurobanco Bank Ltd. is subject to Credit Risk and in that sense the Bank determines a capital reserve of 8% for each of the exposures (according to the model detailed in section 3.1.1 of this report).

The Board of Eurobanco Bank Ltd. understands that all loans granted are susceptible to fall into situations of default, so it has implemented a set of policies and procedures regarding to credit assessment of borrowers and their guarantors, tending to minimize this risk. However, the Entity considers that there could be a residual risk in those cases in which the guarantor of the transaction wouldn't be able to afford the guaranteed loan. Exceptions from this consideration are the credits that have cash guarantees, loans collateralized with cash and those guaranteed by the National Government.

For those loans with guarantees categorized as eligible collaterals by CBOB to reduce the capital reserve for credit risk (see Guidelines for the Management of capital and the calculation of capital adequacy), except for those mentioned above, Eurobanco Bank Ltd. determines economic capital reserve by residual risk according to the following formula:

$$Ci = E * P * 20\%$$

Ci: additional capital

E: exposure by eligible collateral

P: coefficient associated with the collateral kind

As of December 31st 2017, Eurobanco Bank Ltd. only had cash deposits within eligible collaterals, so no economic capital was calculated:

| Entity | Economic Capital ('000) |
|---|---|
| Eurobanco Bank Ltd. | - |

### 3.1.3. Concentration Risk over Loan Portfolio

The Board of Directors of Eurobanco Bank Ltd. has defined to monitor Credit Concentration Risk using the exposure limits defined by Central Bank of the Bahamas on its “Large Exposure Guidelines”. These limits prevents from excessive exposures to individual counterparties, related counterparties and economic groups. If any excess is identified, Eurobanco Bank Ltd. would apply the coefficients determined by the CBOB to constitute a capital reserve.

According to CBOB Guidelines only Large Exposures (over 10% of capital base) are computed to monitor credit concentration. Exposures are to be analyzed net of cash guarantees.

**Single exposure limit:**

The exposure, on an aggregate basis, to individual or group of connected parties, should not exceed 25% (twenty five percent) of its capital base.

**Related Party Limit:**

The exposure to Eurobanco Bank’s Ltd.’s related parties, on an aggregate basis, should not exceed 15% (fifteen percent) of its capital base.

**Aggregate Limit on Large Exposures:**

Large exposures, on an aggregate basis, should not exceed 800% (eight hundred percent) of its capital base.

As of 12/31/2017, Eurobanco Bank Ltd. did not have concentrated exposures and therefore did not reserve capital for that risk.

| Entity | Economic Capital (‘000) |
|---|---|
| Eurobanco Bank Ltd. | - |

## 3.2. Assessment of capital needs for Market Risk

Eurobanco Bank Ltd. uses the Value-at-Risk (VaR) model to measure market risk. This model allows measuring the risk to a level of confidence of 99% with a holding period of 5 days.

The economic capital required to cover unexpected losses due to market risk results from the addition of the calculation of the VaR of each of the assets included in the Bank's trading book.

The positions included for calculate the VaR of the Eurobanco Bank Ltd.’s trading book are securities, net positions for each foreign currency held by the entity and positions in shares, and negotiable obligations.

For the trading portfolio of Eurobanco Bank Ltd., the calculation of Value at Risk (VaR) is done as follows:

$$VaR = V * k * \sigma * T^{1/2}$$

V= net position value

k= constant based on confidence level

σ= volatility

T= holding period

Eurobanco Bank Ltd.’s trading book as of 12/31/2017 consisted of:

- Foreign currency (Euros);
- Government and Privates Securities.

The estimated economic capital by market risk as of 12/31/2017 was as follows (values in thousands of US Dollars):

| Entity | Economic Capital (‘000) |
|---|---|
| Eurobanco Bank Ltd. | 430 |

## 3.3. Assessment of capital needs for Operational Risk

The Board of Eurobanco Bank Ltd. understands that the effective management of operational risk contributes to prevent future losses derived and inherent to events related to this risk.

