HAITONG BANK, S.A.

Market Discipline

Annual Report: 2016

(Disclosure in accordance with Part VIII of Regulation (EU) no. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms)

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Foreword

2016 has seen the full integration of Haitong Bank into Haitong Securities Group. During the year, some key cooperation initiatives have taken place:

- The sale of Haitong Securities India Private Limited to Haitong International Securities (Hong Kong), leveraging on the Group's Pan-Asian business integration;
- The creation of China desks and the establishment of joint working teams at a Group level, allowing Haitong Bank to participate in cross-border DCM and M&A transactions originated together with Haitong Securities and Haitong International.

Nevertheless, during 2016, the Bank has faced significant headwinds. The difficult global investment banking environment was worsened by the deterioration of the macroeconomic conditions and increased political uncertainty in some of our key regions, namely Brazil and the UK, while in Iberia the economic recovery was slower, namely in the first half of the year. In addition, the Bank had to manage a full transition process into a new financial group.

As a consequence, 2016 was a very challenging year for the Bank with a EUR 96 million net loss. The negative operational result was due to the change in the business model which has affected revenue generation and also the existing disproportionate cost structure. This cost structure was related to the former strategy as well as to the need to set up a new banking infrastructure after severing ties with Novo Banco. Finally, on top of this negative operating situation, there was a need to recognise further credit impairments. These were related to the legacy credit portfolio in Project Finance and Acquisition Finance. After several years of portfolio clean-up, we expect to have finally reached the last part of this stage of restructuring.

In this context, Haitong Securities decided, at the end of 2016, to implement a management reshuffle with the aim of relaunching the business. This will be executed under a new strategy underpinned by a recapitalization to support growth. The new strategic positioning, called "Haitong Bank 2025", is based on two strategic pillars, China Angle and Emerging Markets, and three main areas of activity - Investment Banking, Markets (centred on Fixed Income), and Alternative Products. This new business model will be rolled out in the core domestic markets - Iberia, Poland and Brazil, and the distribution hubs - NY and London. This business repositioning will be accompanied, in 2017, by a structural cost reduction.

The new strategy is being implemented under a new set of values: (i) Teamwork; (ii) Transparency; (iii) Accountability; (iv) Communication; (v) Pro-Business Activity; and (vi) Effective Budget Management.

We are preparing Haitong Bank to play a central role at the Group level: the Bank has a strong origination franchise in local markets such as Iberia, Brazil and Poland that can be leveraged on by the distribution capability in the London and New York hubs and going forward into Shanghai and Hong Kong. Our objective is to develop this franchise, adjusting the size and cost of our platform to ensure a sustainable profitable business, whilst supporting the ambition to strengthen Haitong Securities Group's international franchise.

The full integration into Haitong Securities Group and the implementation of "Haitong Bank 2025" are the basis for this new project, paving the way for the Bank's return to profitability. The revised cost structure, as well as the conclusion of the legacy asset restructuring will also contribute for the Bank's performance improvement.

Introduction

The banking sector has been progressively adopting increasingly sophisticated techniques to assess the risks inherent to its activity, a stance clearly encouraged by the current prudential regulation framework applicable to the banking business.

This regulatory framework is based on three pillars applying to the sector's institutions, essentially viewing an increase in the sensitivity of minimum capital requirements to the credit and operational risk levels to which they are exposed (Pillar I) and the reinforcement of the banking supervision process not only to ensure that said minimum requirements are met but also to encourage the sector to develop better risk monitoring and management techniques (Pillar II). Finally, Pillar III, which deals with "Market Discipline", aims to complement the other two pillars in so far as it establishes a set of minimum requirements for banks' public disclosure of key information elements, namely the composition of their capital, their level of exposure to the various types of risk and the processes used to monitor and manage such risks, and also their capital adequacy.

It is in this regulatory context and particularly in regard to the referred Pillar III that Haitong Bank, S.A. (Haitong Bank, Haitong Bank SA Group, Group or Bank), publishes this "Market Discipline" report, which is chiefly of a prudential nature and aims to ensure compliance with the disclosure requirements foreseen in Part VIII of Regulation (EU) no. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms.

The information disclosed relates to the end of financial 2016 and is presented on a consolidated basis.

The financial statements as of end-of-year 2015 were restated, as described on the Note 41 of the 2016 Annual Report, therefore the corresponding figures on this document have been restated accordingly.

Note that this report is available in the "Corporate Governance" area of the Bank's website (www.haitongib.com/). The website also contains information on Haitong Bank, S.A.'s activity and events that complements the information provided in this report

1. Declaration of Responsibility

The Executive Committee of Haitong Bank, S.A. hereby declares and certifies that:

I. In the preparation of this "Market Discipline" report relative to the end of financial year 2016, all procedures deemed necessary for the public disclosure of information were developed and carried out. To the extent of its knowledge, all the information disclosed in this document is true and reliable;

II. The quality of all the information disclosed, including that concerning or originating from entities comprised within the same economic group as the Bank, is adequate;

III. It undertakes to disclose in due time any significant changes occurring during the financial year following that to which this "Market Discipline" report refers.

For the due effects, the information presented on this document, with reference to the end of the 2016 exercise, has suffered during the subsequent exercise of 2017 influence related to the following events that can be considered as relevant facts:

- On May 25th 2017, Haitong Bank S.A. informed the market that its share capital increased by 60.000.000 Euros (40.000.000 Euros in cash and 20.000.000 Euros by contribution in kind of loans), to a global amount of 486.269.000 Euros, represented by 97.253.800 ordinary shares with the nominal amount of 5 Euros each, being the corresponding Statutes modified in accordance.
- On June 14th 2017, Haitong Bank S.A. informed the market that its share capital increased by 160.000.000 Euros, by new entries fully comprised of cash, to a global amount of 649.269.000 Euros, represented by 129.253.800 ordinary shares with the nominal amount of 5 Euros each, being the corresponding Statutes modified in accordance.
- On June 29th 2017, Haitong Bank S.A. informed the market that its share capital increased by 160.000.000 Euros by contribution in kind of loans and own debt, amounting it to a global amount of 806.269.000 Euros, represented by 161.253.800 ordinary shares with the nominal amount of 5 Euros each, being the corresponding Statutes modified in accordance.

The share capital increases described above were fully subscribed and realized by the Bank's shareholder, Haitong International Holdings Limited, established in Hong Hong, subsidiary of Haitong Securities Co., Ltd. (a company whose shares are traded on the Shanghai and Hong Kong stock markets).

The Executive Committee,

2. Scope of application

2.1 Haitong Bank, S.A.: Identification and Origins of the Banking Group

Haitong Bank, S.A. is an investment bank with registered office in Portugal, at Rua Alexandre Herculano, n.º 38, Lisbon. The Bank holds the necessary authorizations from the Portuguese authorities, central banks and other regulatory agencies to operate in Portugal and in the countries where its international branches are located.

It was established in February 1983 as a foreign investment in Portugal under the name FINC – Sociedade Portuguesa Promotora de Investimentos, S.A.R.L. In 1986 the company was integrated into the Espírito Santo Group under the name Espírito Santo – Sociedade de Investimentos, S.A..

In order to enlarge the scope of its business, the company obtained permission from the Portuguese authorities to operate as an investment bank, under ministerial order no. 366/92, of 23 November, which was published in the Diário da República Series II – no. 279, 3 December. The activity as an investment bank started under the name Banco ESSI, S.A., on 1 April, 1993.

In 2000, BES (now Novo Banco, S.A.) acquired the entire share capital of the Bank in order to reflect in its consolidated financial statements all the synergies generated by both institutions.

Following the Bank of Portugal's application of a resolution measure to Banco Espirito Santo, S.A. on 3 August 2014, the Bank became fully held by Novo Banco, S.A..

In December 2014 Novo Banco, S.A. entered an agreement to sell to Haitong International Holdings Limited (Haitong) the entire share capital of Banco Espírito Santo de Investimento, S.A.. Haitong is a Hong Kong based wholly-owned subsidiary of Haitong Securities Co., Ltd., a company whose shares are listed on the Shanghai Stock Exchange and The Stock Exchange of Hong Kong Limited.

This transaction, which involved the acquisition of the entire share capital of BES Investimento by Haitong International Holdings Limited, was completed in September 2015, upon which the Bank changed its name to Haitong Bank, S.A..

Haitong Bank currently operates through its headquarters in Lisbon, its branches in London, Warsaw and Madrid, and its subsidiaries in Brazil, Ireland, United Kingdom, India and Mexico. Haitong Bank's financial statements are consolidated by Haitong International Holdings Limited, with registered office at Po Chun Chambers, no. 89, Des Voeux Road Central, Hong Kong.

2.2 Scope and Basis of Consolidation for Accounting and Prudential Purposes

The structure of the group of companies where the Bank has a direct or indirect holding greater or equal to 20%, over which the Bank exercises control or has significant influence, and that were included in the consolidated scope, is as follows:

TABLE I – Consolidated Companies

	Incorporation date	Acquisition date	Headquarters	Activity	% Economic interest	Consolidation method
Haitong Bank, S.A.	**1983**	**-**	**Portugal**	**Investment bank**	**100%**	**Full consolidation**
Haitong Investment Ireland PLC	1996	1996	Ireland	Non-bank finance company	100%	Full consolidation
Lusitania Capital, S.A.P.I. de C.V., SOFOM, E.N.R.	2013	2013	Mexico	Non-bank finance company	100%	Full consolidation
MCO2 - Sociedade gestora de Fundos de Investim	2008	2008	Portugal	Asset management - investment funds	25%	Equity method
Haitong Capital - SCR, S.A.	1988	1996	Portugal	Venture capital fund	100%	Full consolidation
Salgar Investments	2007	2007	Spain	Real estate / Non-Bank finance company	25%	Equity method
SES Iberia	2004	2004	Spain	Asset management - investment funds	50%	Full consolidation
Fundo Espírito Santo IBERIA I	2004	2004	Portugal	Venture capital fund	46%	Equity method
WindPart, Lda	2013	2013	Portugal	Holding company	20%	Full consolidation (a)
Haitong (UK) Limited	2010	2010	United Kingdom	Holding company	100%	Full consolidation
Haitong Securities (UK) Limited	2000	2010	United Kingdom	Brokerage house	100%	Full consolidation
Noble Advisory India Private Ltd	2008	2010	India	Research services provider	100%	Full consolidation
Clear Info-Analytic Private Ltd	2004	2010	India	Research services provider	100%	Full consolidation
Haitong Banco de Investimento do Brasil S.A.	2000	2000	Brazil	Investment bank	80%	Full consolidation
FI Multimercado Treasury	2005	2005	Brazil	Investment fund	80%	Full consolidation
Haitong do Brasil Participações Ltda	2004	2004	Brazil	Asset management	80%	Full consolidation
Haitong Negócios, SA	1996	1999	Brazil	Holding company	80%	Full consolidation
Haitong do Brasil DTVM, SA	2009	2010	Brazil	Asset management	80%	Full consolidation
Haitong Securities do Brasil S.A.	2000	2000	Brazil	Brokerage house	80%	Full consolidation
Haitong Securities USA	2015	2015	U.S.A.	Brokerage house	100%	Full consolidation

a) These companies were fully consolidated as the Group exercises control over their activities.

