



**Best – Banco Electrónico de Serviço Total, S.A.**

# **2018 Annual Report**

**Translation Note:**

This document set is a free translation of the original issued in the Portuguese language. In the event of discrepancies the original version prevails

## **BEST – Banco Electrónico de Serviço Total, S.A.**

### **2018 Annual Report**

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## Management Report – 2018

Banco Best, incorporated in 2001, offers the whole range of products and services of a universal Bank, helping its customers to identify savings solutions and investment opportunities available at any time, as well as with all of their financial needs and day-to-day money management. With strong technological support and open architecture, Banco Best offers a set of services that allow customers to take advantage of the best of the new information technologies via the internet, namely faster and more efficient processes and transactions and access to innovative services that facilitate and streamline the relationship between the customers and the Bank.

Banco Best's business strategy is focused on serving the investment needs of a segment of individual customers who require more sophisticated and diversified financial services, while at the same time meeting their financial needs for various purposes, using standard banking services. Customers with other legal profiles, such as companies and foundations, can also be served by this business strategy with regard to meeting the above needs. BEST, through its B2B activity, also makes its customized platform available to national and international Institutional Investors, providing these entities with a more comprehensive, flexible and effective management of their cash and cash equivalents.

Banco Best forms part of the NOVO BANCO Group, its share capital of Euros 63 million being, directly and indirectly, wholly owned by NOVO BANCO, as indicated in Chapter III of this report.

Banco Best is based in Lisbon, at Praça Marquês de Pombal and does not have ordinary branches. Therefore, its financial products and services are provided via other channels, such as:

- The internet, through its website ([www.bancobest.pt](http://www.bancobest.pt)) and mobile banking (App Best Mobile; App Best Trading Pro);
- Investment Centres located in Lisbon, Oporto, Braga, Aveiro, Leiria and Faro, that rely on a Relationship Manager (RM) network;
- Remote Relationship (RR) network, a permanent management team rendering normal services at a distance, to customers needing once-off assistance;
- Contact Centre (telephonic banking) that in addition to telephonic attendance also intervenes in the opening of accounts via video call in a 100% digital process.

In addition, Banco Best also has a network of promoters and bound agents registered with the Bank of Portugal and the CMVM, called Business Introducers (BIs) and Relationship Agents (RAs), respectively, that work as service providers in accordance with the relevant legal provisions. Some of these Financial Advisors have their own offices, known as “RA Offices”, where they develop their business activity as per the applicable legal provisions.

## **I – Economic Overview**

In 2018 we saw a continuity in the expansion of the world economy. However, the pace of growth observed in 2018 was slightly lower than in the previous year. The world economy grew by 3.7% in 2018 (-0.1 pp vs. 2017), due to growth of 2.3% in developed economies and 4.6% in emerging economies.

The US economy stood out with the fastest growth among developed economies. US GDP accelerated in 2018, posting a growth of 2.9% (compared with 2.2% in 2017). The dynamism of the American economy derived from the increased consumption of families and public entities, and the growth of investment as well as exports. At the same time, unemployment approached the levels recorded in the late 1960s (in September and November, it fell to 3.7%, the lowest since 1969, from which it subsequently eased in December to 3.9%). According to International Monetary Fund (IMF) estimates, the expansionary fiscal policy will tend to aggravate the Federal Government deficit that will exceed 4.5% of GDP by 2019 (almost twice the deficit observed just three years ago), which will tend to exacerbate an upward dynamic in the ratio of public debt to GDP. Given the current cycle of activity expansion in the US, in 2018 prices rose at a faster pace, with inflation standing at around 2.2% (+0.3 pp vs. 2017).

The economy of the Eurozone will have recorded an average annual growth of 1.9% in 2018, which is decelerating (+2.5% in 2017), supported by domestic demand, especially by private consumption and investment (mainly in stocks, but also in fixed capital), with public consumption also growing, albeit with a negligible contribution, and with net exports showing a negative contribution. The Eurozone was able to return, 10 years after the start of the Great Recession, to unemployment rates close to those at the end of 2006. Domestic demand remained strong, supported by the labour market and by accommodative financial conditions, but insufficient to avoid an economic slowdown due to the lower dynamism of exports, which have been responsible for the slowdown in global trade. The slowdown in economic activity in the Eurozone was more significant in the 2<sup>nd</sup> half of the year, with Germany showing a decline in activity in the 3<sup>rd</sup> quarter of 2018 (in chain) and zero growth in the last quarter of the year.

For 2018 as a whole, the German economy grew by 1.5%, representing a reduction of 0.7 pp compared with the previous year, this being the lowest growth rate of the last 5 years.

In relation to Portugal, in 2018, GDP registered an annual increase of 2.1%, surpassing Euros 200 thousand million. In line with that observed in the main Eurozone countries, the Portuguese economy decelerated, with the growth of 2018 being 0.7 pp lower than that of the previous year. While the domestic Internal Demand grew by 2.8% compared with 2017, the net External Demand registered a more negative contribution when compared with the previous year (-0.7 pp in 2018 and -0.3 pp in 2017). It should also be noted that in respect of Internal Demand in Portugal, in 2018, private consumption increased by 2.5%, investment grew by 5.6% in real terms while public consumption presented a growth rate of 0.8%. Part of the growth in private consumption is due to the drop in the unemployment rate, which at the end of the year, stood at around 6.6%.

As regards Monetary Policy, the ECB kept its reference rate unchanged (deposit facility interest rate at a negative 0.4% and refinancing operations at 0% interest rate), having concluded, in December 2018, its asset acquisition program begun in 2015. In the US, the Federal Reserve continued its program of returning to normal monetary policy, raising interest rates four times throughout the year and continuing its asset reduction program.

The year 2018 was marked by the return of volatility to the financial markets. After the year of 2017, when US stock market volatility reached record lows, the same did not occur during the year just ended, with volatility rising to levels that had not been observed since 2015. The VIX (a volatility indicator) returned to levels, in December 2018, not recorded since the February corrections, with most stock markets suffering significant losses.

The major US indexes, Dow Jones (-5.6%), S&P 500 (-6.2%) and Nasdaq (-3.9%) closed the year with losses, after having surpassed record highs in 2018: the Nasdaq index hit a high of 8,109 points on 29 August, the S&P 500 hit 2,930 points on 20 September and the Dow Jones 26,828 points on 3 October. In August, the bull market reached its highest level since the 1930s, with a duration of 114 months (since March 2009), thus exceeding the 113 months of the previous bull market. The technological sector, which proved to be one of the main drivers of the boom in the financial markets - with Apple and Amazon stocks reaching the \$1 thousand million market value mark for the first time – ended up presenting a poor performance in the last quarter of the year, jeopardizing the gains accumulated since the beginning of the year. The FANG index, composed of ten listed companies (Facebook, Amazon, Netflix, Alphabet, Alibaba, Apple, Tesla, Nvidia, Twitter and Baidu), fell between July and November, more than 20%, entering a bear market mode.

In Europe, of note were the French CAC 40 (-11%), the Portuguese PSI-20 (-12.2%), the British FTSE 100 (-12.5%), the Eurostoxx 50 (-14.3%), the Spanish IBEX (-15%), the Italian FTSE MIB (-16.2%) and the German DAX (-18.3%) drops. In Asia, the highlight goes to the Japanese Nikkei 225 (-12.1%), the Chinese Shanghai Composite (-24.6%), the Hong Kong's Hang Seng (-13.6%) and in Latin America the Mexican Mexbol (-15.6%) drops. The only positive indexes were the Brazilian Ibovespa (+15%) and the Indian Sensex (+5.9%). The MSCI index for emerging markets decreased 14.6%, contributing to the decline of the MSCI worldwide (-8.7%).

In the USA, a gradual process of sovereign interest rate curve levelling was observed, with the difference between 10-year and 3-month interest rates falling below 40 bp for the first time since 2007. On the other hand, the 10-year spreads on the debt of Eurozone peripheral countries vs those of the German debt increased during the year, with the exception of Portugal (-4 bp), with the highest increase being seen in Italy (+91 bp), in a context of uncertainty regarding the budgetary policy that would be followed by the current Italian Government until the moment the European Commission pressured it to revise the State Budget Proposal for 2019 (with the budget deficit being revised from 2,4% to 2.04%) so as to, in this manner, avoid an Excessive Deficit Procedure. In Spain, the spread vis-à-vis the German debt increased by 3 bp, against a background of continued political uncertainty in our neighbouring country. In the two-year spreads, the movements were mixed but, in this case, mostly ascendant, with Italy showing a significant increase (+71 bp), but with Greece and Portugal standing out positively (-25 bp and -26 bp, respectively), in both cases with economic cases supporting the relief (with Greece benefiting from having left the assistance program on 20 August, putting an end to eight years of financial rescue).

As regards commodities, composite indexes declined, with the Reuters/Jefferies CRB declining 12.4% and the S&P GSCI 15.4%. Among the S&P GSCI categories, a predominantly negative behaviour was observed, with downward trends in base metals (-19%), precious metals (-2.9%) and energy (-20.9%), and only increasing in agricultural products (+0.6%). Oil prices rose for the first three quarters of the year as a result of rising geopolitical risk, the Iranian nuclear issue and the reduction of Venezuela's oil production. However, the "black gold" prices ended up performing poorly in the last quarter of the year, with the poor performance of raw-material prices between October and December being decisive for the annual losses.