The Operational Risk management strategy of Eurobanco Bank Ltd. rests mainly on its human capital, highly trained and reliable. For its part, the banking operations of Eurobanco Bank Ltd. works under the framework of manuals and procedures for its operations. The articulation of both pillars is based on a clear allocation of responsibilities and segregation of functions.

It promotes a strongly internal control culture that safeguards the efficient Operational Risk management even when the business environment changes faster than updating the manuals.

The threshold of tolerance to the Operational Risk events is minimal, which requires permanent processes of awareness of employees.

Eurobanco Bank Ltd. uses the “Basic Indicator” method from Basel II – Pillar I, in order to calculate the Operational Risk Capital. The Basic Indicator method establishes that the Entity would hold capital equal to the average of the 15% over the previous 3 (three) years of positive annual gross.

The estimated economic capital by operational risk as of 12/31/2017 was as follows (values in thousands of US Dollars):

| Entity | Economic Capital (‘000) |
|---|---|
| Eurobanco Bank Ltd. | 306 |

## 3.4. Assessment of capital needs for Interest Rate Risk

Eurobanco Bank Ltd. has defined a model of economic capital calculation for interest rate risk that aims to monitor the economic exposure to the results and the bank's equity (economic impact approach) that would be generated by a variation of +/- 200 basis points in the market interest rate.

The calculation is made considering all defined products that are sensitive to interest rate fluctuations within the analysis horizon of one year. Based on the calculation of the variation for each product, the variation for the entire portfolio can be obtained, using the current value calculated for the entire portfolio (discounted at the reference rate calculated based on expectations of change in yield of sovereign bonds), and performing the calculation for a scenario of +/- 200 bp of parallel movement of the rate curve.

The determination of the capital required to operate due to a parallel movement of the 200-point interest rate curve arises from the subtraction between the assets subject to interest rate variation minus the liabilities subject to same variation, discounted at the reference rate (Equity of the Entity) and the same calculation but with the rate increased.

"Equity" refers to the current value of GAP between Assets and Liabilities subject to interest rate variation.

The estimated economic capital by interest rate risk as of 12/31/2017 was as follows (values in thousands of US Dollars):

| Entity | Economic Capital ('000) |
|---|---|
| Eurobanco Bank Ltd. | 14 |

## 3.5. Assessment of capital needs for Liquidity and Funding Concentration Risk

Eurobanco Bank Ltd. has implemented accurate measures to reduce the liquidity risk resulting from a mismatch between its assets and its payment obligations.

On a monthly basis, Eurobanco Bank Ltd. monitors the liquidity risk indicators by calculating them and comparing the results against the limits and thresholds defined by the Board of Directors, deviations are analyzed by the Risk and Credit Committee. The calculations include an analysis of the mitigation of funding concentration risk, estimating the levels of hedging of deposits maturities, through highly liquid assets in the Bank's portfolio.

All decisions taken by the Committee are discussed by the Executive Committee at a subsequent meeting, approving the definitions or defining new courses of action to be followed.

The Board of Eurobanco has identified as one of its main risks regarding Bank's liquidity, the deposits concentration. This is a characteristic of its business model.

As of December 31, 2017, the 10 largest depositors represented 88% of the Bank's deposits.

Eurobanco Bank Ltd.'s main strategy for dealing with a liquidity crisis is to respond to a cash outflow with liquid assets from its own portfolio.

On the other hand, Eurobanco Bank Ltd. manages to maintain compliance with the liquidity ratio (Deposits / Deposits) limit defined by the Board of Directors, as can be seen in section 2.2.2.5.

Conscious of its capacity to deal with liquidity stress situations, the Board of Directors of Eurobanco Bank Ltd. has defined that within 90 days the Entity must be able to deal with the loss of 50% of the 10 major depositors and 20% of the remaining deposits with the maturity flow of its loan portfolio and / or its liquid assets. If the projections show that it cannot cover this deposits outflow, it must reserve 20% of the uncovered surplus, as a reserve of economic capital for liquidity and funding concentration risk.