In 2013 Haitong Bank launched a simplification plan for the Group. Under this process several measures were taken, including the sale and merger of investments, with no significant impact on the financial statements. The simplification process was pursued during 2016, involving the following main changes to the Group's structure:

Subsidiary Companies

- In January 2016 Haitong Bank, S.A. fully subscribed and paid up Haitong Securities USA LLC initial share capital of USD 300 thousand, adding it to the scope of its consolidated companies.

- In March 2016 Haitong Bank, S.A. fully subscribed the capital increase of Haitong Securities USA LLC, an investment of USD 10,000 thousand.

- In March 2016 Haitong Bank, S.A. fully subscribed the capital increase of Haitong Securities India Private Limited, an investment of INR 344,748 thousand. Haitong Bank, S.A. subscribed 13,725,289 new shares increasing the number of shares held in this company to 19,635,252.

- In March 2016 Haitong Bank, S.A. concluded the winding up of its New York Branch and returned the respective license to the New York Department of Financial Services. Since then Haitong Bank remained present in this market through a Representative Office, whose license had been granted by the same Supervision Authority in January 2016. In October 2016, Haitong Bank, S.A. started its activities as a broker dealer through its subsidiary Haitong Securities USA LLC.

- In May 2016, Haitong Bank, S.A. agreed to purchase all of the 1,477,491 shares held by the minority shareholder of Haitong Securities India Private Limited, for INR 245,795 thousand.
- In July 2016 Haitong Bank, S.A. concluded the winding up of Haitong & Company (UK) Limited.
- In October 2016 Haitong Bank, S.A. fully subscribed and paid up Haitong Securities USA LLC share capital increase, an investment of USD 3,438 thousand.
- In October 2016 the corporate name of Espírito Santo Investimentos, S.A. was changed to Haitong Negócios, S.A..
- In December 2016, Haitong Bank, S.A. concluded the sale of its subsidiary Haitong Securities India Private Limited (19,635,252 shares) for the amount of USD 11,365 thousand.

Associated Companies

- In March 2016, a capital distribution of Fundo Espírito Santo IBERIA I took place, attributing a total of EUR 1,573 thousand to Haitong Capital – SCR, S.A.
- In July 2016, a capital distribution of Fundo Espírito Santo IBERIA I took place, attributing a total of EUR 173 thousand to Haitong Capital – SCR, S.A.
- In December 2016, Haitong Capital – SCR, S.A. sold 20% of its participation in Coporgest - Companhia Portuguesa de Gestão e Desenvolvimento Imobiliário, S.A. for the amount of EUR 1,993 thousand.

Moreover, the following should also be stressed:

I. To the extent of the Bank's knowledge, there is no material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities between the Bank and its subsidiaries;
II. There are no subsidiaries not included in the prudential scope of consolidation whose actual own funds are lower than the minimum required;
III. There are no subsidiaries included in the Bank's scope of consolidation that are deducted from own funds for prudential purposes, in accordance with Regulation (EU) no. 575/2013;
IV. The Bank's prudential supervision scope coincides with its accounting consolidation scope.

3. Risk management Objectives and Policies

3.1 Statement on the adequacy of the risk management systems

The risk management function operates independently from the business areas, providing advice on risk management to the decision-takers of the Bank. Haitong Bank has in place control systems to identify, monitor and manage risks, as well as areas to support the business development, which the Executive Committee considers adequate in view of the Bank's profile and size.

3.2 Statement on the Overall Risk Profile and its Relation with the Business Strategy

Haitong Bank's main objective is to provide a wide range of financial services to large and medium-sized Corporate Clients, Institutional Clients, and in some specific segments, Private Clients.

Haitong Bank is uniquely positioned to foster investment and capture cross-border flows between Asia, Europe, Latin America and Africa. Its cross-border platform leverages on the Bank's geographical coverage and the connectivity into China, firmly supporting the Shareholder's international strategy.

The Bank maintains its focus on growing client focused fee-generating activities with a light balance sheet, leveraging on its distribution capacity in the London and New York hubs.

At the end of 2016, Haitong Bank's business model was based on three main areas: Investment Banking (including the lending activities under Project Finance and Acquisition Finance & Other Credits), Markets and Wealth and Fund Management.

The Bank continues to deeply analyze its business structure, aiming to find the best organization model to support its core strategy: (i) Capturing the growing cross-border M&A flows from Chinese Companies and (ii) originate Emerging Markets, including Chinese Capital Markets Deals to Distribute in Europe and the Americas.

Haitong Bank aims to become a world leading China-focused investment bank, backed by its solid expertise and the Haitong Securities market position in Asia. As a full-service investment bank, we shaped our organization in three business streams: Investment Banking, Markets and Wealth and Fund Management.

Haitong Bank acknowledges that its risk management model is a key factor for achieving the Group's strategic objectives and provides additional line of defense in protecting enterprise value. Taking in consideration our current risk profile and the appropriate balance between enterprise value creation initiatives and control mechanisms intended to protect enterprise value, Haitong Bank is currently willing to accept a moderate risk tolerance to pursue sustainable growth and recognition.
Haitong Banks' overall risk vision assessment is set around the following three guiding principles:

- **Capital**: Haitong Bank aims to maintain prudent capital buffers on top of both internal and regulatory capital requirements;
- **Liquidity and Funding:** Haitong Bank as a whole and all its subsidiaries individually, aims to maintain a solid short-term position and a sustainable medium long-term funding profile;
- **Earnings**: The Group has the goal of generating recurrent earnings to guarantee its sustainability and a reasonable level of profitability for the Shareholder.

It is under this vision and sustained by a solid governance model that the Board of Directors fosters a strong culture of risk at all levels of the organization, as well as strict compliance with the law, regulations and rules of conduct.

The table below shows Haitong Bank's strategic risk ratios and indicators, related to Solvability and Liquidity:

TABLE II – Solvency and Liquidity Ratios

CRD IV/CRR Phased-in	Dec-16	Dec-15
Common Equity Tier 1 (CET1) Ratio	7.1%	9.9%
Total Capital Ratio	9.7%	10.0%
Liquidity Coverage Ratio	328%	147%

3.3 Strategies, Processes, Structure and Organization

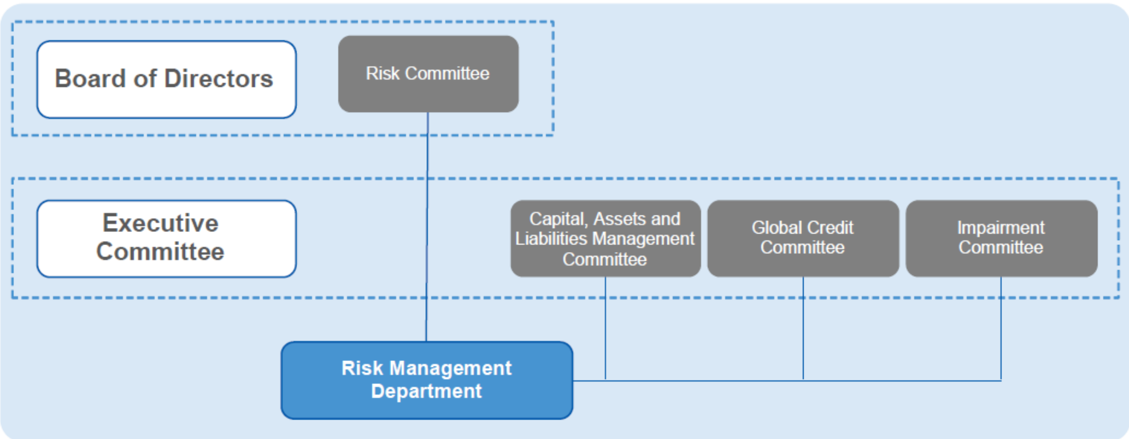
As a result of the recent acquisition of 100% of its share capital by Haitong Securities, Co., Ltd. in September 2015, Haitong Bank's management and governance model is being redefined viewing its alignment with the new shareholder's objectives and practices.

Acting with independence of business lines and units whose risks it controls, the Risk Management is a Bank's central organizational feature, enabling to make informed decision and assuring that the risk management processes approved by the Board of Directors are duly implemented and followed.

The Board of Directors is responsible for establishing the risk appetite policy and control systems framework that assure the Bank has the necessary skills and resources to meet its objectives.

The risk management function is independent from the business units, supervising all material risks to which Haitong Bank various units are exposed to and consistently incorporates risk, capital and liquidity concepts into the Group's strategy and business decisions.

The current structure of the relevant Committees for the Bank's Risk Management is summarized below:



RISK COMMITTEE

The Risk Committee is missioned to continuously monitor the development and implementation of the risk strategy and the risk appetite of the institution and verify whether these are compatible with a sustainable strategy in the medium and long-term and with the action programme and budget approved, advising the Board of Directors in these areas.

The Risk Committee is responsible for, in particular:

- Advising the Board of Directors on the Bank's present and future general risk appetite and risk strategy, taking into account all categories of risk, ensuring its alignment with the business strategy, objectives, corporate culture and values;
- Assisting the Board of Directors in supervising the execution of the Bank's risk strategy and in the fulfilment of their respective limits;
- Reviewing periodically the risk profile and risk policies and strategies of the institution;
- Assessing the consistency between the business model, strategy, the recovery plan, the remuneration policies and the budget, as well as the efficiency and effectiveness of the structure, procedures and instruments associated with the implementation and execution of the strategies of risk;
- Issuing recommendations on adjustments to the strategy of risk resulting from changes in the business model, market developments or business context where the Bank operates;
- Analysing and evaluating the methodology and its results to support the process of identification, evaluation and measurement of risks;
- Examining scenarios including stress tests in order to determine their impact on the risk profile of the Bank and assessing the resilience of the institution to changes caused by idiosyncratic, systemic or mixed factors;
- Analysing if the conditions of the products and services offered to clients take into consideration the Bank's business model and risk strategy, and presenting a correction plan to the Board of Directors whenever appropriate;
- Establishing if the incentives set in the Bank's remuneration policy take into consideration the risk, the capital, the liquidity and the expectations in respect of results, including revenues' data;
- Setting the risk reporting framework to be presented at Board of Directors meetings;
- Ensuring the existence of effective procedures for monitoring risk and monitoring internal control deficiencies related to the risk management framework;
- Specifying and reviewing the conditions of authority and independence to support the exercise of responsibilities for risk management, including the adoption of the work plan of the risk management function;

- Reviewing and monitoring periodically the scope and nature of the activities developed by Haitong Group Bank related to risk management; and
- Ensuring that the risk management function has adequate resources for the performance of its duties.

RISK MANAGEMENT DEPARTMENT

As an independent control function that holds the sufficient authority, stature and resources, the Risk Management Department aims to enable the Bank to make informed decision and to assure that the 'risk rules' approved by the management body are duly implemented and followed.