In the foreign exchange market, the EUR/USD ended the year falling 4.7% and the EUR/GBP rising 1.1%. In the last month of the year, the Euro appreciated against most currencies of the advanced economies. In turn, in the United Kingdom, the increase in uncertainty in relation to

Brexit penalized the quotation of the Pound (-1.3% in its exchange against the Euro). Finally, in the emerging economies, currencies fluctuated steadily and unequally against the dollar. These dynamics were felt in December, when the combined impacts were felt of the fourth Fed interest rate hike, the end of the ECB's Quantitative Easing (QE), new stock market losses, a steep decline in sovereign interest rates and a new fall in oil prices.

In terms of interest rates, in the course of 2018, the implicit yield on 10-year German debt reached its highest value of the year in February when it traded around 0.76%, having registering 0.24% at the end of December. As for US sovereign debt, after starting the year at 2.46%, the 10-year debt reached the annual maximum in October 2018, on trading close to 3.25%. However, following the volatility of December and after a downward revision of the interest rate trends and moderation in the Fed members' discourse, 10-year interest rates ended the year at 2.68%.

At the level of the emerging markets, the economic activity spectrum improved at the end of the year, albeit with some exceptions, such as Turkey. One of the effects of this improvement in economic sentiment and investor risk tolerance was the recovery of capital inflows, both of debt and assets, namely in October and November. However, this same measure revealed signs of erosion in December, reflecting the increase in global financial volatility.

One of the points of concern in recent months has been the slowdown of the Chinese economy (with growth prospects of 6.2% for 2019), at the basis of which are two main factors. Firstly, credit growth has slowed down, slowing the growth of Internal Demand. Following the increase in lending in China, the authorities have sought to curb its growth to more sustainable levels. Secondly, fears regarding trade tensions with the US have weighed on sentiment among investors and stock markets, exacerbating the declining domestic demand. In November, according to China's National Statistics Office (NSO), industrial production grew by only 5.4% year-on-year (5.9% in October and 5.7% in December), the lowest growth since the beginning of 2016. Retail sales also declined to 8.1% (8.6% in October). In addition, Chinese exports (in dollars) increased by 5.4% (homologous) in November, with a significant slowdown after the good results obtained in October (15.6%). In this manner, the Chinese exports sector is beginning to show slightly less room for manoeuvre, but with the monetary and fiscal policies still having enough room to support the economy: the People's Bank of China (PBOC) has cut the reserves required from large banks from 17% to 14.5% and announced an additional 1 percentage point cut in January, the Renminbi depreciated about 7% against the USD and public spending is expected to increase in the coming months.

Thus, following a process of synchronized acceleration of world economic activity in 2017 and a turning point in 2018, the year 2019 should be marked by a simultaneous slowdown of the main economies. According to the latest World Bank report, global economic growth is expected to slow from 3% in 2018 to 2.9% in 2019. For 2020 and 2021, the institution projects growth of 2.8%, which compares with the previous forecast of 2.9%.

In its half-yearly report "Global Economic Outlook", the World Bank predicts a growth of the Gross Domestic Product (GDP) of the Eurozone of 1.6% in 2019 (0.1 percentage point below the previous forecasts), of 1.5% for 2020 (estimate unchanged since June) and of 1.3% for 2021. The same will occur in the US, with the economy declining from 2.9% in 2018 to 2.5% in 2019 and 1.7% in 2020. As for China, it is estimated to grow by 6.5% in 2018 and by 6.2% in 2019 and 2020.

The downward revision of the latest official estimates for world economic growth and the declines recorded in the last two months of the year in the main financial markets have reminded investors of the challenges foreseen for 2019. The longevity of the economic cycle, the restrictions on production capacity and on global financing conditions, the slowdown in industrial activity, the intensification of trade tensions, the adoption of less expansionary monetary policies (US interest rate hike and the end of the ECB's asset purchase program), the mitigation of the US fiscal stimuli, Brexit, the tug-of-war between Italy and the European Commission, greater global political uncertainty and the risk of a greater economic slowdown in China are risks that will remain on the investors' radar during 2019.

## **II – Operations in 2018**

Banco Best recorded a net income of Euros 3.6 million in 2018, a growth of 18% over the previous year, maintaining very positive prudential and solvency ratios with, namely, a transformation of deposits to credit ratio of 26% and a Core Tier 1 ratio of 40%. The cost-to-income ratio stood at 69% compared with the 71% of the previous year.

In 2018, Banco Best maintained its leadership strategy in the innovation of the financial products and services offer in Portugal, in its various aspects, of note being the following digital initiatives:

- Start of the account opening process via video call, a 100% digital process that allows the Customer to open an account with the Bank using a smartphone or computer, without the need for a face-to-face presence;



- A new website, with a new architecture, new image, new features and a differentiated approach for customers and non-customers. The use of digital marketing tools was also initiated.
- Bea – Best Electronic Assistant, a chatbot based on artificial intelligence developed by a FinTech in Portugal, which responds to user questions about products and services.
- Best Open Banking, the first Open Banking solution in Portugal, which has anticipated by almost one year, in a controlled environment, the services to be made available under the European Payment Services Directive (PSD2). The Best Open Banking platform allows the various entities, financial and non-financial, to connect to BEST and to test, on a specific platform set up for this purpose, the Open Banking concept, as well as the existing features and the range of services made available;
- Embracing innovation and always attentive to what the future can bring, Banco Best was present in the first subscription operation of a foreign fund in Portugal, realized in a Blockchain environment. In the “real” environment and as a test of the concept, this operation was carried out in partnership with Credit Suisse Asset Management through the infrastructure FundsDLT. The cross-border distribution of an investment fund using Blockchain technology has demonstrated the solidity of a new model that has proven to be more efficient, scalable and effective, marking yet another important step in the evolution of the distribution of investment funds. The transactions covered the entire investment fund subscription process, from the moment of the registration of the order up to the operation processing. For this project, Banco Best developed an API (Application Programming Interface) and created a dedicated application to evaluate the full impact of the customer experience. This innovation has substantially reduced the time between the registration of the order and the settlement of the operation.
- Still in 2018, BEST completed the necessary developments to make available, in early 2019, the first “Robot Advisor” service in Portugal, a fully digital portfolio discretionary management solution, realized by the German Management company DWS.
- During 2018, BEST also renewed its hardware technology base, migrating the applications from the central system to new servers, among the best that the computer equipment industry has available, simultaneously replacing the old contingency/backup system by a modern solution based on the Asset/Asset system, which is the best system for guaranteeing the update, redundancy and activation speed of the contingency system. This system has equipment based on two data centres physically distanced from one another, with an updated communications infrastructure that connects them in Layer2 (Extended Network) mode, with the simultaneous backup in

both centres – Asset/Asset configuration – providing a better guarantee and latency in case of disaster recovery.

- Continuing with the goal of improving its IT infrastructure, in the last quarter of 2018, BEST began the process of updating and upgrading its front-office core system (Siebel/Oracle), process expected to be completed by the end of the first quarter of 2019.

In the area of Asset Management and Trading, the activity of BEST was equally intense, in particular with the objective of promoting financial literacy, realizing, in 2018, several “Best Trading Pro” training cycles, an initiative to stimulate the financial literacy of investors under the motto “Greater Knowledge, Better Investment” that took place in the various Investment Centres of the country, in a total of 9 sessions. Thematic conferences – “Investing in a better world” and “Investing in a healthy life - sustainability, efficiency, innovation” - were also held to present investors with alternative strategies for their investments that simultaneously privilege a sustainable development.

In the investment funds’ area, the strategy to widen and diversify the offer of management companies and investment funds seeks to continue the search for alternative markets investments that add value to the current offer or permit the coverage of specific niche markets. In this sense, Banco Best currently distributes over 3,200 investment funds of 70 management companies to the public in general, in addition to providing about 2,000 additional investment funds exclusively for the B2B institutional market.

Of note in 2018, was the launch of new partnerships, with the distribution in Portugal of the funds of the management companies Rubrics, Investec and Carmignac, each with its own specificities. Rubrics stands out as a specialist house dedicated exclusively to credit, with a range of bond funds, Investec is a company with its origins in South Africa, which currently has a very diversified offer, without forgetting its origins, in the emerging markets, and Carmignac, which has developed its activity in the management of multi-asset funds.

Confirming this strategy of growth and innovation in its investment funds, Banco Best was distinguished in the 7<sup>th</sup> edition of the Euronext Lisbon Awards, in the Financial Innovation category, for the launch, in Portugal, of the first investment fund managed by artificial intelligence - the ACATIS AI Global Equities fund, of the German Management Company Acatis.

Still in the area of investment funds and ETFs, Banco Best held, in 2018, two Conferences on the issue of responsible investment that look at human development. In partnership with UBS (Swiss Management Company), the theme of responsible investments was addressed, coinciding with the launch, in Portugal, for the first time, of a wide range of ETFs on this

theme. In partnership with Pictet (also a Swiss Management Company), the theme of the trends associated with human development was discussed, focusing on the theme of "Nutrition" and on how to position a portfolio of investments that can take advantage of the development of (new) healthy lifestyles. In order to foster these trends of the future with its customers, as well as with society in general, Banco Best started to present in its website an area that highlights these and also realized a radio campaign on the themes "Environmental Sustainability", "Robotics vs. Human", "Health and Human Longevity", "Great World Brands", "Socially Responsible Future" and "Emerging Markets and Frontier Markets".