As of December 31, 2017 Eurobanco Bank Ltd. was in a position to cover excessively the 50% loss of the top ten depositors and 20% of the rest of the clients, so it is not necessary to reserve economic capital to cover this risk.

| Entity | Economic Capital (‘000) |
|---|---|
| Eurobanco Bank Ltd. | - |

## 3.6. Assessment of capital needs for Reputational and Strategic Risk

### 3.6.1. Reputational Risk

Eurobanco Bank Ltd. understands that the Entity's reputation is influenced by several factors, both internal and external, which could negatively affect the perception of interest groups over the Entity.

Internal factors may be present in all products, services, practices and processes, including all aspects related to the management of the Entity. These factors originate mainly in processes internal control failures, and / or in the execution of those controls or processes. Those failures may cause a gap between the performance of the Entity and the expectations of the stakeholders.

External factors are related to the environment in which the Bank performs its activities (changes in the macroeconomic situation, activity of competitors, compliance with regulations, legal actions, market share, customer / regulators / government agencies relations, etc.), with the disclosures made by the Bank's management (transparency, corporate governance actions, business conduct -competence, social responsibility, etc., business strategy, marketing and communication strategy, etc.), with publicity of materialized risk events (robberies, violation of information confidentiality, increase of credit uncollectibility, liquidity deficiencies, etc.), and the publishing of malicious information through the media, Social networks, etc.

The Bank understands that reputational risk is highly correlated with the universe of risks to which Eurobanco Bank Ltd. is exposed, mainly with the operational risk at its origination and with the remaining risks (liquidity, credit, market, interest rate, etc.) in its materialization. In other words, it considers that the Reputational Risk is immersed as a further risk within the Integrated Risk Management Framework, and therefore an incremental / complementary capital determination is made to respond to the impact on the reputation of the events materialized by any of the risks which it is correlated with.

The calculation of the incremental economic capital for reputational risk is made taking into account the risk profile of the Entity, its directors, senior management and subsidiaries.

The analysis of the risk profile is carried out through a self-assessment of a series of risks related to the Bank's reputation (environment, internal factors, stakeholders, and subsidiaries)

For each of the aspects identified in the mentioned categories, the Risk Level and Effectiveness of the Controls that the Entity has implemented are evaluated to mitigate the level of risk in each case.

In both cases, they are evaluated using a 5-level scale (Very High, High, Medium, Low, and Very Low), which additionally entail a quantitative assessment, according to the following tables:

| Risk Level | Value |
|---|---|
| Very High | 1 |
| High | 0.8 |
| Medium | 0.6 |
| Low | 0.4 |
| Very Low | 0.2 |

| Control effectiveness | Value |
|---|---|
| Very High | 0.2 |
| High | 0.4 |
| Medium | 0.6 |
| Low | 0.8 |
| Very Low | 1 |

From the rating assigned to the Risk Level and the Effectiveness of the controls, the Residual Risk Value is obtained, which is calculated as:

**Residual Risk Value** = Risk Level * Control Effectiveness

The residual risk value is aggregated by category (Environment, Internal Aspects of the Entity, Stakeholders and Subsidiaries), obtaining a single value for each of them. This value is obtained by multiplying the residual value of each of the risks that forms the category.

The residual risk values obtained for each category represent the entity's reputational risk profile, considering all factors that could affect it. These values will be used as coefficients for the determination of the incremental economic capital that will be reserved to face potential events in the matter.
The determination of economic capital will be made taking into account the risk profile, as explained above, and the correlation between the reputational risk and the significant risks which the Bank is exposed to (Operational, Credit, Market, Rate and Liquidity).

The economic capital shall be calculated by applying the coefficient determined on each risk profile categories to the economic capital determined for each of the correlated risks. The sum of the values obtained in each category will constitute the reserve of economic capital for reputational risk.