Being actively involved in all material decisions and aligned with parent guideline and practices, the Risk Management Department is responsible for:

- Advising the Risk Committee on the overall business strategy and risk strategy including risk appetite and its tolerance levels;
- Ensuring the institution has effective risk management processes in place to identify, measure and control all material risks as stipulated by the Risk Committee;
- Implementing an adequate identification, measurement, and control of all material risks, in accordance with the Risk Committee guidelines and instructions;
- Providing comprehensive and understandable information and reporting on risks, enabling the management body to understand the institution's overall risk profile and oversee the implementation of the institution's risk appetite;
- Advising the Risk Committee on the amounts, types and distribution of both internal capital and regulatory capital to cover adequately the risks of the institution.

CAPITAL, ASSETS AND LIABILITIES MANAGEMENT COMMITTEE

The Capital, Assets and Liabilities Management Committee is responsible, as per delegation of the Executive Committee, for:

- Submitting to the appraisal of the Executive Committee the policy and/or strategy, it has defined to be included in the Risk Appetite Policy of the Bank and the Group;

- Preparing the Funding and Capital Plan, as well as the Liquidity Contingency Plan, taking into account the policy and/or capital, funding and liquidity management strategy approved by the Executive Committee;
- Ensuring the fully effectiveness of the funding and liquidity management strategy of the Bank and the Group;
- Defining any mitigation measures to comply with the goals laid down in the liquidity management policy of the Bank and the Group;
- Collaborating closely with the Global Credit Committee and the Risk Committee in order to ensure a strategic alignment concerning the liquidity management policy;
- Reporting to the Executive Committee on a regular basis any decisions and initiatives within the scope of the duties described hereinabove.

GLOBAL CREDIT COMMITTEE

The Global Credit Committee shall assess and decide on the approval of:

- Operations proposed by each one of Europe's geographies (Portugal, Spain, United Kingdom and Poland);
- Limits of the delegation of powers of approval for Brazil Credit Committee;
- Operations where respective amounts or specific characteristics exceed the pre-established limits of the delegation of powers of approval for Brazil Credit Committee;
- New products and services of all geographies of the Bank;
- Individual, regional and global limits of exposure and risk tolerance, taking into account the risk appetite and risk policies approved by the Board of Directors.

IMPAIRMENT COMMITTEE

The Impairment Committee shall:

- Monitor and control the evolution of the loan portfolio, both individually and on an overall basis;
- Analyse and decide on impairment amounts to be assigned to credit clients;

- Decide on which credit must be followed by the Capital Structure Advisory Department;
- Review and confirm all clients identified with impairment triggers, default situations or restructured loans due to financial problems and inform the Executive Committee and the Heads of the areas concerned via the *Risk Weekly Report*.

3.4 Risk reporting and measurement systems and Policy for hedging and mitigating risk

The main risks in the activity of the Bank are credit, market, operational and capital risks. Each of these specific risk categories is addressed in detail in the respective chapters.

The risk mitigation policies and monitoring processes are also dealt with in a separate chapter of this report.

3.5 Governance system

The governance arrangements are described in the Corporate Governance section of the 2016 Annual Report.

4. Capital Adequacy

4.1 Own Funds and Capital Ratios

A brief description of the main components of own funds as of 31 December 2016 is given below.

Ordinary shares

Until 3 August 2014 the Bank was part of the Banco Espírito Santo, S.A. Group.

On 3 August 2014 the Bank of Portugal decided to apply a resolution measure to Banco Espírito Santo, S.A., the 100% shareholder of the Bank, and resolved on the incorporation of Novo Banco, S.A., with share capital of EUR 4.9 billion, into which the assets of Banco Espírito Santo, S.A. selected by the Bank of Portugal were incorporated. In this context, the Bank and its branches and subsidiaries were transferred to Novo Banco, S.A..

On 7 September 2015, the Bank's entire share capital was purchased by Haitong International Holdings Limited.

On 17 December 2015 the Bank made a EUR 100 million capital increase through the issuance of 20,000,000 shares with nominal value of EUR 5 each, which was subscribed and paid up by Haitong International Holdings Limited.
As of 31 December 2016 Haitong Bank had a share capital of EUR 426,269 thousand, represented by 85,253,800 shares with a nominal value of EUR 5 each, fully held by Haitong International Holdings Limited.

Share premium

As of 31 December 2016 and 2015 share premiums amounted to EUR 8,796 thousand, relating to the premium paid by the shareholders in the capital increase occurred in previous years.

Other equity instruments

In October 2010 the Group issued subordinated perpetual bonds with conditional interest for a total amount of EUR 50 million. Interest is conditioned and non-cumulative, and payable only if and when declared by the Board of Directors.

This conditioned interest corresponds to the application of an annual rate of 8.5% over nominal value, payable semi-annually. The reimbursement of these securities may be made in full, but not partially, after 15 September 2015, at Haitong Bank's option and subject to the prior approval of the Bank of Portugal. Given their characteristics, these bonds are considered equity instruments in accordance with the accounting policy described in Note 2.10 of the 2016 Annual Report.

In 2011 a total of EUR 46,269 thousand in other equity instruments was extinguished through the acquisition of own securities.

These bonds are subordinated relative to all liabilities of Haitong Bank and rank *pari passu* with any subordinated bonds with the same characteristics which may be issued by the Bank.

As of 31 December 2016 the amount outstanding of these bonds was EUR 3,731 thousand. In 2016 the Group paid interest in the amount of EUR 231 thousand, booked as a deduction to reserves (31 December 2015: EUR 225 thousand).

In May 2016 Haitong Bank, S.A. issued Fixed Rate Perpetual Deeply Subordinated Additional Tier 1 Resettable Instruments for a global amount of EUR 80,000 thousand, designated as “Fixed Rate Perpetual Deeply Subordinated Additional Tier 1 Resettable Instruments”. These instruments have a conditioned and non-cumulative payable only if and when declared by the Board of Directors.
Due to their features, such bonds are deemed to be capital instruments, in accordance with the accounting policy laid down in Note 2.10 of the Annual Report 2016.

4.2 Own Funds Requirements

Regulatory capital requirements are determined by the Bank of Portugal under the CRR (Regulation (EU) no. 575/2013) and CRD IV (Directive 2013/36/EU).

Under these regulatory frameworks, capital requirements are set to accommodate the level of risk the Bank is exposed to, which is measured through risk-weighted assets.

TABLE III – Own Funds

CAPITAL ADEQUACY (Part 1) - Phased-in

(thousands of euro)

Total Equity attributable to equity holders of the Bank (net from prudencial filters)	dez-16	dez-15
Share capital	426,269	426,269
Share premium	8,796	8,796
Net profit/loss	-96,181	-98,328
Other reserves	-111,455	-5,453
Minority interest given recognition in CET1 capital	24,027	28,900
Fair value filters (other comprehensive income)	-1,229	-3,094
Cumulative gains and losses due to changes in own credit risk on fair valued liabilities	2,110	-365
Goodwill	-7,668	-5,248
Other intangible assets	-9,693	-6,376
Deferred tax assets that rely on future profitability and do not arise from temporary differences	-24,572	-6,638
Deferred tax assets that rely on future profitability and arise from temporary differences	-7,766	-6,104
Excess of deduction from AT1 items over AT1 Capital	-	-12,727
Own Funds - Main Level 1	**202,639**	**319,634**
Capital instruments and subordinated loans eligible as AT1 capital	82,239	2,612
Minority interest given recognition in AT1 capital	2,139	2,097
Other transitional adjustments to AT1 Capital	-11,574	-17,435
Excess of deduction from AT1 items over AT1 Capital (deducted in CET1)	0	12,727
Own Funds - Level 1	**275,442**	**319,634**
Capital instruments and subordinated loans eligible as T2 capital	0	151
Minority interest given recognition in T2 capital	2,851	2,796
Other T2 capital elements or deductions	-25	-25
Other transitional adjustments	10	10
Own Funds - Total	**278,279**	**322,566**

At the moment and for reporting purposes related to prudential effects before the supervising authorities, the Group uses the Standard method for handling credit risk and operating risk ("The Standardized Approach" - TSA method).

TABLE IV – Own Funds Requirements

(thousands of euro)

CAPITAL ADEQUACY (Part 2)	dez-16	dez-15
2. Capital requirements (=Sum(2.1 to 2.7))	**229,919**	**259,230**
2.1. For credit, counterparty credit and dilution risks and free deliveries (=2.1.1+2.1.2)	**156,691**	**178,682**
2.1.1. Standardised approach (=2.1.1.1+2.1.1.2)	156,691	178,682
2.1.1.1. Standardised Approach exposure classes, excluding securitisation positions	156,633	176,054
2.1.1.1.1. Claims or contingent claims on central governments or central banks	0	0
2.1.1.1.2. Claims or contingent claims on regional governments or local authorities	479	501
2.1.1.1.3. Claims or contingent claims on Public Sector Entities	0	1,536
2.1.1.1.4. Claims or contingent claims on multilateral development banks	0	0
2.1.1.1.5. Claims or contingent claims on international organisations	0	0
2.1.1.1.6. Claims or contingent claims on institutions	27,054	18,887
2.1.1.1.7. Claims or contingent claims on corporates	81,461	111,862
2.1.1.1.8. Retail claims or contingent retail claims	0	0
2.1.1.1.9. Claims or contingent claims secured on real estate property	0	0
2.1.1.1.10. Past due items	27,030	13,814
2.1.1.1.11. Items belonging to regulatory high-risk categories	1,670	1,949
2.1.1.1.12. Claims on covered bonds	0	0
2.1.1.1.13. Claims on collective investments undertakings (CIU)	2,629	2,261
2.1.1.1.14. Other items	15,480	24,266
2.1.1.1.15. Equity positions	831	979
2.1.1.2. Securitisation positions under the Standardised Approach	58	2,628
2.1.2. IRB approach (=∑(2.1.2.1 to 2.1.2.5))	0	0
2.1.2.1. Not using own estimations of LGD and/or credit conversion factors	0	0
2.1.2.1.1. Claims or contingent claims on central governments or central banks	0	0
2.1.2.1.2. Claims or contingent claims on institutions	0	0
2.1.2.1.3. Claims or contingent claims on corporates	0	0
2.1.2.2. Using own estimations of LGD and/or credit conversion factors	0	0
2.1.2.2.1. Claims or contingent claims on central governments or central banks	0	0
2.1.2.2.2. Claims or contingent claims on institutions	0	0
2.1.2.2.3. Corporate claims or contingent corporate claims	0	0
2.1.2.2.4. Retail claims or contingent retail claims	0	0
2.1.2.3. Equity positions	0	0
2.1.2.4. Securitisation positions	0	0
2.1.2.5. Other assets not related to bond loans	0	0
2.2. Settlement risk	**0**	**0**
2.3. Capital requirements for position, foreign-exchange and commodities risks (=2.3.1+2.3.2)	**38,015**	**34,229**
2.3.1. Standardised approach (=∑(2.3.1.1 to 2.3.1.4))	38,015	34,229
2.3.1.1. Traded debt instruments	30,287	21,446
2.3.1.2. Equity	2,432	190
2.3.1.3. Foreign exchange risks	5,296	12,593
2.3.1.4. Commodities risks	0	0
2.3.2. Internal models approach	0	0
2.4. Capital requirements for operational risk	25,020	**30,615**
2.4.1. Basic indicator approach	0	0
2.4.2. Standard method	25,020	30,615
2.4.3. Advanced measurement approach	0	0
2.5. Capital requirements - Fixed overhead	**0**	**0**
2.6. Capital requirements on unilateral adjustment of credit evaluation	**0**	**0**
2.7. Capital requirements for Credit Valuation Adjustment (CVA)	**10,193**	**15,705**

At the end of 2016 the Bank had a EUR 48 million own funds surplus over the risks incurred.