In a market environment, in 2018, characterized by several major geopolitical events, a widespread lack of definition of interest rate trends and high volatility, the identification of asset classes with a clearly positive performance was a challenge of rare difficulty. Thus, we have seen a greater demand for flexible and diversified investment strategies, as a rule in multi-asset funds, with an emphasis on the Acatis Gané Value Event fund, a fund managed by two boutiques specialized in their areas, Acatis with the Value component and Gané with the Event component, two strategies that have complemented each other quite well in several phases of the markets.

In its trading of insurance products component, Banco Best, from an investment perspective, made available, in 2018, a new capitalization insurance with attractive interest rates, which is issued and managed by UNA, an insurance company that is re-launching itself in the market.

In its component of direct access to the bond market, the highlight goes to its increased offer of bonds, to about 200 issues covering corporate and government bonds, increasing the geographical, sectoral and currency diversification. Banco Best is presently one of the Portuguese financial institutions making available a greater offer to its customers, as well as the greatest digital offer.

As in previous years, Banco Best continued to position itself as an investment platform not only for retail customers, but also for institutions that need access to a wide range of solutions for themselves, and their end customers. In this scope, Banco Best created, in 2018, a specific B2B2C solution for Investment Advisory Companies.

In 2018, Banco Best participated in the Placement Syndicate of 6 Public Offers realized in Portugal. Of note was the fact that, in 2018, we had a company successfully dispersing its capital on the stock exchange:

- Bond Loan "FC Porto SAD 2018-2021"
- Bond Loan "BENFICA SAD 2018-2021"
- Public Subscription Offer "OTRV July 2025"

- Public Sale Offer “Raize Shares”
- Bond Loan “Sporting SAD 2018-2021”
- Public Subscription and Exchange Offer “Mota-Engil 2018-2022”

In the scope of these primary market operations, the volume placed exceeded Euros 38 million.

Regarding the Trading activity, according to CMVM data, Banco Best recorded a positive performance in relative terms. While Banco Best recorded a slight drop of only 4% compared with the previous year, the market dropped 8.9%, leading to Banco Best’s increase in market share from 5.0% to 5.3%, with trading volumes attaining Euros 548 million.

In the online derivatives segment, where BEST’s activity stems from the partnership established with Saxo Bank A/S, in 2018, Banco Best, according to the order reception statistics published by the CMVM, recorded a market share of 16.9% in orders received online for derivatives in the futures market, with the trading volume attaining Euros 10.8 thousand million.

In August, the European regulator implemented risk control measures on derivatives, in the negotiation of Differential Contracts (CFDs) and Binary Options, which had a significant impact on the way these instruments are made available in Europe. In this sense, the volumes traded had, in general, a decrease in most of the European institutions. Nevertheless, despite the measures implemented by ESMA, the year 2018 ended with a growth of 33% in the volumes traded compared with 2017, with Banco Best being Portugal's third largest institution in the trading of derivatives. In 2018, Banco Best strengthened its market share in 4.1 pp, ending the year with 16.9%.

In the services component, Banco Best sought to complete the range of solutions made available to its customers, namely in the components of Investment Consultancy and Discretionary Portfolio Management. In the case of Investment Consultancy, Banco Best started this activity with the provision of investment proposals on a non-recurring consultancy basis, having made a partnership with the Portuguesa Fintech Advicefront.

In the Discretionary Portfolio Management, in 2018, Banco Best established a new partnership with GNB Gestão de Patrimónios in order to make available another financial service to its Customers, specifically discretionary management portfolios of various types, in this manner reinforcing its positioning while platform.

Developed throughout the year and launched in 2019, Banco Best made available, as already mentioned, the first “Robot Advisor” in Portugal in partnership with the German management company DWS, a fully digital and automated Discretionary Management Service.

In order to reinforce the technical analysis component, Banco Best also made available the new "Trade Signals" service, the tool that allows investors to identify business opportunities in the financial markets based on standards and graphic models, simplifying the market analysis at the moment of transacting a vast supply of instruments. The new functionality made it possible to complement the fundamental analysis service “Equity Research Centre”, available to all investors.

As mentioned above, in 2018, Banco Best conducted, in partnership with Credit Suisse Asset Management and through the infrastructure FundsDLT, the first subscription operation of a foreign fund in Portugal, realized in a Blockchain environment.

The entry into force of MiFID II, in 2018, has resulted in, namely:

- the implementation of the first phase of Investment Consultancy - investment proposals - in an innovative process that is being carried out together with a Portuguese Fintech;
- the review of the internal processes of creation, parameterization and trade of the investment products and in the definition of the respective target markets;
- the review of the performance evaluation systems, of the variable remuneration plans applicable to the different commercial networks;
- the certification of the training of employees involved in the creation and/or trading of investment products on the new rules of MiFID II, with all active employees of the internal and external commercial networks obtaining certification at the highest level of Investment Consultancy training.

In relation to the Customer base, in 2018, there was a 20% increase in the raising of new customers, with the average amount per customer being maintained and kept within the defined objectives, with a special focus on attracting high involvement customers (affluent segment), to which several initiatives and campaigns in this area contributed. In 2018, Banco Best restructured its entire Banking product offer range, namely:

- Launch of the Digital Accounts (a cost-free account, in this manner keeping free of management commissions the 100% digital accounts, in line with the Bank’s matrix and the practice of competition, and for which the customer only pays additional services according to their use), and the Digital + Accounts, a commissioned account with a comprehensive and enhanced transactional offer.

- Enrichment of the offer for the younger segment, with access to new investment products appropriate to their profile and long-term objectives;
- Pricing revision of the commissions;
- The launch of corporate credit cards;
- The launch of the Renting/Operational Renting of Vehicles (AOV) offer of Locarent.

At the level of customer raising campaigns, in addition to the Time Deposit with upfront interest, which remains one of the New Customers' preferences, several promotional offers were made under the "Get In Campaign", in which Customers can choose a specific asset/offer based on their involvement with the Bank, committing to maintain this involvement during a reference period, while maintaining the flexibility to choose and diversify their investments according to their profile and objectives. In addition, a new offer of Protocols was made available to partner entities (allowing all employees of these companies to have special advantages in the "salary" accounts opened with Banco Best (Digital Account or Salary Account), essentially small and medium-sized companies, with the aim of diversifying the customer raising channels of the Bank, as well as its inclusion in portals/aggregators of the specialty. In addition, member-get-member actions have also been developed, where the customers of the institution present themselves as ambassadors of the Bank to their friends and family members and promote/reinforce their connection to the Bank.

We have also instilled a growth dynamic in the offer of deposit auctions, a historic offer of the Bank since its inception, and that has been maintained on a daily basis ever since. Of special relevance were the thematic auctions, Halloween, Cyber-Monday, Christmas Season, among others, where customers bid and benefited from unique conditions for their investments.

Regarding credit cards, in addition to the launch of credit cards for companies, solutions that increased the final cost to the customer with no particular added value were discontinued, thus allowing us to focus and reinforce the attributes that customers value most. Of particular note was the strengthening of the partnership with TAP through its program Miles&Go, doubling the awards offered in this scope.

In terms of customer deposits, a final value of € 546 million was recorded, an increase of € 52 million over 2017. Despite the historically low rates, fundraising and retention actions continue to have very significant effects, with more than Euros 35 million having been raised in direct funding initiatives. Demand for credit declined 12% to Euros 141 million, due, also, to the volatility and negative evolution of the main financial markets and the importance of the credit solutions collateralized by financial assets to the total loans in the balance sheet. There was a

loss level ratio in line with the reference levels in the market, due to the conservative policy governing the granting of credit and the typology of the products offered.

In 2018, Banco Best maintained a strong focus on training, in particular to achieve the goal set at the end of 2017 and that was attained in early 2018, of all employees of the internal and external commercial networks of BEST being certified in Investment Consultancy under MiFID II. Thus, 12.9 thousand hours of training were invested on this area alone, compared with a global total of 21.9 thousand hours of training in 2018.

In 2018, the payroll registered the departure of 20 employees, partially offset by the recruitment of 18 new employees. In this way, BEST closed December 2018 with 129 employees compared with the 131 of the previous year. It should be noted that the staff comprising the payroll is relatively young, with an average age of 41.5 years, with only 31% of the employees with ages over or equal to 45 years. It is also gender-balanced, with 53% of men and 47% of women and has a high level of academic qualification, with 81% of the employees having higher education and no employees at BEST having lower than Secondary Education.

As part of the initiatives to motivate BEST employees and in order to align the central and commercial teams with the strategy and objectives of the Bank, in 2018, a meeting of all employees of BEST was held for the first time. In addition to the interventions the Executive Directors of Banco Best and the Chair of the Board of Directors of Banco Best and of NOVO BANCO, Mr. António Ramalho, the Marketing, Investments, IT and Commercial Directorates played a prominent role.

Banco Best follows the most advanced environmental policy measures applicable to the financial sector:

- ✓ in the choice of suppliers, with environmental factors being considered in the selection and adjudication process;
- ✓ through a rational consumption, restricted to the minimum necessary, of supplies and services of third parties, and with maximum energy efficiency and the reduction of paper and plastic consumption, strongly accelerated in 2018 with the initiative to distribute a glass bottle to each employee with his/her name engraved on same, in that manner reducing the consumption of plastic bottles and cups;
- ✓ through efficient waste management, including the recycling of paper and printer toners;

- ✓ with the opting for environmentally friendly products, namely with the consumption of treated drinking water in the water dispenser, avoiding the waste associated with bottled water packaging;
- ✓ by replacing professional travelling with telematics contacts, or by using the most environmentally friendly means of transport;
- ✓ by the marketing of environmentally friendly financial products and services, through funds that invest in renewable energy and through ethical funds;

The activity risk management policies at Banco Best are governed by a set of principles and activities completely aligned with NOVO BANCO, as detailed below.