The estimated economic capital by reputational risk as of 12/31/2017 was as follows (values in thousands of US Dollars):

| Entity | Economic Capital (‘000) |
|---|---|
| Eurobanco Bank Ltd. | 13 |

### 3.6.2. Strategic Risk

The determination of economic capital by strategic risk will be made considering a capital reserve of 8% on the excess of the significant variations of the 6 fundamental pillars of the strategic management of the Entity:

- Credit performance
- Liquidity level
- Profitability and solvency
- Efficiency
- Indebtedness
- Capital planning

The Key Risk Indicators that conform each of the above mentioned pillars are detailed in section 2.2.2.7. of this document.

The actual balances information will be based on the Bank’s accounting at the end of each month and the budget will be taken from the Projections of the Entity.

Therefore, when a deviation in absolute values of 25% from the budgeted for the Entity's strategy is identified, the 8% coeficient will be applied to the surplus as a capital reserve.

The estimated economic capital by strategic risk as of 12/31/2017 was as follows (values in thousands of US Dollars):

| Entity | Economic Capital ('000) |
|---|---|
| Eurobanco Bank Ltd. | 234 |

# 4. Aggregated capital requirements

Eurobanco Bank Ltd. calculates the total capital requirements by simply adding the capital needs for each of the risks is exposed to, in accordance with the result of the individual measurements described on section 3.

| Risk | Capital Self-Assesment ('000 usd) |
|---|---|
| **Credit Risk** | 4.237 |
| Credit Risk | 4.237 |
| Credit Concentration Risk | 0 |
| Residual Risk | 0 |
| **Market Risk** | 430 |
| **Operational Risk** | 306 |
| **Interest Rate Risk** | 14 |
| **Liquidity and funding concentration Risk** | 0 |
| **Reputational Risk** | 13 |
| **Strategic Risk** | 234 |
| | |
| **Total Economic Capital Needs** | 9.472 |
| Capital (Tier 1 and Tier 2) | 28.442 |
| Difference | 18.970 |
| | |
| **Excess over economic capital needs** | 200% |

# 5. Capital Planning and Stress Testing

## 5.1. Period covered by planning

Stress Tests carried out by Eurobanco Bank Ltd. consists on simulation models applied to 2018 budget. These scenarios test the bank's ability to deal with exogenous crisis scenarios which consequences are capital losses in the value of its investments and increase in the funding cost. Aggregated consequences are: asset value deterioration and the decrease of business volume.

Stress testing is based on balances as of December 31st 2017, considering 2018 Eurobanco Bank Ltd. Budget.

## 5.2. Methodology summary

Eurobanco Bank Ltd. has adopted the stress testing methodology of its parent company, taking into consideration its business size, assumed risk profile, relative importance within the financial system and the nature and complexity of its operations.

The stress tests were designed to provide information to Eurobanco’s Management and Board of Directors about possible scenarios considering the risks that the Entity is exposed to, in order to timely anticipate the magnitude of the contingent capital needs to deal with the situation without affecting the solvency or liquidity of the Bank.

On stress scenarios definition process, extreme and adverse, but possible, situations are identified. Stress scenarios are constructed considering Eurobanco’s business structure and vulnerabilities sharpened by exogenous factors (market). Additionally, they are used to evaluate the maximum stress situation that the Bank could manage.

Eurobanco Bank Ltd. understands that stress tests may not cover all the risks which the Entity is exposed to. This process plays a very important role in strengthening the Corporate Governance internal structures as well as contributing to the good health of both the individual bank and the financial system as a whole.

The stress tests developed by Eurobanco include simple changes in one or more risk factors, based on the analysis of historical events and future projections. Based on the study of real situations occured in the past, a retrospective analysis of the main variables involved in those events is carried out and compared with the current and projected economic, political and market discipline situation.

Considering the analysis above, two basic stress scenarios were constructed with impact on market volatility, generating an increase in interest rates with the consequent devaluation of financial assets and an increase in the cost of funding and liquidity risk. Two one year term scenarios were designed.