TABLE V – Capital Adequacy

CAPITAL ADEQUACY (Part 3)	dez-16	dez-15
		(thousands of euro)
Surplus(+)/Deficit(-) of total capital	48,359	63,336
Total capital ratio (%)	9.68%	10.0%
Capital adequacy of the financial conglomerate		

4.3 Internal Capital Adequacy Self-Assessment Process (ICAAP)

The self-assessment process of internal capital adequacy (ICAAP) is carried out every year in accordance with the regulations in force. Its purpose is to guarantee that the risks to which the Bank is exposed are adequately assessed and that the available capital is adequate relative to its current and prospective risk profile.

The ICAAP exercise, undertaken within the scope of the Bank's Risk Appetite Policy, follows an internal governance model that ensures the involvement of the Executive Committee in the apprehension of its conclusions.

The ICAAP exercise is preceded by the identification of the material risks to which the Bank's activity is subject. Material risks are identified through an analysis of the frequency of occurrence of events associated with each risk and their respective impact, based on Haitong Bank's risk taxonomy.

The ICAAP process encompasses all the risks considered in Basel's Pillar I, even when not reaching relevant materiality levels, and all the risks considered material. The risks considered materially relevant in the last ICAAP exercise were the operational risk, concentration risk, pension fund risk, interest rate risk of the banking book, reputational risk, business strategic risk, currency risk, market risk of the trading book and sovereign risk.

Besides providing a snapshot of the risks at the exercise reference date, the ICAAP process also includes a prospective component where the Bank's business plan for the next three years is assessed. In order to test the Bank's resilience to adverse periods the projected central scenario is subject to stress impacts with severely penalizing factors for the Bank's performance.

The ICAAP's results thus allow the Bank's management to gauge whether the organization's level of capitalization is adequate vis-à-vis the risks arising from its activity, and whether the medium-term business plan is sustainable and consistent with the Risk Appetite policy defined.

4.4 Leverage Ratio

The leverage ratio is defined as the capital measure (given by the amount of Tier 1 capital) divided by the total exposure measure, which corresponds to the sum of the exposure values of all the Bank's assets and off-balance sheet items, after some adjustments (namely the application of credit conversion factors to off-balance-sheet items or the exclusion of elements deducted to own funds).

The leverage ratio is subject to a period of observation by the supervision authorities so as to permit to monitor the evolution of its components and the behavior of the ratio relative to the requirements based on each exposure type. A regulatory requirement for the leverage ratio must be maintained from 1 January 2018 onwards. At present the minimum reference ratio stipulated by the regulatory rules is 3% until the end of 2017.

As of 31 December 2016 Haitong Bank's leverage ratio was 6,1% (transitory regime), as shown in the table below.

TABLE VI – Leverage Ratio

(thousands of euro)

	dez-16	dez-15
Total Exposure	**4,608,381**	**4,243,738**
Repo-style transactions according to article 220 of CRR	514,059	136,750
Derivatives: Market value	372,825	358,203
Derivatives: Add-on Mark-to-Market Method	100,427	124,479
Undrawn credit facilities, which may be cancelled unconditionally at any time without notice	302	1,299
Medium/low risk trade related off-balance sheet items	28,798	19,256
Other off-balance sheet items	177,554	237,427
Other assets	3,414,416	3,366,323
Capital Tier 1 - phased-in	**275,442**	**319,634**
Tier 1 regulatory adjustments	-60,392	-45,260
Regulatory adjustments regarding own credit risk	2,110	-365
Leverage ratio - phased-in	**6.1%**	**7.6%**

Considering its leverage ratio as at 31 December 2016 (6.1%) and the minimum reference level (3%) Haitong Bank does not incur in the risk of excessive leverage.

5. Counterparty credit risk exposures

5.1 Determination of the value at risk

Counterparty credit risk arising from treasury transactions, foreign exchange transactions and transactions with derivative financial instruments is quantified. The value at risk is calculated as the sum of the positive market value of the transactions and the potential change in market value over the transactions' maturity. The negative market values of transactions and the amounts received as guarantee are deducted to value at risk whenever there are netting agreements or collateral agreements established with the counterparties.

In case of default by the counterparty, netting agreements permit the early termination of outstanding operations at the respective market value, and determine a single net settlement amount. The collateral agreements entered by the Bank provide for the lodging of deposits with the party for which the net market value of the ongoing transactions is positive, and these deposits are also taken into account in the calculation of the netted exposure. The establishment of collaterals through real estate assets or other guarantees is not usual.

For prudential purposes the risk-weighted value of derivative instruments is calculated according to the mark-to-market method defined in Part III, Title II, Chapter 6, section 3 of the Regulation (EU) no. 575/2013. The risk-weighted value of repurchase transactions is calculated according to the rules defined for the standardized approach in Part III, Title II, Chapter 6, section 5 of the Regulation (EU) no. 575/2013.

5.2 Approval and Monitoring Process

All transactions involving credit or market risk, as well as the risk limits framework for each Haitong Bank business unit (in Portugal, Spain, Poland, the United States of America, Mexico, Brazil, the United Kingdom and Ireland) are approved by the Global Credit Committee.

This committee has the following specific responsibilities:

- Evaluate and decide on operations proposed by each one of Europe's geographies (Portugal, Spain, United Kingdom and Poland);
- Define limits of the delegation of powers of approval for Brazil Credit Committee;
- Approve operations where respective amounts or specific characteristics exceed the pre-established limits of the delegation of powers of approval for Brazil Credit Committee;
- Approve new products and services of all geographies of the Bank;
- Establish individual, regional and global limits of exposure and risk tolerance, taking into account the risk appetite and risk policies approved by the Board of Directors.

This ensures that the maximum exposure limits approved per counterparty, rating and sector are attributed taking into account the specific features of markets, products, currencies and maturities.

The approval of limits is preceded by an in-depth analysis of the markets, particularly regarding their liquidity, to ensure that the Bank's strategic objectives can be reached at both individual and consolidated level. The use of internal and external ratings for purposes of establishing portfolio ceilings that limit credit approvals by both product and rating levels, inhibit credit approvals for the worse risk ratings.

The credit risk monitoring and control activities aim to quantify and control the evolution of credit risk and to allow early definition and implementation of particular measures to deal with specific situations where there is a deterioration of risk – with a view to mitigating potential loses -, as well as to outline global strategies for credit portfolio management.

In this context, and with the central aim of complying with risk management standards, the credit risk monitoring function and its implementation are objectively considered as one of the top priorities of the risk management and control system. This function comprises the following main processes:

- Daily and weekly portfolio monitoring;

Haitong Bank's teams in each geography, through a straight articulation with the risk management team in Portugal, ensure risk monitoring and control routines are properly implemented. This involves the following processes:

- Daily collection, preparation, control and reporting to the different business areas of information on loans, securities portfolios, derivatives and other products' positions and use level of approved limits;
- Weekly risk reporting on each category of risk, namely the risk appetite of the Bank's loan portfolio by type of instrument, the total exposure by instrument, country, rating, industry sector, maturity, margin, capital requirements, new/recent approvals by the Global Credit Committee, limits exceeded, impairment signs, among others;
- Preparation of support material for external and internal reporting on credit and counterparty risk.

- Monitoring of clients with impairment triggers;
- To strengthen monitoring and control of the loan portfolio the Impairment Committee has the specific purpose of assessing the Bank's loan portfolio provisions, especially for impaired exposures. The Committee uses credit risk model information in conjunction with the analysis, among others, of:
    - The Client's overall exposure and the existence of overdue loans;

- o The economic and financial viability of the Client's business and its capacity to generate sufficient resources to service its debt in the future;
- o The existence of privileged creditors;
- o The existence, nature and estimated value of collaterals;
- o The Client's exposure in the financial sector;
- o The amount and timing of expected recoveries.

An exposure is considered to be impaired, when: (i) there is objective evidence of impairment resulting from one or more events occurring after its initial recognition; (ii) the event or events have an impact on the recoverable value of the future cash flows of the loan or loan portfolio, as far as this can be reasonably estimated.

- Global analysis of the credit portfolio risk profile;

Credit portfolio management is an ongoing process that requires interaction among the various teams responsible for the management of risk during the different stages of the credit process. The risk appetite of credit portfolios, specifically in what concerns the evolution of credit exposure and the monitoring of credit losses, is reported on a monthly basis to the Executive Committee.

Portfolio ceilings are used to monitor the evolution of the risk appetite of the various credit portfolios. Compliance with the established ceilings is monitored on a regular basis. The resulting information is distributed to the business areas and to the Global Credit Committee.

As to concentration risk – the risk that arises from the possibility of an exposure or group of exposures producing sufficiently large losses to undermine an institution's solvency - Haitong Bank has established limits for the largest individual exposures and for exposures by sector. The regular monitoring of these limits, together with that of regulatory limits, namely for Large Exposures, reinforces the Bank's monitoring and follow-up framework for credit risk concentration. The impact of concentration risk is incorporated in the economic capital model for credit risk.

Every year the Bank submits to the Bank of Portugal the reporting template for compliance with Instruction 5/2011 on Concentration Risk, which contains the calculation of the individual concentration levels.

The detailed calculation of risk-weighted assets for counterparty risk (Regulation (EU) no. 575/2013) and credit derivatives is presented in the following section.

5.3 Quantitative Information

TABLE VII – Counterparty Credit Risk - Standardized Approach

(thousands of euro)

	December, 2016			Capital requirements	
	Original exposure	Credit risk mitigation techniques with substitution effects on the original net exposure	Fully adjusted exposure	dez-16	dez-15
Repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions	1,696,159	0	1,696,060	95,620	777
Derivative	477,496	0	473,252	390,620	284,781
Contractual cross-product netting	0	0	0	0	0

TABLE VIII – Credit derivatives

Credit portfolio (thousands of euro)

Credit derivatives transactions	dez-16		dez-15	
	Long positions	Short positions	Long positions	Short positions
a) Credit default swaps	66,407	0	39,221	9,833
b) Total return swaps	0	0	0	0
c) Credit linked notes	0	0	0	0
d) Other credit derivatives	0	0	0	0

Intermediation activities (thousands of euro)

Credit derivatives transactions	dez-16		dez-15	
	Long positions	Short positions	Long positions	Short positions
a) Credit default swaps	23,000	229,071	33,000	424,482
b) Total return swaps	0	0	0	0
c) Credit linked notes	220,035	990	333,594	2,671
d) Other credit derivatives	0	0	0	0

6. Capital buffers

Under this regulatory framework, the minimum CET1 ratio is 4.5%, the minimum Tier1 ratio is 6% and the minimum Total capital ratio is 8%.

In addition, these minimum ratios are supplemented by the capital conservation buffer. CRD IV requirements permit to phase in the impact of this buffer, beginning on January 1, 2016, in increments of 0.625% per year until it reaches 2.5% of RWAs on January 1, 2019.