In relation to credit risk, a permanent management of the loan portfolios is carried out, favouring interaction between the various teams involved in risk management throughout the successive stages of the loan process. This approach is complemented by the introduction of continuous improvements both in methodologies and tools for risk assessment and control, as well as at the level of the decision procedures and circuits. In this regard, the monitoring of the Bank's credit risk profile, namely with regard to the evolution of credit exposures and the monitoring of credit losses, is carried out regularly by the Risk Committee. Compliance with the approved credit limits and the correct operation of the mechanisms associated with credit line approvals are also regularly analysed within the scope of the current commercial activity. At the end of 2018, the amount of the gross loans' exposure and the impairment constituted was Euros 142.0 million and Euros 0.8 million, respectively.

Market risk management, which generally represents any loss resulting from an adverse change in the value of a financial instrument as a result of changes in interest rates, exchange rates and share and commodity prices, is integrated with the balance sheet management through the Capital, Assets and Liabilities Committee (CALCO) structure constituted at the NOVO BANCO Group level.

This body analyses the Bank's liquidity position, namely the balance sheet evolution, an extensive analysis of the gaps and the key indicators of the activity (Liquidity Coverage Ratio, liquidity and commercial gaps, evolution of deposit and credit rates). In summary, a comprehensive liquidity risk assessment and its evolution are carried out, with a special focus on the current liquidity buffers and the generation/maintenance of eligible assets and their respective impacts on the LCR liquidity ratio. At the end of 2018, the regulatory minimum mandatory Liquidity Coverage Ratio (LCR) of 100% was, in BEST's case, 152%, also revealing an increase of 18 pp over 2017.



At the market risk level, the main risk measurement element is the estimation of potential losses under adverse market conditions, for which the Value at Risk (VaR) methodology is used. The Bank uses a VaR with recourse to the Monte Carlo simulation, with a confidence interval of 99% and an investment period of 10 days. Volatility and correlations are historical, based on a one-year observation period. As a complement to the VaR, extreme scenarios (stress-testing) have been developed that allow for the evaluation of the impacts of potential losses higher than those considered in the VaR measurement. At the end of 2018, BEST had a VaR of Euros 13.3 million for its trading positions.

For operational risk management, which includes operational, information systems, compliance and reputational risks, a system has been developed and implemented to ensure the standardization, systematization and recurrence of the activities for the identification, monitoring, control and mitigation of this risk. This system is supported by an organizational structure, integrated in the Global Risk Department of NOVO BANCO exclusively dedicated to this task as well as Operational Risk Management Representatives designated by each of the departments and subsidiaries considered relevant, who are responsible for compliance with the established procedures and the day-to-day management of this risk in their areas of competence.

Lastly, regarding Capital Management and Solvency and Leverage Ratios, it should be noted that, in prudential terms, the Bank is subject to the supervision of the Bank of Portugal, which, based on the Community's capital adequacy directive, establishes the rules that should be observed at this level by the various institutions under its supervision. These rules determine a minimum ratio of total own funds in relation to the requirements resulting from the risks assumed, which the institutions must comply with.

The European Parliament and the Council approved, on 26 June 2013, Directive 2013/36/EU and Regulation (EU) no. 575/2013, which now regulate in the European Union, respectively, the access to the activity of credit institutions and investment companies and the determination of the prudential requirements to be observed by those same entities as from 1 January 2014. The Regulation also provides for institutions to report their leverage ratio to the supervisor. These standards transpose into the European legal order the recommendations of the Basel Committee, normally referred to as Basel III.

Notice 6/2013, of 23 December, of the Bank of Portugal, regulated the transitional regime provided for in that Regulation.

Currently, under the new legal order of Basel III, the capital elements of BEST for the purpose of determining the solvency ratio, are divided into Common Equity Tier 1, Tier 1, Tier II and Total Own Funds, with the following composition:

- Common Equity Tier I: This category includes, essentially, realized share capital, share premiums, eligible reserves and the positive results for the financial year, when audited. The deductions from Common Equity Tier I include the eligible amount of intangible assets, the negative actuarial deviations arising on post-employment responsibilities to employees, the excess value of deferred tax assets and of shareholdings in financial companies and, where applicable, the negative results for the financial year.
- Tier I: In addition to the amounts considered in Common Equity Tier I, this category includes, where applicable, preference shares and hybrid capital instruments.
- Tier II: Mainly incorporates, where applicable, eligible subordinated debt issued.

The capital of BEST is exclusively composed of Common Equity Tier I elements, with the solvency ratio reaching the figure of 40.3% at the end of 2018, thus complying with the capital ratio imposed by the Bank of Portugal.

The risk management function, which is vital for the development of Banco Best's activity, aims to identify, assess, monitor and report all materially relevant risks to which the Bank is subject, both internally and externally, and performs its functions in a manner independent of the functional areas, providing risk management advice to the management body.

The Risk Management function, is centralized in the Global Risk Office (GRO) and is independent of the business areas, operating with the functional support of the Global Risk Department of NOVO BANCO.

The functions of the Global Risk Office (GRO) include:

- Encourage and implement the methodologies for identifying and assessing operational risk in the respective areas of responsibility;
- Participate in self-assessment exercises and ensure the reporting of information on sources of risk, events, near misses and indicators of operational risk;
- Ensure the identification and implementation of risk mitigation actions;
- Monitor customers with warning signs regarding credit risk;
- Globally analyse the loan portfolio profile, namely regarding the evolution of credit exposure and the monitoring of credit losses;
- Ensure articulation with the NOVO BANCO - Global Risk Department - Operational Risk, not only in the aspects mentioned, but also in relation to the operational risk

control and management performed daily in each of the respective areas of competence

Regarding the 2018 Financial Statements, the 9% growth in total assets in the Bank's Balance Sheet over the previous year, is to be highlighted. BEST closed the financial year with Total Assets of Euros 651 million. The growth of Due to customers (+11%), the decrease of Loans and advances to customers (-12%) were directly reflected in an increase in the Loans and advances to Banks (hereinafter also termed "Due by banks") (+ Euros 95 million).

Regarding the Income Statement, the Net interest income, totalling Euros 6.6 million, decreased by 4% from the previous year, essentially due to the decrease in interest earned. In terms of interest paid, of note is the effect of the increased weight of Demand deposits to 66% of Due to customers, with the corresponding decrease in the average rate paid on these liabilities, net of hedging operations, of 4 bp.

Operating Income stood at Euros 18.6 million, higher than the previous year. Operating costs increased by 9% over the previous year, mainly as a result of the heavy investment in information technology, be it with the change of the website or with the complete renovation of the central computer equipment. However, the trend of previous years of containment of staff costs, which fell by 5% compared with 2017, continued, and some typologies of G&A costs were optimized, with the most significant decreases achieved being in:

- Rentals, down 10% from the previous year, mainly due to a better use of the space in the headquarters that made redundant 219 m<sup>2</sup> of space with the corresponding reduction of the rental;
- Postage and delivery of documents with savings of 27% in the year 2018, a direct result of the implementation of the optimization project regarding paper communications being sent to customers;

There was also a decrease in the volume of depreciation, which saw a reduction of 42% compared with the previous year.

The growth of the operating income in excess of that of the costs, allowed for a favourable evolution in the cost-to-income ratio to 69%, compared with the 71% of the previous year.

The sale of the majority of the portfolio of past due and unpaid loans of Banco Best as part of a common project of the NOVO BANCO Group, reduced the balance of past due loans in 2018 to Euros 182 thousand compared with the Euros 1.4 million recorded on 31 December 2017. The ratio of the past due loans and advances to the Loans and advances to customers is now at the lowest level ever, at 0.13% compared with the 0.86% of the previous year.

Banco Best, in 2018, reinforced impairment losses in the income statement in Euros 245 thousand, compared with the Euros 371 thousand of the previous year, amounts that are, even so, consistently low and are justified by Banco Best's use of extremely cautious criteria in terms of risk assumption associated with the granting of credit and in the management of its activity. In terms of year end values and following the loan sale mentioned above, there is a coverage of 453% of past due loans by provisions, with past due loans representing 0.13% of total loans to customers; of note, with regard to both indicators, is the excellent performance compared with the banking sector and the positive evolution from the previous year.

Banco Best's Own funds were reinforced in 2018 with the incorporation of 10% of the previous year's net income, through the constitution of mandatory reserves, with the remaining 90% being distributed to the shareholders; the Core Tier 1 ratio increased to circa 40% in 2018, with this indicator presenting a very high level when compared with the remaining banks, both at the national and international level.

The allocation of Euros 1.3 million to provisions for taxes on income, decreased Banco Best's Net income to Euros 3.6 million in 2018, even so circa 18% above that of the previous year.

As synthetic indicators of the financial results obtained by BEST in 2018, we highlight the Cost-to-Income ratio of 69%, the ROE of 5.0% and the positive Net income of Euros 3.6 million.