The stress tests are carried out by Eurobanco Bank Ltd. as minimum with annual frequency in stable markets and in all situations that market volatility is foreseen, in coordination with the operational management of the Entity and supervised by the Board of Directors. Once the scenarios have been developed, the tests carried out and the corresponding contingency plans designed, they are subject to the analysis and validation of the Risk and Credit Committee, for subsequent approval by the Executive Committee.

In the analysis of stress tests, Eurobanco takes into account, not only its internal fluctuations, but also the possible responses of the rest of the market participants to stress events that affect them. Also, stress tests were designed to show the correlation between multiple risk factors that affect Eurobanco Bank Ltd. in aggregate form.

The results of the stress tests are used to adjust the business strategies for each of the significant risks of Eurobanco, to generate actions that limit its exposure to losses and non-compliance with regulations, to review the limits and thresholds defined for each risk indicator and to adequate contingency plans to the Bank's own needs that are shown by the stress of its risk factors. These results are reported and discussed with the Board of Directors.

The stress tests conclusion is that Eurobanco Bank Ltd. is in good health to overpass stress situations in the market, maintaining required levels of capital to operate, as well as its liquidity and solvency ratios.

## 5.3. Stress scenarios and results

Stress scenarios allow Eurobanco’s management to make a simplification of reality and help through assumptions, arguments and conclusions to explain the cause-effect relationships between the different variables.

In the scenarios proposed assume the market normal conditions, where prices (the interest rate in financial terms) are defined by the free money supply.

The proposed scenarios are theoretical, and although they were constructed based on a prospective analysis, they could differ from possible situations of stress that Eurobanco could face in the future which will depend on macroeconomic context, regulations, market behavior, legal aspects and political and social situation. Likewise, as in the economy, man's behavior influences the course of markets, which can act in different ways when facing same stimulus.

Eurobanco Bank Ltd.’s management objective in the stress scenario is to ensure that the projections are consistent with Eurobanco’s performance during other stress scenarios traversed throughout its history, and that Management and the Board discuss and agree on possible action plans in case of an occurrence. Those action plans would allow the rapid execution of actions to mitigate a materialized stress situation.

Given Eurobanco Bank Ltd.’s operations, two stress scenarios were designed affecting key variables of the Entity. It is important to note that those variables that are not being analyzed or stressed remain without changes. In the next section the correlation between the variables that are considered within the stress scenarios, are explained.

### 5.3.1. Stress Scenario

#### 5.3.1.1. Scenarios description

Based on serveral exogenous factors, sharpened for the purpose of stress testing and according to Eurobanco Bank Ltd’s risk profile, two hypothetical scenarios were designed on the basis of a short and moderated market volatility period with effect on macroeconomic variables and monetary aggregates. During the third quarter, a strong fall in market prices of bonds and shares happens, what generates a “fly to quality” effect, from emerging markets to developed ones.

On the designed scenarios, it is considered that there are no variables that may compensate or neutralize the scenario’s negative effects on Eurobanco Bank Ltd.’s solvency.

The stress test scenarios were developed based on a quarterly increase on the interest rate of 25bp which affects international market´s volatility. No recovery was projected during this one-year scenario. Those scenarios consider market risk, the effect on Bank’s liquidity and economic results within the stressed period.

There is an important difference between scenarios one and two. This means that in scenario two, Eurobanco Bank Ltd. decides to take advantage of the increasing market volatility in order to raise its trading revenues.

Eurobanco Bank Ltd’s portfolio would be at market fair value of USD 30 million, so the fly to quality movement will cause a theoretical devaluation of the financial instruments of USD 1,5 million throughout July.

Therefore, in order to mitigate the devaluation, considering the increase in market rates and the consequent loss due to the devaluation of securities, the Bank decides to make partial sales of the financial instruments at estimated market value during the second half of the year, in order to reduce its own position. The objective of this action is to prevent potential major losses and to improve Eurobanco Bank Ltd.'s liquidity.

As a consequence of the stress hypothesis, the holding / trading profit diminishes a 75% in scenario I and 62,5% in scenario II, going from USD 2 million to USD 0,5 million and USD 0,75 million after the stressed time period.