Still under the CRD IV capital buffers context, Bank of Portugal decided in November 2016 to impose a capital surcharge to six Portuguese banking groups classified as O-SIIs (Other Systemically Important Institutions) in the scope of its annual revision of the identification of the imposition of capital buffers, pursuant to Article 138-R (2) of the Legal Framework of Credit Institutions and Financial Companies (RGICSF). The O-SII buffer will be effective from January 1, 2018. According to Bank of Portugal's decision, Haitong Bank was, at this point in time, excluded from the scope of application of this macro-prudential buffer.

The regulation also provides a counter-cyclical capital buffer of up to 2.5%, to be imposed in the event that national supervisors deem it necessary in order to counteract excessive credit growth in Portugal. As of January 1, 2017, Bank of Portugal decided not to impose any additional counter-cyclical capital buffer, by setting a 0% of total risk exposure amount). This decision applies to the first quarter of 2017 and will be subject to revision on a quarterly basis.

7. Indicators of global systemic importance

Haitong Bank, S.A. has not been identified as a Global Systemic Importance Institution (G-SII) in accordance with Article 131 of Directive 2013/36/EU.

8. Credit Risk

8.1 Definition and Methods

Credit risk represents the potential financial loss arising from the failure of an obligor or counterparty to honor its contractual obligation. As the major risk to which the Bank is exposed, credit risk management and control are supported by a robust system that permits to identify, assess, quantify and report risk. A policy of constant monitoring of the credit portfolios has been pursued that privileges the interaction of various teams involved in the risk management on the course of the credit process lifetime.

Loans and advances to customers include loans and advances originated by the Bank, which are not intended to be sold in the short-term, being recognized on the date the cash is advanced to customers.

Loans and advances to customers are derecognized from the balance sheet when:

I. the Group's contractual rights to receive the cash flows have expired,

II. the Group has transferred substantially all the risks and rewards of ownership, or

III. although retaining some but not substantially all of the risks and rewards of ownership, the Bank has transferred the control over the assets.

Loans and advances to customers are initially recorded at fair value plus transaction costs and are subsequently measured at amortized cost, using the effective interest rate method, net of impairment losses.

The Group assesses, at each balance sheet date, whether there is objective evidence of impairment within its loan portfolio. Impairment losses identified are recognized in the income statement, and are subsequently reversed through the income statement if, in a subsequent period, the amount of the impairment losses decreases.

A loan or a loan portfolio, defined as a group of loans with similar credit risk characteristics, is impaired when:

I. there is objective evidence of impairment resulting from one or more events occurring after its initial recognition;

II. that event (or events) has an impact on the recoverable amount of the estimated future cash flows of that loan or of the loan portfolio, that can be reliably estimated.

The Group first assesses whether objective evidence of impairment exists for each loan individually. For this assessment and in identifying the impaired loans on an individual basis, the Bank uses the information that feeds the credit risk models implemented and takes into consideration, amongst others, the following factors:

- the aggregate exposure to the customer and the existence of non-performing loans;
- the viability of the customer's business model and its ability to generate sufficient cash flows to service its debt obligations in the future;
- the existence of privileged creditors;
- the existence, nature and estimated realisable value of collaterals;
- the exposure of the customer within the financial sector;
- the amount and timing of expected recoveries.

When loans have been individually assessed and no evidence of loss has been identified, these loans are grouped together on the basis of similar credit risk characteristics for the purpose of evaluating the impairment on a portfolio basis (collective assessment). Loans that are assessed individually and found to be impaired are not included in a collective assessment for impairment.

If an impairment loss is identified on an individual basis, the amount of the impairment loss to be recognized is calculated as the difference between the book value of the loan and the present value of the expected future cash flows (considering the recovery period), discounted at the original effective interest rate. The carrying amount of impaired loans is reduced through the use of an allowance account. If a loan has a variable interest rate, the discount rate for measuring the impairment loss is the current effective interest rate determined under the contract rules.

The calculation of the present value of the estimated future cash flows of a collateralized loan reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral.

When a loan is considered by the Bank as uncollectible and an impairment loss of 100% has been recognized, it is written off against the assets.

The Bank classifies its other financial assets at initial recognition taking into consideration the intention inherent to them, under the following categories:

- <u>Financial assets at fair value through profit or loss</u>

This category includes: (i) financial assets held for trading, which are those acquired principally for the purpose of selling in the short term or that are owned as part of a portfolio of financial assets, normally securities, for which there is evidence of a recent actual pattern of short-term profit taking and (ii) financial assets that are designated at fair value through profit or loss at inception, with changes being recognized in the income statement.

The Bank classifies, at inception, certain financial assets at fair value through profit or loss when:

- such financial assets are managed, measured and their performance evaluated on a fair value basis;
- such financial assets are being hedged (on an a economical basis), in order to eliminate an accounting mismatch; or
- such financial assets contain an embedded derivative.

The structured products acquired by the Bank corresponding to financial instruments containing one or more embedded derivatives meet the above mentioned conditions, and, in accordance, are classified under the fair value through profit or loss category.

- Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets: (i) intended to be held for an indefinite period of time, (ii) designated as available-for-sale at initial recognition or (iii) that are not classified in the other categories referred to above

The Bank's 2016 Annual Report contains a detailed description of the methodologies used for i) Initial recognition, initial measurement and derecognition; ii) Subsequent measurement; iii) Reclassification between categories; and iv) Impairment of the referred categories.

8.2 Quantitative Information and Value Adjustments and Provisions

This point presents the breakdown of exposures:

1) by exposure class and geographical location (tables IX and X)
2) by industry sector and residual maturity (tables XI and XII)
3) Breakdown of overdue and impaired exposures by industry sector and geographical location (tables XIII and IV)
4) Value adjustments and provisions table (table XV)

TABLE IX – Activity Breakdown by Class of Exposure

(thousands of euro)

Risk Classes	Original exposure		Original exposure (average)	
	dez-16	dez-15	dez-16	dez-15
Standardised approach	**4,990,025**	**4,609,379**	**4,710,393**	**4,490,350**
Central governments or central banks	1,419,567	590,506	909,228	324,318
Regional governments or local authorities	4,258	4,748	4,524	1,644
Public Sector Entities	0	19,329	3,222	6,799
Institutions	1,191,674	1,100,369	1,070,595	968,009
Corporates	1,329,349	1,679,703	1,533,545	2,408,749
Retail portfolio	0	0	0	3,271
Positions guaranteed by real estate	0	0	0	0
Past due items	608,048	520,267	567,545	233,950
Collective investments undertakings (CIU)	37,113	32,688	34,350	72,174
High-risk regulatory categories items	14,030	16,460	14,137	5,603
Other items	359,972	616,280	542,004	432,235
Shares	22,178	23,600	26,734	27,845
Securitisation positions on standardised approach	3,836	5,426	4,510	5,753

TABLE X – Activity Breakdown by Region

(as a percentage of original risk position)

Risk Classes	dez-16 Original risk position National	dez-16 International Spain	dez-16 International New York	dez-16 International Brazil	dez-16 Total	dez-15 Original risk position National	dez-15 International Spain	dez-15 International New York	dez-15 International Brazil	dez-15 Total
Standardised approach	**43.5%**	**8.5%**	**0.3%**	**47.7%**	**100.0%**	**50.8%**	**13.7%**	**0.2%**	**35.3%**	**100.0%**
Central governments or central banks	9.0%	0.0%	0.0%	19.5%	28.4%	5.1%	0.0%	0.0%	7.7%	12.8%
Regional governments or local authorities	0.0%	0.1%	0.0%	0.0%	0.1%	0.0%	0.1%	0.0%	0.0%	0.1%
Public Sector Entities	0.0%	0.0%	0.0%	0.0%	0.0%	0.4%	0.0%	0.0%	0.0%	0.4%
Institutions	5.2%	1.4%	0.2%	17.0%	23.9%	7.2%	1.9%	0.1%	14.7%	23.9%
Corporates	15.7%	2.7%	0.0%	8.2%	26.6%	20.0%	3.8%	0.0%	12.6%	36.4%
Retail portfolio	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Past due items	5.2%	4.1%	0.0%	2.9%	12.2%	3.3%	7.8%	0.0%	0.2%	11.3%
Collective investments undertakings (CIU)	0.7%	0.0%	0.0%	0.1%	0.7%	0.7%	0.0%	0.0%	0.0%	0.7%
High-risk regulatory categories items	0.3%	0.0%	0.0%	0.0%	0.3%	0.4%	0.0%	0.0%	0.0%	0.4%
Other items	7.2%	0.0%	0.0%	0.0%	7.2%	13.4%	0.0%	0.0%	0.0%	13.4%
Shares	0.3%	0.1%	0.0%	0.1%	0.4%	0.3%	0.1%	0.0%	0.1%	0.5%
Securitisation positions on standardised approach	0.1%	0.0%	0.0%	0.0%	0.1%	0.1%	0.0%	0.0%	0.0%	0.1%
% Total original risk position	**43.5%**	**8.5%**	**0.3%**	**47.7%**	**100.0%**	**50.8%**	**13.7%**	**0.2%**	**35.3%**	**100.0%**

TABLE XI – Exposures Breakdown by Industry Sector

Risk Classes	Other manufacturing industries		Construction		Commerce		Transport and comunication		Financial activities		Real estate activities		Services		Other sectors	
	dez-16	dez-15	dez-16	dez-15	dez-16	dez-15	dez-16	dez-15	dez-16	dez-15	dez-16	dez-15	dez-16	dez-15	dez-16	dez-15
Standardised approach																
Central governments or central banks	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	16.2%	6.6%	0.0%	0.0%	0.0%	0.0%	12.2%	6.1%
Regional governments or local authorities	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%
Public Sector Entities	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.4%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Institutions	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	23.9%	23.9%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Corporates	1.5%	2.1%	2.7%	5.8%	0.2%	1.1%	5.4%	7.3%	5.7%	4.1%	0.2%	0.3%	3.3%	4.4%	7.6%	11.3%
Past due items	1.1%	0.8%	2.1%	1.3%	1.4%	0.8%	1.8%	1.1%	0.3%	0.0%	0.0%	1.5%	4.8%	5.1%	0.6%	0.7%
Collective investments undertakings (CIU)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.7%	0.7%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
High-risk regulatory categories items	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.3%	0.4%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Other items	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	7.2%	13.4%
Shares	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.4%	0.4%	0.0%	0.0%
Securitisation positions on standardised approach	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total	**2.6%**	**2.9%**	**4.8%**	**7.1%**	**1.6%**	**1.9%**	**7.3%**	**8.9%**	**47.2%**	**35.8%**	**0.2%**	**1.9%**	**8.5%**	**9.9%**	**27.8%**	**31.5%**