### III - Shareholder Structure and Corporate Bodies

In financial year 2018, the shareholder structure of Banco Best underwent a slight change, with 100 shares previously held by GNB - Companhia de Seguros de Vida, S.A. being sold to GNB – Gestão de Ativos, SGPS, S.A.. The shareholder structure as at 31 December 2018 continued to be 100% within the NOVO BANCO Group, with the following distribution:

|  | % Share Capital |                |
|--|-----------------|----------------|
|  | 31.12.2018      | 31.12.2017     |
| NOVO BANCO, S.A.                                       | 100.00%         | 100.00%        |
| GNB - Companhia de Seguros Vida, S.A. <sup>(a)</sup>   | -               | 0.00%          |
| NOVO BANCO dos Açores, S.A. <sup>(a)</sup>             | 0.00%           | 0.00%          |
| Novo Banco Servicios Corporativos, S.L. <sup>(a)</sup> | 0.00%           | 0.00%          |
| GNB - Gestão de Ativos, SGPS, S.A. <sup>(a)</sup>      | 0.00%           | -              |
|  | <b>100.00%</b>  | <b>100.00%</b> |

<sup>(a)</sup> Hold 100 shares

As at 31 December 2018, the Corporate Bodies of BEST were as follows:

### **General Meeting Board**

Patrícia Afonso Fonseca Moraes Bastos (Chair)

Pedro Moreira de Almeida Queiroz de Barros (Secretary)

### **Board of Directors**

António Manuel Palma Ramalho (Chair)

Maria Madalena Monteiro da Mata Torres Pitta e Cunha (Member)

Pedro Alexandre Lemos Cabral das Neves (Member)

Jorge Daniel Lopes da Silva (Member)

Carlos Manuel Portela Enes Epifânio (Member)

### **Supervisory Board**

António Joaquim Andrade Gonçalves (Chair)

Fernando Jorge Henriques Bernardo (Member)

Isabel Maria Beja Gonçalves Novo (Member)

Joaquim Manuel da Silva Neves (Alternate Member)

### **Statutory Auditor**

Effective: Ernst & Young & Associados - SROC, S.A. - Statutory Auditor no. 178

Represented by António Filipe Dias da Fonseca Brás - Statutory Auditor no. 1661

Alternate: João Miguel Alves - Statutory Auditor no. 896

### **Company Secretary**

José Alexandre Pereira Soares de Santo António

Alternate: Pedro Moreira de Almeida Queiroz de Barros

The corporate bodies were elected at the General Meeting held on 29 April 2016 for a three year term of office (2016-2018), with, however, the following changes occurring in 2018.

- With effect as from 30 April 2018, Ms. Marília Boavida Correia Cabral resigned from the position of Executive Director;
- With effect as from 30 April 2018, Mr. Luís Fernando Rocha dos Reis resigned from the position of Non-Executive Director;

#### **IV - Relevant facts after the close of the financial year**

Nothing of note.

#### **V – Outlook**

The possible international political and macroeconomic instability in the year 2019, the uncertainties surrounding Brexit and its effects on European markets and an environment still very undefined in terms of the increase in interest rates may create some volatility in financial markets, with a direct impact on the valuation of financial products marketed by Banco Best. In any event, and without prejudice to possible unexpected events that may materialize, no relevant impacts are foreseen at the level of Banco Best's own activity. This is because it has a low risk level in its balance sheet and benefits from diversification as a result of an extensive range of financial products, both in terms of banking products such as deposits, cards and bank loans, as well as in terms of financial products recorded off-balance sheet, such as Investment Funds, Shares, Customer bonds or those promoted by BEST, as is the case of renting, and of service platforms for other entities.

In terms of the national economy, the continuation of the relief within the austerity climate and the improvement of growth rates, not only in Portugal but also across the Eurozone, is foreseen, provided the uncertainties related to Brexit do not materialize in a very expressive manner. The macroeconomic indicators showing a significant improvement in the Portuguese economy, have been reflected in some euphoria in Portuguese consumers and in the real estate market, with a direct negative impact on the national savings capacity, which in and of itself represents a challenge for Banco Best, in terms of the potential growth of attracting national customers' funds.

Despite the uncertainties that always hover over the global economy and that can potentially affect the Portuguese economy and capitalizing on the type of core competencies on which its progress has been based, Banco Best projects the development of its business activity in 2019 along the following main lines:

- To be a very innovative Bank, being able to offer a high quality service to all customers and future customers through the various channels, with a greater focus on the digital channels;
- To continue to deepen the relationship with Fintech and Regtech, as occurred in practice in 2018 in the previously mentioned processes of setting up the account opening process by video call, in the launch of a tool to enhance investment

consultancy in an intelligible manner, in the launch of the digital assistant BES – Best Electronic Assistant, a chatbot based on artificial intelligence, and in the first subscription operation of a foreign fund in Portugal, realized in a Blockchain environment;

- To increase the diversification and independence of its financial offer, maintaining a wide range of Asset Management and Trading products and services aimed at satisfying the need for diversification of financial assets and currencies that allows customers to quickly take advantage of investment opportunities as they arise in function of the constant financial climate changes; to widen this financial platform model to other aspects of the activity (Banking, insurance, among others).

On the other hand, the task of cost-cutting and control is to be maintained, with an emphasis on the availability of the offer through the most effect channels, aiming, in this manner, to improve BEST's efficiency levels in a market that is expected to remain strongly competitive.

## **VI - Proposal for the appropriation of results**

Pursuant to Article 66(5)(f) of the Portuguese Commercial Companies Code, the Board of Directors of Banco Best proposes for approval by the Shareholders' General Meeting that the net income for the period, positive in the amount of Euros 3 564 096.94 (three million five hundred and sixty-four thousand ninety-six Euros and ninety-four Cents) be appropriated as follows:

- Euros 356 409.69 to the Legal reserve;
- Euros 3 207 687.25 to Other reserves and Retained earnings.

## **VII – Additional Information**

In compliance with legal requirements, the Board of Directors expressly confirms that:

- The Bank neither holds own stocks nor did it acquire or sell any;
- There were no transactions between the Bank and its Directors;
- The Bank has no past due debts to the State, namely Social Security and the Tax Authorities;
- The Bank has no branches.

## VIII - Concluding remarks

On concluding the Management Report for 2018, the Board of Directors wishes to acknowledge the cooperation of all those who have contributed towards achieving the established goals, in the performance of their duties, namely:

- The Monetary and Financial Authorities and supervisory bodies, notably the Bank of Portugal, Securities and Exchange Commission and Portuguese Insurance Institute for their collaboration and support;
- Our Customers for their trust and preference;
- Our shareholders for their constant support and interest in the activity of the Bank;
- The General Meeting Board and Supervisory Board members, the Statutory Auditor and the Secretary of the Company for their permanent and constructive involvement;
- Our Employees for their commitment, motivation, willingness and professional competence.

Lisbon, 22 March 2019

### **Board of Directors:**

António Manuel Palma Ramalho

Maria Madalena Monteiro da Mata Torres Pitta e Cunha

Pedro Alexandre Lemos Cabral das Neves

Jorge Daniel Lopes da Silva

Carlos Manuel Portela Enes Epifânio



## ANNEX TO THE MANAGEMENT REPORT

1. In compliance with that laid down in Article 447 of the Portuguese Commercial Companies Code, we declare that none of the members of the Management and Supervisory bodies is a holder of Company shares.
2. Shareholders holding more than one tenth of the share capital of the Company, as at 31 December 2018, in compliance with that laid down in Article 448 of the Portuguese Commercial Companies Code, are:

| Shareholders   | No. shares | %        |
|----------------|------------|----------|
| NOVO BANCO, SA | 62,999,700 | 99.9995% |

Lisbon, 22 March 2019

**The Board of Directors:**

António Manuel Palma Ramalho

Maria Madalena Monteiro da Mata Torres Pitta e Cunha

Pedro Alexandre Lemos Cabral das Neves

Jorge Daniel Lopes da Silva

Carlos Manuel Portela Enes Epifânio

# **FINANCIAL STATEMENTS AND NOTES TO THE FINANCIAL STATEMENTS**

## BEST - BANCO ELECTRÓNICO DE SERVIÇO TOTAL, S.A.

### INCOME STATEMENT FOR THE FINANCIAL YEARS ENDED 31 DECEMBER 2018 AND 2017

|  |         | (thousands of Euros) |                  |
|--|---------|----------------------|------------------|
|  |         | 31.12.2018           | 31.12.2017       |
| Interest and similar income  | 5       | 7 824                | 7 887            |
| Interest expense and similar charges   | 5       | <u>( 1 243)</u>      | <u>( 1 032)</u>  |
| <b>Net interest income</b>   |         | <b>6 581</b>         | <b>6 855</b>     |
| Dividend income  | 19      | 37                   | 80               |
| Fee and commission income  | 6       | 15 006               | 14 723           |
| Fee and commission expenses  | 6       | ( 4 840)             | ( 5 123)         |
| Net gains/(losses) from financial assets and liabilities at fair value through profit and loss             | 7       | 399                  | ( 88)            |
| Net gains/(losses) from financial assets and liabilities at fair value through profit and loss mandatorily | 7       | 94                   | -                |
| Net gains/(losses) from financial assets and liabilities at fair value through other comprehensive income  | 8       | 804                  | 6                |
| Net gains/(losses) from foreign exchange revaluation   | 9       | ( 346)               | 344              |
| Net gains/(losses) from disposal of other financial assets   | 10      | 957                  | -                |
| Other operating income/(losses)  | 11      | <u>( 59)</u>         | <u>52</u>        |
| <b>Operating income</b>  |         | <b>18 633</b>        | <b>16 849</b>    |
| Staff costs  | 12      | ( 4 549)             | ( 4 780)         |
| General and administrative expenses  | 13      | ( 8 165)             | ( 6 756)         |
| Depreciation and amortization  | 20 & 21 | ( 216)               | ( 373)           |
| Provisions, net of reversals   | 25      | ( 61)                | ( 912)           |
| Impairment losses of loans and advances, net of reversals and recoveries                                   | 18      | 244                  | 371              |
| Impairment losses of other financial assets, net of reversals and recoveries                               | 17 & 19 | ( 1 049)             | -                |
| Impairment losses of other assets, net of reversals and recoveries   | 22      | <u>-</u>             | <u>( 2)</u>      |
| <b>Operating expenses</b>  |         | <b>( 13 796)</b>     | <b>( 12 452)</b> |
| <b>Profit/(loss) before income tax</b>   |         | <b>4 837</b>         | <b>4 397</b>     |
| <b>Income tax</b>  |         |                      |                  |
| Current tax  | 26      | ( 1 277)             | ( 1 218)         |
| Deferred tax   | 26      | <u>4</u>             | <u>( 165)</u>    |
| <b>Net income for the period</b>   |         | <b>3 564</b>         | <b>3 014</b>     |
| Basic earnings per share (in Euros)  | 14      | 0.06                 | 0.05             |
| Diluted earnings per share (in Euros)  | 14      | 0.06                 | 0.05             |