Applying these countermeasures, the Entity manages to maintain its liquidity ratio in both scenarios (cash and cash equivalents/deposits) in 106%, ensuring Entity's liquidity and solvency. That is to say that the projected scenarios would not affect the liquidity of the bank.

Additionally, the funding cost will lightly increase (10%), without affecting deposits volume, and lightly decreasing financial spread.

Net profit level would be reduced from USD 1,138 million to USD -0,403 million and to USD -0,153 million.

#### 5.3.1.2. Stress testing effects on Financial Statements

The proposed stress scenarios have the following effects on Eurobanco Bank Ltd.'s Financial Statements:

- ***Portfolio reduction***

The fly to quality movement causes a reduction of the market value of financial instruments. For such reason Eurobanco Bank Ltd.'s decided to make partial sales of the financial instruments at fair market value during the second half of the year, in order to reduce its own position.

The following charts show the financial instruments position variation between Base Scenario and Stress Scenarios:

Base Scenario

| | DEC.,2017 | JUN, 2018 | JUL, 2018 | AUG, 2018 | SEP, 2018 | OCT, 2018 | NOV, 2018 | DEC, 2018 |
|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | |
| Financial assets designated at fair value through profit or loss | 34.136.936 | 30.000.000 | 30.000.000 | 30.000.000 | 30.000.000 | 30.000.000 | 30.000.000 | 30.000.000 |

Stress Scenario

| | DEC.,2017 | JUN, 2018 | JUL, 2018 | AUG, 2018 | SEP, 2018 | OCT, 2018 | NOV, 2018 | DEC, 2018 |
|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | |
| Financial assets designated at fair value through profit or loss | 34.136.936 | 30.000.000 | 21.000.000 | 15.750.000 | 11.820.000 | 8.900.000 | 6.700.000 | 5.000.000 |

The countermeasures applied reduce the impact on the net profit, originated on the market value devaluation of the financial instruments within Eurobanco Bank Ltd.'s portfolio. Even so, the holding / trading profit accumulated as of December 2018, diminishes a 75% in scenario I and 62,5% in scenario II.

The following charts show the variation of profit related to financial instruments between Base Scenario and Stress Scenarios:

Base Scenario

| | DEC.,2017 | JUN, 2018 | JUL, 2018 | AUG, 2018 | SEP, 2018 | OCT, 2018 | NOV, 2018 | DEC, 2018 |
|---|---|---|---|---|---|---|---|---|
| Accrual and trading on securities, and net premiums on forward sales, repurchases and options | 2.092.137 | 1.000.000 | 1.150.000 | 1.315.000 | 1.482.000 | 1.650.000 | 1.817.000 | 2.000.000 |

Stress Scenario 1

| | DEC.,2017 | JUN, 2018 | JUL, 2018 | AUG, 2018 | SEP, 2018 | OCT, 2018 | NOV, 2018 | DEC, 2018 |
|---|---|---|---|---|---|---|---|---|
| Accrual and trading on securities, and net premiums on forward sales, repurchases and options | 2.092.137 | 1.000.000 | (350.000) | (185.000) | (18.000) | 150.000 | 317.000 | 500.000 |

Stress Scenario 2

| | DEC.,2017 | JUN, 2018 | JUL, 2018 | AUG, 2018 | SEP, 2018 | OCT, 2018 | NOV, 2018 | DEC, 2018 |
|---|---|---|---|---|---|---|---|---|
| Accrual and trading on securities, and net premiums on forward sales, repurchases and options | 2.092.137 | 1.000.000 | (350.000) | (135.000) | 82.000 | 300.000 | 517.000 | 750.000 |

- ***Effects on net income***

The fly to quality causes a decrease in the fair value of bonds. This causes a theoretical reduction of 5% of their fair value of bonds, which means a devaluation of the financial instruments of USD 1,5 million throughout July.

This movement aim counteracts the uncertainty of the investors. As a consequence, Eurobanco Bank Ltd. increases the cost of its deposit interest rate up to 10%.