TABLE XII – Exposures Breakdown by Residual Maturity

Classes de Risco	RM < 1 year		1 year < RM < 5 years		5 years < RM < 10 years		VR > 10 Anos	
	dez-16	dez-15	dez-16	dez-15	dez-16	dez-15	dez-16	dez-15
Standardised approach								
Central governments or central banks	13.0%	8.7%	15.5%	4.1%	0.0%	0.0%	0.0%	0.0%
Regional governments or local authorities	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%
Public Sector Entities	0.0%	0.0%	0.0%	0.4%	0.0%	0.0%	0.0%	0.0%
Institutions	1.8%	0.5%	19.8%	19.2%	0.8%	1.5%	1.4%	2.6%
Corporates	2.7%	4.7%	11.3%	16.8%	0.8%	1.3%	11.8%	13.6%
Retail portfolio	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Past due items	5.1%	2.1%	3.5%	4.5%	0.6%	0.1%	3.0%	4.5%
Covered bonds	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Collective investments undertakings (CIU)	0.4%	0.4%	0.3%	0.4%	0.0%	0.0%	0.0%	0.0%
High-risk regulatory categories items	0.3%	0.4%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Other items	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	7.2%	13.4%
Shares	0.4%	0.5%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Securitisation positions on standardised approach	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total	**24%**	**17%**	**51%**	**45%**	**2%**	**3%**	**23%**	**34%**

TABLE XIII – Breakdown of overdue and impaired exposures

(thousands of euro)

	Outstanding Exposure		Past due exposure		Impairment [1]	
	dez-16	dez-15	dez-16	dez-15	dez-16	dez-15
Agriculture	13,176	11,408	0	0	93	69
Mining	3,686	42,616	0	0	0	0
Food, beverage and tobaco	12,157	56,315	0	199	408	5,179
Shoes	0	2,723	197	0	98	14
Paper industry	14,186	0	0	0	0	0
Refining and oil	2,168	365	0	0	0	0
Chemicals and rubber	13,622	9,345	16,907	24,914	21,871	7,532
Non-metallic minerals	10,262	6,077	0	0	77	696
Metallic products	30,290	38,218	118	0	155	5,650
Production of machinery, equipment and electric devices	23,708	15,609	0	0	120	125
Production of transport material	521	1,744	0	0	0	9
Electricity, gas and w ater	281,973	299,171	6,652	5,598	13,832	12,599
Collection, purification and distribution of w ater, sanitation, w aste management and cleaning	23,146	17,217	5,362	5,959	1,956	167
Construction	66,115	189,085	87,324	37,047	24,743	22,707
Real estate activities	2,914	5,842	0	0	1,584	29
Wholesale and retail; repair of motor vehicles and motorcycles	73,744	92,165	1,974	1,519	350	18,994
Transports and storage	275,155	326,659	26,983	8,376	15,940	6,806
Tourism	0	0	0	12,930	0	12,932
Printing and publishing	9,891	9,856	0	640	2,435	52
Radio and television broadcast	0	170	0	0	0	6
Communication activities	8,746	17,272	0	0	519	79
IT Consulting	22,370	15,831	0	0	22,370	15,831
Monetary intermediation	272,712	235,543	0	0	0	0
Holding companies	182,235	186,611	47,098	4,212	116,393	105,582
Financial activities	160,853	63,917	793	623	15,134	10,828
Real estate activities	11,598	51,432	0	27,207	2,026	55,502
Services provided to companies	59,772	68,758	56	3,741	1,454	7,384
Administrative activities and suporting services	5,905	4,456	0	0	4,010	2
Travelling activities	0	7,703	15,520	15,520	15,520	15,559
Renting activities	44,790	1,761	0	63,773	25,790	49,211
Public services	1,533,416	1,136,596	0	0	0	0
Local public services	4,100	5,581	0	0	20	23
Human health activities and social support	32,733	36,060	0	0	99	103
Arts, entretainment, sports and recreation activities	18,963	594	316	0	15,789	117
Other service activities	4,591	38,744	0	3,142	24	18,605
Consumer loans	370	358	0	0	0	0
Loans to individuals	0	33	0	0	0	2
	3,219,868	**2,995,835**	**209,300**	**215,400**	**302,810**	**372,394**

(1) Does not include non-current assets held for sale.

Note:

"On-balance sheet exposures" are stated gross of impairment. The figures presented include asset items. Hence, in addition to "Total Loans", "Financial Assets Held for Trading" and "Available-for-Sale Financial Assets" are also considered for this purpose.

TABLE XIV – Breakdown of overdue and impaired exposures by region

(thousands of euro)

	Exposure		Past due exposure		Impairment [1]	
	dez-16	dez-15	dez-16	dez-15	dez-16	dez-15
National	1,010,904	856,751	93,912	26,987	124,630	90,116
Spain	45,371	94,166	45,198	40,886	51,088	79,716
United States of America	0	0	0	0	0	0
Brazil	1,570,307	1,393,130	5,559	6,158	29,116	25,066
Cayman Islands	50,722	84,714	0	0	4,626	2,894
Ireland	449,963	536,290	59,593	135,847	89,586	170,713
Poland	92,328	30,506	5,038	5,521	3,763	3,888
Mexico	0	0	0	0	0	0
United Kingdom	273	278	0	0	0	0
Total	**3,219,868**	**2,995,835**	**209,300**	**215,400**	**302,810**	**372,394**

TABLE XV – Value Adjustments and Provisions

(thousands of euro)

Impairment, provisions and amortisations	dez-16	dez-15	dez-14
Opening balance	**400,896**	**356,222**	**153,363**
Charges	129,171	149,757	258,630
Uses	-137,135	-21,207	-39,132
Re-adjustments/Cancellations	-74,556	-77,766	-14,348
Other adjustments	0	0	-2,491
- Other and Adjustment for exchange rate differences	9,464	-6,110	200
- Transfers of provisions	4,197	0	0
Closing balance	**332,037**	**400,896**	**356,222**

As at 31 December 2016 the Bank had the following exposures and corresponding outstanding provisions:

TABLE XVI – Outstanding provisions

(thousands of euro)

	dez-16		dez-15	
	Balance exposure	Provisions	Balance exposure	Provisions
Available for sale financial assets	790,346	46,861	468,311	37,541
Loans and advances to banks	853,687	15,419	258,795	15,397
Loans and advances to customers	841,095	255,949	1,041,341	334,849
Non-current assets held for sale	3,600	0	3,600	0
Other assets	409,666	13,808	629,444	13,107
Provisions for guarantees and other commitments	N.A.	1,647	N.A.	5,001
Provisions for liabilities	N.A.	7,168	N.A.	5,809

The following provision reinforcement/charges and reversals resulting from the recognition of impairments were made in 2016, with an impact on the Bank's consolidated income statement:

TABLE XVII – Impairment nature

(thousands of euro)

	dez-16		dez-15	
	Charges	Uses	Charges	Uses
Available for sale financial assets	4,769	-4,551	6,429	10,413
Loans and advances to banks	965	943	149	-32
Loans and advances to customers	116,687	195,587	132,125	81,056
Held-to-maturity investments	0	0	0	0
Non-current assets held for sale	0	0	0	0
Other assets	6,750	6,049	11,053	13,647
Provisions for liabilities (net)	3,768	2,409	3,334	41,668

8.3 Calculation of risk-weighted assets

As referred further up, following the carve-out process from Novo Banco, Haitong Bank currently uses the Standardized Approach to calculate risk-weighted assets for Credit Risk.

In the standardized approach, credit exposures are previously classified within regulatory risk classes according to their characteristics (e.g., type of counterparty, type of product). After making all the adjustments foreseen in Part III, title II of Regulation (EU) 575/2013 to the value of these exposures, namely relating to provisions, risk mitigation instruments or credit conversion factors (CCFs), they are attributed the appropriate regulatory risk weights. The risk weights applicable to credit exposures depend on the external ratings at any given time attributed to them. Once the value of the exposures to be weighted and the respective weights have been determined, the risk-weighted assets permitting to calculate the Bank's solvency are finally estimated.

The Haitong Bank Group uses the external ratings assigned to determine the risk weights applicable to exposures to central governments and central banks, institutions and corporates, in accordance with the rules set out in Regulation (EU) 575/2013.

For risk weighting purposes, exposures to debt securities are allocated the ratings specifically assigned to the respective issues. If no specific ratings exist for the issues, the ratings assigned to the respective issuers, when such exist, are used. Credit exposures other than represented by debt securities are only assigned the rating of the respective issuers, when such exist.

<u>Quantitative Information</u>

The Bank's credit risk exposure is presented in the tables below.

TABLE XVIII – Standardized Approach

(thousands of euro)

	Risk weights							
	0%	20%	50%	75%	100%	150%	Other	TOTAL
1. Original exposure by risk classes								
Central governments or central banks	1,418,478	0	0	0	1,088	0	0	1,419,567
Regional governments or local authorities	0	4,258	0	0	0	0	0	4,258
Public Sector Entities	0	0	0	0	0	0	0	0
Institutions	0	796,932	173,907	0	220,835	0	0	1,191,674
Corporates	0	0	0	0	1,329,349	0	0	1,329,349
Past due items	0	0	0	0	360,123	247,925	0	608,048
Collective investments undertakings (CIU)	0	0	0	0	37,113	0	0	37,113
High-risk regulatory categories items	0	0	0	0	0	14,030	0	14,030
Other items	207,767	0	0	0	124,672	0	27,532	359,972
Shares	0	0	0	0	22,178	0	0	22,178
Securitisation positions on standardised approach	2,846	0	914	0	0	0	76	3,836
Total original exposures	**1,629,092**	**801,190**	**174,820**	**0**	**2,095,359**	**261,956**	**27,608**	**4,990,025**
2. Exposure by risk classes (reserve base of risk weights)								
Central governments or central banks	1,022,284	0	0	0	0	0	0	1,022,284
Regional governments or local authorities	0	29,944	0	0	0	0	0	29,944
Public Sector Entities	0	0	0	0	0	0	0	0
Institutions	0	253,721	173,907	0	200,472	0	0	628,100
Corporates	0	0	0	0	1,018,259	0	0	1,018,259
Past due items	0	0	0	0	73,515	176,238	0	249,753
Collective investments undertakings (CIU)	0	0	0	0	32,859	0	0	32,859
High-risk regulatory categories items	0	0	0	0	0	13,918	0	13,918
Other items	207,767	0	0	0	124,672	0	27,532	359,972
Shares	0	0	0	0	10,389	0	0	10,389
Securitisation positions on standardised approach	0	0	914	0	0	0	76	990
Total exposures	**1,230,051**	**283,665**	**174,820**	**0**	**1,460,166**	**190,156**	**27,608**	**3,366,467**
3. TOTAL capital requirements (=Σ(2."X"risk weights))	**0**	**56,733**	**87,410**	**0**	**1,460,166**	**285,233**	**69,097**	**1,958,640**

9. Encumbered and unencumbered assets

With the purpose of keeping the market informed about the liquidity and funding profile of credit institutions and promoting transparency with regard to the encumbrance of assets, article 443 of Regulation (EU) no. 575/2013 of the European Parliament and of the Council of 26 June 2013 requires the disclosure of information about encumbered and unencumbered assets.

Based on this regulatory framework, on 15 January 2014 the Bank of Portugal issued instruction no. 28/2014, which stipulates that the credit institutions and investment companies listed in article 4-A (sub-paragraphs a) to d)) of the Regime Geral das Instituições de Crédito e Sociedades Financeiras (the Portuguese General Law on Credit Institutions and Financial Companies) that fall under the scope of Regulation (EU) no. 575/2013 and Directive 2013/36/ EU of the European Parliament and of the Council of 26 June (Directive no. 2013/36/EU) required to provide information on a consolidated basis to the Bank of Portugal, must disclose consolidated information about encumbered and unencumbered assets.