The attached explanatory notes form an integral part of these financial statements

## BEST - BANCO ELECTRÓNICO DE SERVIÇO TOTAL, S.A.

### STATEMENT OF COMPREHENSIVE INCOME FOR THE FINANCIAL YEARS ENDED 31 DECEMBER 2018 AND 2017

|   |       | (thousands of Euros) |              |
|---|-------|----------------------|--------------|
|   | Notes | 31.12.2018           | 31.12.2017   |
| <b>Net income for the period</b>  |       | <b>3 564</b>         | <b>3 014</b> |
| <b>Other comprehensive income for the period</b>  |       |                      |              |
| <b>Items that will not be reclassified to the income statement</b>                                      |       |                      |              |
| Change in the fair value reserve of equity instruments at fair value through other comprehensive income | a)    | 5                    | -            |
|   |       | <b>5</b>             | <b>-</b>     |
| <b>Items that may be reclassified to the income statement</b>   |       |                      |              |
| Securities at fair value through other comprehensive income   |       |                      |              |
| Unrealized gains and losses in the period   | 29    | ( 265)               | 1 517        |
| Gains and losses included in the income statement   | 29    | -                    | -            |
| Income taxes  | 29    | 68                   | ( 394)       |
|   |       | <b>( 197)</b>        | <b>1 123</b> |
| <b>Total comprehensive income for the period</b>  |       | <b>3 372</b>         | <b>4 137</b> |

a) See Statement of Changes in Shareholders' Equity

The attached explanatory notes form an integral part of these financial statements

# BEST - BANCO ELECTRÓNICO DE SERVIÇO TOTAL, S.A.

## BALANCE SHEET AS AT 31 DECEMBER 2018 AND 2017

(thousands of Euros)

|   | Notes | 31.12.2018     | 31.12.2017     |
|---|-------|----------------|----------------|
| <b>Assets</b>                                     |       |                |                |
| Deposits with banks                               | 15    | 33 260         | 44 694         |
| Derivatives held for trading                      | 16    | 584            | 285            |
| Loans and advances to banks                       | 17    | 401 598        | 306 690        |
| Loans and advances to customers                   | 18    | 141 156        | 159 727        |
| Securities' portfolio                             | 19    | 68 154         | 81 603         |
| Other tangible assets                             | 20    | 1 274          | 351            |
| Intangible assets                                 | 21    | -              | -              |
| Deferred tax assets                               | 26    | 214            | -              |
| Other assets                                      | 22    | 4 343          | 3 540          |
| <b>Total Assets</b>                               |       | <b>650 583</b> | <b>596 890</b> |
| <b>Liabilities</b>                                |       |                |                |
| Financial liabilities held for trading            | 16    | 647            | 744            |
| Deposits from banks                               | 23    | 20 356         | 19 210         |
| Due to customers                                  | 24    | 545 846        | 493 890        |
| Provisions  | 25    | 2 591          | 2 461          |
| Current tax liabilities                           | 26    | 730            | 432            |
| Deferred tax liabilities                          | 26    | -              | 182            |
| Other liabilities                                 | 27    | 4 856          | 4 359          |
| <b>Total Liabilities</b>                          |       | <b>575 026</b> | <b>521 278</b> |
| <b>Shareholders' Equity</b>                       |       |                |                |
| Share capital                                     | 28    | 63 000         | 63 000         |
| Other reserves and Retained earnings              | 29    | 8 993          | 9 598          |
| Net income for the period                         |       | 3 564          | 3 014          |
| <b>Total Shareholders' Equity</b>                 |       | <b>75 557</b>  | <b>75 612</b>  |
| <b>Total Liabilities and Shareholders' Equity</b> |       | <b>650 583</b> | <b>596 890</b> |

The attached explanatory notes form an integral part of these financial statements

## BEST - BANCO ELECTRÓNICO DE SERVIÇO TOTAL, S.A.

### STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE FINANCIAL YEARS ENDED 31 DECEMBER 2018 AND 2017

(thousands of Euros)

|  | Reserves, Retained earnings and Other comprehensive income |                     |  |               | Net income for the period | Total Shareholders' Equity |
|--|--|---------------------|--|---------------|---------------------------|----------------------------|
|  | Share capital  | Fair value reserves | Other reserves, Retained earnings and Other comprehensive income | Total         |                           |                            |
| <b>Balance at 31 December 2016</b>   | <b>63 000</b>  | <b>( 52)</b>        | <b>8 253</b>   | <b>8 201</b>  | <b>2 746</b>              | <b>73 947</b>              |
| Comprehensive income:  |  |                     |  |               |                           |                            |
| Changes in fair value, net of tax (see Note 29)                                    | -  | 1 123               | -  | 1 123         | -                         | 1 123                      |
| Net income for the period  | -  | -                   | -  | -             | 3 014                     | 3 014                      |
| <b>Total comprehensive income</b>  | <b>-</b>   | <b>1 123</b>        | <b>-</b>   | <b>1 123</b>  | <b>3 014</b>              | <b>4 137</b>               |
| Constitution of reserves (see Note 29)   | -  | -                   | 2 746  | 2 746         | ( 2 746)                  | -                          |
| Distribution of dividends (see Note 29) a)   | -  | -                   | ( 2 471)   | ( 2 471)      | -                         | ( 2 471)                   |
| Other movements  | -  | -                   | ( 1)   | ( 1)          | -                         | ( 1)                       |
| <b>Balance at 31 December 2017</b>   | <b>63 000</b>  | <b>1 071</b>        | <b>8 527</b>   | <b>9 598</b>  | <b>3 014</b>              | <b>75 612</b>              |
| Impact of transition to IFRS 9   | -  | ( 290)              | ( 426)   | ( 716)        | -                         | ( 716)                     |
| <b>Balance at 1 January 2018</b>   | <b>63 000</b>  | <b>781</b>          | <b>8 101</b>   | <b>8 882</b>  | <b>3 014</b>              | <b>74 896</b>              |
| Comprehensive income:  |  |                     |  |               |                           |                            |
| Changes in fair value, net of tax (see Note 29)                                    | -  | ( 197)              | -  | ( 197)        | -                         | ( 197)                     |
| Impairment reserves of securities at fair value through other comprehensive income | -  | -                   | 5  | 5             | -                         | 5                          |
| Net income for the period  | -  | -                   | -  | -             | 3 564                     | 3 564                      |
| <b>Total comprehensive income</b>  | <b>-</b>   | <b>( 197)</b>       | <b>5</b>   | <b>( 192)</b> | <b>3 564</b>              | <b>3 372</b>               |
| Constitution of reserves (see Note 29)   | -  | -                   | 3 014  | 3 014         | ( 3 014)                  | -                          |
| Distribution of dividends (see Note 29) a)   | -  | -                   | ( 2 712)   | ( 2 712)      | -                         | ( 2 712)                   |
| Other movements  | -  | -                   | 1  | 1             | -                         | 1                          |
| <b>Balance at 31 December 2018</b>   | <b>63 000</b>  | <b>584</b>          | <b>8 409</b>   | <b>8 993</b>  | <b>3 564</b>              | <b>75 557</b>              |

a) Corresponds to a dividend per share of Euros 0.04 euros paid to shares in circulation, during 2018 and 2017

The attached explanatory notes form an integral part of these financial statements