On the stress scenarios, Eurobanco Bank Ltd's net profit was reduced from USD 1,138 million to USD -0,403 million on scenario I and to USD -0,153 million on scenario II. As it's shown in the charts below, even on the stressed scenarios, Eurobanco Bank Ltd. mantains its solvency.

Base Scenario

| | DEC.,2017 | JUN, 2018 | JUL, 2018 | AUG, 2018 | SEP, 2018 | OCT, 2018 | NOV, 2018 | DEC, 2018 |
|---|---|---|---|---|---|---|---|---|
| Net profit, being total comprenhensive income for the year | 1.419.297 | 521.563 | 609.490 | 711.417 | 810.344 | 916.271 | 1.017.198 | 1.138.125 |

## Stress Scenario 1

| | DEC.,2017 | JUN, 2018 | JUL, 2018 | AUG, 2018 | SEP, 2018 | OCT, 2018 | NOV, 2018 | DEC, 2018 |
|---|---|---|---|---|---|---|---|---|
| Net profit, being total comprenhensive income for the year | 1.419.297 | 521.563 | -890.510 | -788.583 | -689.656 | -594.729 | -509.802 | -403.875 |

## Stress Scenario 2

| | DEC.,2017 | JUN, 2018 | JUL, 2018 | AUG, 2018 | SEP, 2018 | OCT, 2018 | NOV, 2018 | DEC, 2018 |
|---|---|---|---|---|---|---|---|---|
| Net profit, being total comprenhensive income for the year | 1.419.297 | 521.563 | -890.510 | -738.583 | -589.656 | -444.729 | -309.802 | -153.875 |

- ***Effect on Key Risk Indicators***

The following charts show the performance of Key Risk Indicators regarding Liquidity and Leverage on both Base and Stress Scenarios.

## Base Scenario

| | DEC.,2017 | JUN, 2018 | JUL, 2018 | AUG, 2018 | SEP, 2018 | OCT, 2018 | NOV, 2018 | DEC, 2018 |
|---|---|---|---|---|---|---|---|---|
| **Ratios** | | | | | | | | |
| Cash and cash equivalents / Deposits | 78% | 80% | 82% | 82% | 82% | 84% | 84% | 84% |
| Cash and cash equivalents + Financial assets / Deposits | 105% | 108% | 107% | 107% | 107% | 107% | 107% | 107% |
| Leverage | 4,5 | 3,8 | 4,1 | 4,1 | 4,1 | 4,4 | 4,4 | 4,4 |

## Stress Scenario 1

| | DEC.,2017 | JUN, 2018 | JUL, 2018 | AUG, 2018 | SEP, 2018 | OCT, 2018 | NOV, 2018 | DEC, 2018 |
|---|---|---|---|---|---|---|---|---|
| **Ratios** | | | | | | | | |
| Cash and cash equivalents / Deposits | 78% | 80% | 88% | 93% | 96% | 99% | 100% | 102% |
| Cash and cash equivalents + Financial assets / Deposits | 105% | 108% | 106% | 106% | 106% | 106% | 106% | 106% |
| Leverage | 4,5 | 3,8 | 4,4 | 4,3 | 4,3 | 4,7 | 4,7 | 4,6 |

## Stress Scenario 2

| | DEC.,2017 | JUN, 2018 | JUL, 2018 | AUG, 2018 | SEP, 2018 | OCT, 2018 | NOV, 2018 | DEC, 2018 |
|---|---|---|---|---|---|---|---|---|
| **Ratios** | | | | | | | | |
| Cash and cash equivalents / Deposits | 78% | 80% | 88% | 93% | 96% | 99% | 101% | 102% |
| Cash and cash equivalents + Financial assets / Deposits | 105% | 108% | 106% | 106% | 106% | 106% | 106% | 106% |
| Leverage | 4,5 | 3,8 | 4,4 | 4,3 | 4,3 | 4,7 | 4,6 | 4,6 |