TABLE XIX – Encumbered Assets

(thousands of euro)

Assets	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Unencumbered assets
Assets of the reporting institution	**1,577,837**		**3,176,910**	
Equity instruments	0	0	43,090	43,090
Debt securities	1,393,485	0	475,068	475,068
Other assets	182,669		823,858	

(thousands of euro)

Collateral received	Fair value of encumbered collateral received or own debt securities issued	Fair value of collateral received or own debt securities issued available for encumbrance
Collateral received by the reporting	**4,208**	**0**
Equity instruments	0	0
Debt securities	4,208	0
Other collateral received	0	0
Own debt securities issued other than own covered bonds or ABS	**0**	**268,736**

(thousands of euro)

Encumbered assets, encumbered collateral received and matching liabilities	Liabilities, contingent liabilities and securities lent	Assets, collateral received and own debt securities issued other than covered bonds and encumbered ABS
Carrying amount of selected financial liabilities	**1,152,728**	**1,580,363**

Moreover, the 2016 Annual Report provides additional information about encumbered assets, namely in Notes 16, 18, 19, 21, 28, 29, 30 and 38 to the Financial Statements.

10. Credit Risk - Use of ECAIs

The Bank's internal rating function was effectively internalized by retaining an experienced team of analysts and by keeping the rating tool (scorecards and guidelines) sponsored by Standard and Poor’s.

A new system was internally developed that allows to manage and monitor effectively both internal and external ratings, through the rating auditing process, the mitigation of operational risks, through verifications, and the production of alerts relative to modifications in credit risk.

The internal ratings measure the probability of default within a timeframe of one year and are assigned to all clients and counterparties of Haitong Bank. They are mandatory for credit decisions and used as impairment triggers and warning signals. The annual updating and maintenance of the internal rating framework is outsourced to Standard and Poor's.

The ratings assigned by external rating agencies to risk exposures are initially allocated automatically through a process specifically developed for the purpose. This process is monitored and the relations established are subject to validation and stored in a dedicated database.

11. Market Risk

11.1 Management Practices

Market risk is the possible loss resulting from an adverse change in the value of a financial instrument due to fluctuations in interest rates, foreign exchange rates, share/indexes prices, commodity prices, real estate prices, volatility and credit spreads.

The proposed limits are submitted for approval to local Credit Committee in Brazil, and to the Global Credit Committee in Lisbon. The limits are reviewed at least annually or whenever required by strategic reasons or market conditions.

To obtain a clear picture of the risks incurred and to provide the whole organization with clear messages regarding the desired risk appetite, a wide range of risk assessment measures are used, complemented by position, stop loss, and concentration limits..

Risk assessment measures used include VaR (Value at Risk), the BPV (Basis Point Value) sensitivity measure, and Greeks (Delta, Vega and Rho). VaR quality and accuracy is gauged by back testing analysis.

The way in which the risk assessment and control methodologies, described above, are implemented is adapted to factor in the specific features of the market in which each business entity operates..

11.2 Position risk, counterparty credit risk and risk of liquidation of the trading portfolio

The calculation of own funds requirements for market risk is based on the prudential trading book.

These risks are calculated using the standardized approach, in accordance with Part III, Title IV of Regulation (EU) no. 575/2013, with the general risk of debt instruments being calculated based on maturity.

All products are analyzed so as to identify the preponderant risk factor according to which own funds requirements can be adequately calculated

TABLE XX – Own Funds Requirements (Trading Book)

(thousands of euro)

Trading book risks	Capital Requirements	
	dez-16	dez-15
Total Trading book risks = ∑(1 to 2)	**32,719**	**21,635**
1. Position risk (1.1. + 1.2.)	**32,719**	**21,635**
1.1. Standardised approach for trading book = ∑(1.1.1. to 1.1.6.)	**32,719**	**21,635**
1.1.1. Debt Instruments		
1.1.1.1. Specific Risk	7,499	3,034
1.1.1.2. General risk	22,788	18,411
1.1.1.3. Additional requirements for Options - Non-Delta risk	0	0
1.1.2. Equity		
1.1.2.1. Specific Risk	1,634	95
1.1.2.2. General risk	798	95
1.1.3. Collective investments undertakings (CIU)	0	0
1.1.4. Exchange-traded futures and options	0	0
1.1.5. OTC futures and options	0	0
1.1.6. Others	0	0
1.2. IRB approach for trading book	0	0
2. Settlement Risk	0	0

11.2 Foreign exchange and commodities risks in the banking and trading books

The calculation of own funds requirements for foreign exchange and commodities risks is based on the trading book and the banking book.

These risks are calculated using the standardized approach, in accordance with Part III, Title IV of Regulation (EU) no. 575/2013, using the simplified approach for commodities risk.

All products are analyzed so as to identify the preponderant risk factor according to which own funds requirements can be adequately calculated.

TABLE XXI – Own Funds Requirements: Foreign Exchange and Commodities

(thousands of euro)

Foreign-exchange and commodities risks	Capital Requirements	
	dez-16	dez-15
1. Foreign-exchange risk (1.1.+ 1.2.)	**5,296**	**12,593**
1.1. Standardised Approach	5,296	12,593
1.2. IRB Approach	0	0
2. Commodities risk (2.1.+ 2.2.)	**0**	**0**
2.1. Standardised Approach = ∑(2.1.1. to 2.1.4.)	**0**	**0**
2.1.1. Maturity ladder approach or simplified method	0	0
2.1.2. Exchange-traded futures and options	0	0
2.1.3. OTC futures and options	0	0
2.1.4. Others	0	0
2.2. IRB approach	0	0

12. Operational Risk

12.1 Overview

Operational risk may be defined as the probability of occurrence of events with a negative impact on earnings or capital resulting from inadequate or negligent application of internal procedures, information systems, staff behavior, or external events. Legal risk is also included in this definition. Operational risk is therefore considered as the sum of the operational, information systems, compliance and reputational risks.

12.2 Management Practices

Operational risk is managed through a set of procedures that standardize, systematize and regulate the frequency of actions aimed at the identification, monitoring, control and mitigation of this risk. The priority in operational risk management is to identify and mitigate or eliminate risk sources, even if these have not resulted in financial losses.

In 2016, the Operational Risk function was integrated within the Risk Management Department.

The management methodologies in place are supported by the principles and approaches to operational risk management issued by the Basel Committee and those underlying the Risk Assessment Model implemented by the Bank of Portugal, recognized as translating the best practices in this area.

The operational risk management model is supported by a structure within the organization exclusively dedicated to its design, monitoring and maintenance. This structure works in close coordination with the elements indicated below, whose active participation is crucial:

- The departments, branches and subsidiaries integrated within the scope of operational risk management, who are responsible for the day-to-day management of operational risk, guaranteeing that the established procedures are implemented;
- The Compliance Department, which plays an important role in guaranteeing that the processes are well documented and in compliance with relevant laws and regulations;
- The Internal Audit Department which tests the effectiveness of risk management and controls, identifies required steps for improvement and assesses their implementation;
- The Information Technology Department for its role on business continuity.

The operational risk management entails the following:

- Identification and reporting of operational risk events. This database not only considers loss-events but also events with positive impacts and others with no accounting impacts;
- Implementation of procedures to monitor the registration of events in order to verify the effectiveness of the identification/mitigation processes implemented in each subsidiary and branch and at the same time ensure the collection and consistency of the information on events with financial impacts;
- Regularly carrying out self-assessment analyses to identify the larger risks and corresponding mitigation actions;
- Calculation of capital requirements in accordance with the Standardized Approach (this is performed by the Management Information Department).

12.3 Quantitative Information

Calculation of own funds requirements in accordance with the Standardized Approach

Operational risk is managed through a system of procedures that standardize, systematize and regulate the frequency of actions viewing the identification, monitoring, control and mitigation of this risk.
The own funds requirements determined for prudential reporting purposes as at 31 December 2016 were calculated in accordance with the Standardized Approach.

In accordance with the Standardized Approach, own fund requirements for operational risk, KTSA, correspond to the average, of the last three years, of the sum of the risk-weighted relevant indicators, which are determined on a yearly basis, for the eight regulatory business lines - Corporate finance, Trading and sales, Payment and settlement, Commercial banking, Agency services, Retail banking, Retail brokerage and Asset management.

$$K_{TSA} = \frac{\sum_{i=1}^{3} \max\left[\sum_{j=1}^{8} (IR_j \times \beta_j), 0\right]}{3}$$

Where:

- IR_j corresponds to the relevant indicator of a given year for each of the eight (j) business lines;
- β_j is the risk factor (percentage) for each of the eight (j) business lines;

Calculation of the Relevant Indicator

In accordance with Regulation (EC) no. 1606/2002 of the European Council and Parliament of 19 July 2002, as transposed into Portuguese law through Decree-Law no. 35/2005 of 17 February and Bank of Portugal's Notice no. 1/2005, the Bank prepares its separate financial statements in accordance with the Adjusted Accounting Standards (“NCAs”) and its consolidated financial statements in accordance with the International Financial Reporting Standards (IFRS), as established by the Bank of Portugal.

The NCAs provide for the application to the separate financial statements of the International Financial Reporting Standards (IFRS) as adopted by the European Union, except for certain issues regulated by Banco de Portugal, such as impairment of loans to customers and the accounting treatment given to the recognition under retained earnings of the adjustments in retirement and survival pension liabilities determined on the transition.

The IFRS comprise the accounting standards issued by the International Accounting Standards Board (IASB) and its predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) and its predecessor body.

The relevant indicator is calculated based on the accounting concepts defined in Bank of Portugal's Instruction no. 23/2007, considering the following accounting headings:

TABLE XXII – Accounting headings

Income statements	Account
(+) Interest receivable and similar income	79
(-) Interest payable and similar charges	66
(+) Shares and other variable-yield/fixed securities income	82-821
(+) Commissions received	80+81
(-) Commissions paid	67+68
(+) Results from financial operations	[83-(831+833+834)]-[69-(691+693+694)]
(+) Other operating income	[84-(841+842+843)]

The above headings must reflect the following adjustments, when necessary:

- the relevant indicator must be stated gross of provisions and operating costs, i.e., it must be calculated before the deduction of any provisions and operating costs, the latter including fees paid for outsourcing services rendered by third parties which are not subsidiaries;
- fees paid for outsourcing services rendered by third parties which are subsidiaries contribute to reduce the relevant indicator;
- fees received for the provision of outsourcing services contribute to increase the relevant indicator;
- To the extent that they do not result from the current activity of institutions, income from the sale of non-trading book items, extraordinary results, income from insurance (excluding the part of insurance brokerage considered as ancillary to the institutions' current activity) and insurance indemnities received are not used in the calculation of the relevant indicator.

Relevant indicators are calculated at individual and consolidated level.

The mapping of business lines is based on the cost centres of each entity. Except for the Bank's units in Portugal, the Madrid Branch, the Warsaw Branch, Haitong Investment Ireland PLC, Haitong UK Limited, Haitong Securities USA, LLC and Haitong Banco de Investimentos do Brasil, S.A. (Brazil), all the other entities of the Bank were considered as monoline given that their activity is essentially concentrated in one business line.