## BEST - BANCO ELECTRÓNICO DE SERVIÇO TOTAL, S.A.

### CASH FLOW STATEMENT FOR THE FINANCIAL YEARS ENDED 31 DECEMBER 2018 AND 2017

(thousands of Euros)

|  | Notes | 31.12.2018       | 31.12.2017       |
|--|-------|------------------|------------------|
| <b>Cash flows from operating activities</b>                          |       |                  |                  |
| Interest and similar income received                                 |       | 7 463            | 9 519            |
| Interest expense and similar charges paid                            |       | ( 973)           | ( 893)           |
| Fees and commissions received  |       | 15 007           | 14 723           |
| Fees and commissions paid  |       | ( 4 841)         | ( 5 123)         |
| Recovery of loans and advances                                       |       | 33               | 75               |
| Cash payments to employees and suppliers                             |       | ( 11 744)        | ( 11 530)        |
|  |       | <b>4 945</b>     | <b>6 771</b>     |
| <i>Changes in operating assets and liabilities:</i>                  |       |                  |                  |
| Deposits with/loans from central banks                               |       | ( 500)           | -                |
| Financial assets at fair value through profit and loss               |       | 2                | 2                |
| Financial assets at fair value through profit and loss mandatorily   |       | 63               | -                |
| Financial assets at fair value through other comprehensive income    |       | ( 7 655)         | ( 43 032)        |
| Acquisition of financial assets at amortized cost                    |       | ( 125 736)       | -                |
| Disposal of financial assets at amortized cost                       |       | 144 644          | -                |
| Loans and advances to banks  |       | ( 94 081)        | ( 18 517)        |
| Deposits from banks  |       | 1 139            | 3 681            |
| Loans and advances to customers                                      |       | 18 809           | ( 23 477)        |
| Due to customers and other loans                                     |       | 51 683           | 51 579           |
| Other operating assets and liabilities                               |       | 41               | 1 173            |
| <b>Cash flows from operating activities before income taxes</b>      |       | <b>( 6 646)</b>  | <b>( 21 820)</b> |
| Income taxes paid  |       | ( 1 128)         | ( 1 046)         |
| <b>Net cash flows from operating activities</b>                      |       | <b>( 7 774)</b>  | <b>( 22 866)</b> |
| <b>Cash flows from investing activities</b>                          |       |                  |                  |
| Dividends received   |       | 37               | 80               |
| Acquisition of tangible fixed assets                                 |       | ( 1 140)         | ( 14)            |
| Disposal of tangible fixed assets                                    |       | 1                | 1                |
| <b>Net cash flows from investing activities</b>                      |       | <b>( 1 102)</b>  | <b>67</b>        |
| <b>Cash flows from financing activities</b>                          |       |                  |                  |
| Dividends paid on ordinary shares                                    |       | ( 2 712)         | ( 2 471)         |
| <b>Net cash flows from financing activities</b>                      |       | <b>( 2 712)</b>  | <b>( 2 471)</b>  |
| <b>Net changes in cash and cash equivalents</b>                      |       | <b>( 11 588)</b> | <b>( 25 270)</b> |
| <b>Cash and cash equivalents at beginning of period</b>              |       | <b>39 761</b>    | <b>64 688</b>    |
| Effect of foreign exchange rate changes on cash and cash equivalents |       | ( 346)           | 343              |
| Net changes in cash and cash equivalents                             |       | ( 11 588)        | ( 25 270)        |
| <b>Cash and cash equivalents at end of period</b>                    |       | <b>27 827</b>    | <b>39 761</b>    |
| <b>Cash and cash equivalents include:</b>                            |       |                  |                  |
| Deposits with banks  | 15    | 33 260           | 44 694           |
| Mandatory deposits with Central Banks (a)                            |       | ( 5 433)         | ( 4 933)         |
| <b>Total</b>   |       | <b>27 827</b>    | <b>39 761</b>    |

(a) BEST constitutes its minimum reserves indirectly through Novo Banco, S.A. (see Note 15)

The attached explanatory notes form an integral part of these financial statements

## **BEST – Banco Electrónico de Serviço Total, S.A.**

### **NOTES TO THE FINANCIAL STATEMENTS AS AT 31 DECEMBER 2018**

(Amounts stated in thousands of Euros, except when otherwise indicated)

#### **NOTE 1 – ACTIVITY**

**BEST – Banco Electrónico de Serviço Total, S.A. (Bank or BEST or Banco Best)** is a financial institution with registered office in Portugal. For the purpose, it holds the necessary authorizations from the Portuguese authorities, the Bank of Portugal (i.e. the Central Bank – “Banco de Portugal”) and other regulatory authorities to operate in Portugal.

BEST was incorporated by public deed of 9 May 2001, with a share capital of Euros 32 422 thousand, having begun its activity on 25 June of that year. In 2002 and 2003, BEST increased its share capital to Euros 43 000 thousand and Euros 55 000 thousand, respectively (see Note 26). In 2005, the share capital was again increased to Euros 61 000 thousand and, in 2006, to Euros 63 000 thousand.

The Bank raises funds from third parties, in the form of deposits or other funds, which, together with its own resources, it invests in granting loans and advances to customers, in securities and in other assets; it also provides other banking services in Portugal.

The functioning of the administrative and operational areas of BEST is assured by NOVO BANCO under a service agreement.

On 3 August 2014, following the Resolution Measure applied by the Bank of Portugal to Banco Espírito Santo, its majority shareholder, BEST was included in the NOVO BANCO Group’s consolidation perimeter.

The Bank forms part of the NOVO BANCO Group and its financial statements are fully consolidated in those of NOVO BANCO, with registered office at Avenida da Liberdade, no. 195, in Lisbon. During 2015, a shareholding exchange was realized whereby the NOVO BANCO shareholding in Saxo Bank A/S was exchanged for the latter’s 25% shareholding in BEST. With this share exchange operation, the NOVO BANCO Group now holds the entire share capital of BEST (see Note 28).



## NOTE 2 – MAIN ACCOUNTING POLICIES

### 2.1. Bases of presentation

In accordance with Regulation (EC) no. 1606/2002, of 19 July, of the European Council and Parliament, and Notice no. 5/2015, of 7 December, of the Bank of Portugal, the financial statements of BEST are prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union and in force as at 1 January 2018.

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

The financial statements herein presented relate to 31 December 2018. The accounting policies applied by the Bank in their preparation are consistent with those used in the preparation of the financial statements as at 31 December 2017.

### **Changes in accounting policies**

#### New standards issued and standards amended

The Bank adopted in the preparation of the financial statements as at 31 December 2018, the accounting standards issued by the IASB and the IFRIC interpretations, effective since 1 January 2018, described in Note 35. The accounting policies adopted by the Bank in the preparation of the separate financial statements, described in this Note, were adopted accordingly.

New standards with material impact on their first-time adoption are described below.

In these financial statements the Bank adopted for the first time IFRS 9 and the amended IFRS 7, with mandatory application for periods beginning on or after 1 January 2018. The Bank did not early adopt any other standard or interpretation.

#### *IFRS 9 Financial Instruments*

IFRS 9 is mandatory and replaces IAS 39 for periods beginning on or after 1 January 2018. The Bank did not restate comparative information with reference to 2017, having used a possibility provided for in IFRS 9. In this manner, the comparative information with reference to 2017 is

presented in accordance with IAS 39 and is not comparable with the information presented with reference to 2018.

In the scope of the adoption of IFRS 9, the impacts of the transition were recognized directly in retained earnings on 1 January 2018, as disclosed in Note 34 to the financial statements.

#### Changes to the classification and measurement

To determine the classification and measurement, IFRS 9 requires that all financial assets, other than equity instruments and derivatives, be analysed based on a combination of the Bank's business model to manage them and the characteristics of the contracted cash flows.

The measurement categories provided for in IAS 39 for financial instruments (i) fair value through profit and loss; (ii) available for sale; (iii) held-to-maturity and (iv) amortized cost were replaced by:

- Financial assets at amortized cost;
- Financial assets at fair value through other comprehensive income;
- Financial assets at fair value through profit and loss;
- Financial assets at fair value through profit and loss mandatorily.

The accounting of financial liabilities is similar to that provided for in IAS 39, except for the treatment of gains and losses arising from the entity's own credit risk related to financial liabilities measured at fair value through profit and loss, which are presented in other comprehensive income without subsequent reclassification in the income statement.

Under IFRS 9, embedded derivatives are not classified as core financial assets but are classified based on the business model and contractual terms. The accounting of derivatives embedded in financial liabilities and in non-financial contracts did not change in relation to IAS 39. The accounting policy of the Bank for embedded derivatives is described in Note 2.3.

#### Changes to the calculation of impairment

The adoption of IFRS 9 significantly altered the impairment calculation method of the Bank, replacing the losses incurred model in IAS 39, with the expected loss model prescribed in IFRS 9.

IFRS 9 states that an entity shall recognize a provision for expected credit losses on financial assets such as loans and advances to customers, other debt instruments not recognized at fair value through profit and loss, loan commitments and financial guarantee contracts. The entity shall measure the provision for losses in an amount equivalent to the expected credit losses within

twelve months if there has been no significant increase in credit risk since the asset was recognized. If the financial asset complies with the classification rules of a financial asset purchased or originated in credit impairment, the provision for losses should be equivalent to the credit losses over the respective duration of the asset.

The Bank's impairment methodology is described in Note 2.4.

The impact of the application of IFRS 9 as at 1 January 2018 is disclosed in Note 34.

#### *IFRS 7*

The Bank adopted IFRS 7 Financial Instruments: Disclosures, which was amended to reflect the changes in IFRS 9 versus IAS 39.

The changes include disclosures about the transition as described in Note 34, qualitative and quantitative information on expected credit losses, as well as the main estimates and judgments considered by management in the transition.

The remaining accounting policies used by the Bank in the preparation of these financial statements are consistent with those used in the preparation of the financial statements with reference to 31 December 2017.

The accounting standards and interpretations recently issued but not yet effective and that the Bank has not yet adopted in the preparation of its financial statements may also be analysed in Note 35.

The preparation of financial statements in conformity with IFRS requires the application of judgement and the use of estimates and assumptions by the Bank that affect both the process of applying the accounting policies and the reported amounts of income, expenses, assets and liabilities. Changes in such assumptions and differences between these and the reality in the future may impact these estimates and judgement applied. The areas involving a higher degree of judgement or complexity or where the assumptions and estimates used are significant to the financial statements are analysed in Note 3.

These financial statements were approved at the Board of Directors' meeting of 22 March 2019, and await the approval of the Shareholders' General Meeting. However, it is the conviction of the Board of Directors that these will be approved without significant changes.