TABLE XXIII – Operational Risk

(thousands of euro)

Segments	Relevant indicator		
	dez-16	dez-15	dez-14
1. Basic indicator approach			
Standard approach	194,558	147,516	107,732
- Corporate finance	31,115	26,112	20,747
- Trading and sales	82,187	65,502	45,241
- Retail brokerage	2,274	1,245	730
- Commercial banking	71,876	50,128	38,988
- Retail banking	2,328	39	0
- Payment and settlement	0	0	0
- Agency services	0	0	0
- Asset management	4,778	4,489	2,027
Advanced measurement approach (a)	0	0	0

13. Exposures in Equities in the Banking Book

13.1 Overview

The Bank holds positions in equities in the banking book with the objective of value creation. Hence the strategic holdings, holdings in companies where the Group sees an upside potential, equities received as payment in kind for loans and credit converted into equity, are included in the banking book.

The Bank's exposure in equities is accounted in two asset portfolios: (i) assets recognized at fair value with value changes taken to the income statement, and (ii) assets available for sale, with value changes recognized under equity as a separate item - "Fair Value Reserves" - and subject to impairment tests.

The methods used to determine fair value emphasize the valuations of the markets where the securities are listed, using purchase prices, whenever available. If the securities are not listed in an organized market, quotes are requested from brokers regularly trading in the securities in question; for equities not traded by such brokers, the Bank uses several valuation techniques which it considers as the most appropriate for each of the exposures, including the use of recent transactions, when such are known, valuations based on market multiples of entities of a similar nature, or for the more significant exposures, valuations carried out by specialized entities.

Exposures in equities included in the available for sale portfolio are regularly assessed in order to determine their impairment. The Bank determines that available-for-sale financial assets are impaired when there has been a significant or prolonged decline in their fair value. This determination requires a judgment based on the collection and assessment of all available relevant information, including the normal volatility of the financial instruments' prices. For this purpose and considering the high volatility of the markets, the parameter used as impairment trigger for equity securities is the continued or significant decline in their market value against the acquisition cost. In addition, valuations are obtained through market quotes (mark to market) or valuation models (mark to model) that require the use of certain assumptions or judgment in defining fair value estimates. The use of alternative methodologies and different assumptions and estimates can result in a different level of impairment losses being recognized, with a consequent impact in the income statement.

13.2 Quantitative Information

TABLE XXIV – Exposures in Equities in the Banking Book

(thousands of euro)

	Quoted shares		Unquoted shares						Derivatives: equity/Index contracts		Other equity instruments		Total	
			Private equity		Others		Total							
	dez-16	dez-15	dez-16	dez-15	dez-16	dez-15	dez-16	dez-15	dez-16	dez-15	dez-16	dez-15	dez-16	dez-15
Acquisition cost/ Notional amount	1,430	1,822	10,115	9,487	3,098	2,853	14,643	14,162	0	0	33,183	29,779	**47,826**	**43,941**
Fair value	333	516	3,762	3,753	2,498	2,253	6,593	6,522	0	0	26,830	21,948	**33,423**	**28,470**
Market value										N/A		N/A		
Results arising from sales and liquidations in the period													**n.d.**	**n.d.**
Total unrealised gains or losses													**-14,403**	**-15,471**
Total latent revaluation gains or losses													**n.d.**	**n.d.**

14. Banking book interest rate risk

14.1 Methodologies

Interest Rate Risk arises from the exposure of a bank's financial situation to adverse movements in interest rates. Interest Rate Risk may be understood in two different but complementary ways, namely as the effect on the net interest margin, or as the impact on capital, resulting from interest rate movements that affect the institution's banking book. In fact, fluctuations in market interest rates not only affect the net interest margin - through their impact on the income and costs of financial products sensitive to those fluctuations - but also the underlying value of such products that are part of the Bank's assets, liabilities and off-balance sheet items.

The banking book exposure to interest rate risk is calculated on the basis of the Bank for International Settlements (BIS) methodology, classifying all interest rate sensitive assets, liabilities and off balance sheet items, excluding those from trading, using repricing schedules. The model used is similar to the duration model, using a stress testing scenario corresponding to a parallel shift of 200 basis points in the yield curve for all interest rate levels (Bank of Portugal's Instruction 19/2005). All financial products which do not have an associated interest return are considered as non-interest rate sensitive (cash, equities, other assets, including real estate, and other liabilities). Term deposits (interest-bearing or not) are considered in the maturity tenor of on demand up to one month.

The banking book exposure to interest rate risk is calculated on a quarterly basis.

On the other hand, within the scope of ICAAP interest rate risk in the banking book is quantified according to the Value-at-risk (VaR) model, using the historical simulation method. Based on the historical interest rates in each time band the absolute annual changes are determined (corresponding to a holding period of one year). Subsequently, the accumulated impact of a shift in the yield curve is determined for each day of the historical period in which changes have been determined, based on: position (or net pricing gap), modified duration, and change observed in each time band.

14.2 Quantitative Information

TABLE XXV – Interest Rate Risk (Banking Book)

(thousands of euro)

Interest rate risk (Banking book)			Impact	
			dez-16	dez-15
Impact on capital from a shift of 200 basis points in the yield curve	Value	+ (1)	40,742	14,829
		- (2)	-40,742	-14,829
	% Own funds	+ (1)	10.39%	3.78%
		- (2)	-10.39%	-3.78%

(1) "+" = upward shift in the yield curve

(2) "-" = downward shift in the yield curve

15. Exposure to securitisation positions

15.1 Overview

As of 31 December 2016 the Bank had no asset securitization operations originated by Group units.

15.2 Calculation of risk-weighted exposure amounts

Risk-weighted exposures inherent to investments in securitization operations are also treated under the standardized approach

In order to determine the risk weights applicable to securitization exposures Haitong Group uses the ratings assigned by external agencies.

TABLE XXVI – Credit Risk of Securitization Exposures: Standardized Approach

(thousands of euro)

Securitisations	Original securitisation positions	Exposure value (net of value adjustments and provisions)	Exposure deducted from own funds (-)	Breakdown of the exposure value subject to risk weights						Total risk-weighted exposure amount	
				Standardised approach					1250%		
				CQS 1	CQS 2	CQS 3	CQS 4	All other CQS	Unrated	dez-16	dez-15
Total exposure amount	**3,836**	**990**	**0**						**0**	**723**	**32,846**

16. Remuneration Policy

The information concerning the remuneration policy and practices of the institution for those categories of staff whose professional activities have a material impact on its risk profile is contained in the "2.16 Employee Benefits" section of the 2016 Annual Report and in Annex V to this Report, "Remuneration of the Board of Directors and Supervisory Board Members and Relevant Staff (Senior Managing Directors and Control Functions Staff), as they are regulated through the Bank's internal norms, specifically "Remuneration Policy for the Board of Directors and Supervisory Board Members" and "Employee Remuneration Policy for Senior Staff".

17. Credit risk mitigation techniques

17.1 Overview

The risk mitigation techniques most used by the Bank are physical collateral, especially immovable property and financial collaterals, and personal guarantees. The use of collaterals is a key element of the risk policy and credit decision process, influencing the acceptance criteria, the decision levels, and the pricing.

The calculation of regulatory capital requirements encompasses the effects of the instruments foreseen in Section 2, Chapter 4, Title II, Part III of Regulation (EU) no. 575/2013, namely immovable property collaterals, eligible financial instruments in the Financial Collateral Comprehensive Method, and guarantees provided by sovereigns, financial institutions or entities with external ratings above A- (or equivalent).

Other types of guarantees are also used, which, while not eligible as risk mitigators for purposes of calculating regulatory capital requirements, effectively reduce the credit risk to which the Bank is subject.

On account of their broad use, we stress the personal guarantees provided by company partners in certain financing operations.

In the markets area, the Bank uses various credit risk mitigation techniques, notably, repo-style transactions, netting, margin accounts (formalized through ISDA-CSA agreements) and credit derivatives.

17.2 Valuation of collaterals received and haircuts

The valuation/revaluation of collaterals is carried out under the terms set out in a specific rule, and complies with the requirements set out in Regulation (EU) no. 575/2013.

The application of haircuts is a simple task performed by the information system, which segments the guarantees/collaterals according to their various types and divides them between eligible and non-eligible for risk mitigation purposes. Where there is only partial coverage, the corresponding haircuts are applied to the covered portion while the non-covered portion is treated as such.

17.3 Monitoring Processes

The level of coverage by collaterals is monitored by the Impairment Committee when assessing the impairment in the credit portfolio. As an integral part of the risk monitoring process, the coverage level by the various types of collaterals, in the case of equities, is reported to and analyzed on a daily basis by the Risk Control Department.

The following point contains quantitative information about the impact of risk mitigation techniques on the replacement of exposures, by class (effect of third-party guarantees) and on the reduction in the amount of exposures (effect of collaterals).

17.4 Quantitative Information

TABLE XXVII – Credit Risk Mitigation Techniques – Standardized Approach

(thousands of euro)

Risk classes	Net exposure	Credit risk mitigation techniques with substitution effects on the original net exposure		Credit risk mitigation techniques with effect on the net exposure amount: funded credit protection (a)		Fully adjusted exposure
		Personal credit protection	Substitution effect on the exposure (net of outflows and inflows)	Volatility adjustment to the exposure amount	Financial collateral: amounts adjusted by volatility and any discrepancy between expiration periods (Cvam) (-)	
Total exposures	**4,658,731**	**-71,006**	**0**	**150,796**	**1,333,787**	**3,476,730**
Standardised approach						
Central governments or central banks	1,418,473	0	45,089	0	441,278	1,022,284
Regional governments or local authorities	4,027	0	25,916	0	0	29,944
Public Sector Entities	0	0	0	0	0	0
Institutions	1,191,210	0	0	115,052	664,587	641,675
Corporates	1,313,576	-25,916	-25,916	35,744	226,932	1,096,471
Retail portfolio	0	0	0	0	0	0
Past due items	313,206	-45,089	-45,089	0	0	268,116
Collective investments undertakings (CIU)	32,859	0	0	0	0	32,859
High-risk regulatory categories items	14,030	0	0	0	0	14,030
Other items	359,972	0	0	0	0	359,972
Shares	10,389	0	0	0	0	10,389
Securitisation positions on standardised approach	990	0	0	0	990	990

(a) - Comprehensive financial collateral method. Exposure amount shall mean the net exposure after the substitution effect.

TABLE XXVIII – Concentration Analysis – Funded and unfunded credit protection

(thousands of euro)

	Unfunded credit protection		Funded credit protection	
	dez-16	dez-15	dez-16	dez-15
Total positions covered	**71,088**	**84,563**	**1,385,609**	**1,001,592**
Breakdown by industry sector:				
Commerce	36,421	19,123	0	0
Construction	8,668	24,548	0	0
Other manufacturing industries	11,948	12,329	5,160	2,367
Services	4,591	18,738	6,905	291
Other sectors	9,459	9,824	5,597	5,237
Transport and comunication	0	0	0	0
Financial activities	0	0	1,367,947	993,698
Real estate activities	0	0	0	0