## 2.2. Foreign currency transactions

Foreign currency transactions are translated into the functional currency using the foreign exchange rates prevailing on the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies are translated into Euros at the foreign exchange rates ruling at the balance sheet date. Foreign exchange differences arising on this translation are recognized in the income statement.

Non-monetary assets and liabilities measured at historical cost, denominated in foreign currency, are translated using the foreign exchange rates prevailing on the date of the transaction. Non-monetary assets and liabilities denominated in foreign currency that are stated at fair value are translated into Euros at the foreign exchange rates ruling on the date the fair value was determined. The resulting foreign exchange differences are accounted for in the income statement, except if related to equity instruments classified as financial assets at fair value through other comprehensive income, which are accounted for in reserves.

Foreign exchange differences relating to cash flow hedges and hedging of net investments in foreign operating units, if any, are recognized in other comprehensive income.

## 2.3. Derivative financial instruments and hedge accounting

### Classification

Derivatives held for risk management purposes include (i) hedging derivatives and (ii) derivatives acquired to manage the risk of certain financial assets and liabilities designated at fair value through profit and loss but that were not classified as hedging derivatives.

All other derivatives are classified as trading derivatives.

### Recognition and measurement

Derivatives are initially recognized at fair value on the date the derivative contract is entered into (trade date). Subsequent to initial recognition, the fair value of derivative financial instruments is re-measured on a regular basis and the resulting gains or losses on re-measurement are recognized directly in the income statement, except for derivatives designated as hedging instruments. The recognition of the gains or losses resulting on the derivatives designated as hedging instruments depends on the nature of the risk being hedged and the hedging model used.

Derivatives traded on organized markets, namely futures and some options contracts are recorded as derivatives held for trading and are revalued through the income statement. Since the changes in fair value of these derivatives are settled daily through margin accounts held by the Bank, they have a nil carrying value. The margin accounts are recorded in Other assets (see Note 22) and include the minimum collateral required in respect of open positions.

The fair values of derivative financial instruments correspond to quoted market prices, on active markets, if available or are determined using valuation techniques, including discounted cash flow models and options pricing models, as appropriate.

### Hedge accounting

- Classification criteria

Hedge accounting is used for derivative financial instruments designated as hedging instruments, provided the following criteria are cumulatively met:

- (i) The hedging instruments and the hedged items are eligible for a hedging relationship;
- (ii) At the inception of the hedge, the hedging relationship is identified and formally documented, including the identification of the hedged item and of the hedging instrument, the nature of the risk covered and the evaluation of the effectiveness of the hedge;
- (iii) There is an economic relationship between the item hedged and the hedging instrument;
- (iv) The credit risk effect does not dominate the changes in value resulting from that economic relationship; and
- (v) The effectiveness of the hedge can be reliably measured, both at the inception of the hedge and on an ongoing basis.

The use of derivatives is framed within the risk management strategy and objectives of the Bank.

- Fair value hedge

In a fair value hedge, the carrying value of the asset or liability, determined in accordance with the respective accounting policy, is adjusted to reflect the change in the fair value attributable to the hedged risk. Changes in the fair value of hedging derivatives are recognized in the income statement, together with the changes in fair value of the hedged assets or liabilities attributable to the hedged risk. In cases where the hedging instrument covers an equity instrument designated at fair value through other comprehensive income, the changes in fair value are also recognized in other comprehensive income.

If the coverage no longer meets the requirement of effectiveness, but the objective of risk management remains, the Bank can adjust the coverage to meet the eligibility criteria (rebalancing).

If the hedge no longer meets the criteria for hedge accounting (in the event the hedging instrument expires, is sold, terminates or is exercised, without its substitution having been made in accordance with the documented risk management objective of the entity) the derivative financial instrument is transferred to the trading portfolio and hedge accounting is discontinued prospectively. If the asset or liability corresponds to a fixed income instrument, the re-measurement adjustment is amortized in the income statement to maturity using the effective interest rate method.

- Cash flow hedge

When a derivative financial instrument is designated as a hedge against the variability of highly probable future cash flows (cash flow hedge), the effective portion of the changes in the fair value of the hedging derivative is recognized in reserves, being recycled to the income statement in the financial years in which the hedged item affects the income statement. The gain or loss relating to the ineffective portion is immediately recognized in the income statement.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss recognized in reserves is recycled to the income statement when the hedged transaction also affects the income statement. When a hedged transaction is no longer expected to occur, the cumulative gain or loss recorded in equity is immediately recognized in the income statement and the hedging instrument is transferred to the trading portfolio.

As at 31 December 2017 and 2018, the Bank did not have any hedging operations classified as cash flow hedges.

### Embedded derivatives

If a hybrid contract includes a base contract that is a financial asset under IFRS 9, the Bank classifies the entire contract in accordance with the policy outlined in Note 2.4.

If a hybrid contract includes a base contract that is not an asset under IFRS 9, an embedded derivative shall be separated from the base contract and accounted for as a derivative under this Standard if, and only if:

a) The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the base contract;

- b) A separate instrument with the same terms as the embedded derivative would satisfy the definition of a derivative; and
- c) The hybrid contract is not measured at fair value with changes in fair value being recognized in profit and loss (i.e. a derivative that is embedded in a financial liability at fair value through profit and loss is not separated).

These embedded derivatives are recorded at fair value with the changes being recognized in the income statement.

#### **2.4. Other financial assets: Loans and advances to banks, Loans and advances to customers and Securities**

Since 1 January 2018, the Bank classifies financial assets at the time of acquisition based on the business model considered and the characteristics of the contractual cash flows of these assets. This classification determines how the asset is measured after its initial recognition:

- At amortized cost: if it is included in a business model which objective is only to obtain contractual cash flows, which correspond only to payments of principal and interest on the amount of the principal outstanding (SPPI - solely payments of principal and interest);
- At fair value through other comprehensive income: if included in a business model which purpose is to obtain contractual cash flows and/or sales proceeds and the contractual cash flows fall within the scope of SPPI. In addition, it may be irrevocably chosen at initial recognition to present in equity the subsequent changes in the fair value of an investment in an equity instrument;
- Measured at fair value through profit and loss mandatorily: all cases not falling within the scope of SPPI;
- Measured at fair value through profit and loss: the remaining financial instruments not included in the business models described above. If these assets are acquired for the purpose of being transacted in the short term, they are classified as held for trading.

Until 1 January 2018, the Bank classified financial assets in financial assets at amortized cost, at fair value through profit and loss, as available for sale and as held to maturity.

The Bank, in accordance with its documented risk management strategy, contracts derivative operations (derivatives held for risk management purposes) in order to cover certain risks of certain operations, without, however, resorting to hedge accounting as described in Note 2.3. In these situations, assets and liabilities are recognized at fair value through profit and loss. In this manner,

consistency in the valuation of assets and liabilities and derivatives (accounting mismatch) is ensured.

### **Initial recognition and measurement, and derecognition**

These financial assets are initially recognized at fair value plus transaction costs, except for financial assets at fair value through profit and loss, where transaction costs are directly recognized in the income statement.

Financial assets are derecognized from the balance sheet when (i) the Bank's contractual rights to their cash flows have expired, (ii) the Bank has substantially transferred all the risks and benefits associated with their holding, or (iii) although the Bank retained part, but not substantially all the risks and rewards associated with their holding, control over the assets was transferred. When an operation measured at fair value through other comprehensive income is derecognized, the accumulated gain or loss previously recognized in other comprehensive income is reclassified to profit and loss. In the specific case of equity instruments, the cumulative gain or loss previously recognized in other equity is not reclassified to profit and loss, being transferred between equity accounts.

Loans and advances to banks and Loans and advances to customers are recorded on the date the amount of the transaction is advanced to the counterpart. The acquisitions and disposals of securities are recognized on the trade date, that is, on the date the Bank undertakes to acquire or dispose of the asset.

### **Financial assets at amortized cost or at fair value through other comprehensive income**

In accordance with IFRS 9 - Financial Instruments, for a financial asset to be classified and measured at amortized cost or at fair value through other comprehensive income, it is necessary that:

- (i) the contractual clauses shall give rise to cash flows that correspond only to payments of principal and interest on the outstanding amount (SPPI-solely payments of principal and interest). For the purposes of the SPPI test, the principal is the fair value of the financial asset at the time of initial recognition. The contractual flows that are SPPI are consistent with a basic loan agreement. Contractual clauses that introduce exposure to risks or volatility of contractual cash flows that are not related to a basic loan agreement, such as exposure to changes in share or commodity prices, do not give rise to contractual cash flows that are only payments relating to principal and interest calculated on the amount of principal outstanding. In these cases, financial assets must be measured at fair value through profit and loss;



(ii) the business model of the financial asset is to receive only the contractual flows to maturity (asset at amortized cost) or to receive the contractual flows to maturity and obtain a gain on its sale (asset at fair value through other comprehensive income). The assessment of the business models of the financial asset is fundamental for its classification. The Bank determines business models by financial asset groups according to how they are managed to achieve a particular business objective. The Bank's business models determine whether cash flows will be generated by obtaining only contractual cash flows, flows from the sale of financial assets or both. On the initial recognition of a financial asset, the Bank determines whether it is part of an existing business model or reflects a new business model. The Bank reassesses its business models in each reporting period to determine whether changes in business models have occurred since the last reporting period.

The above requirements do not apply to lease receivables, which meet the criteria set out in IAS 17 - Leases.

Financial assets that are subsequently measured at amortized cost or at fair value through other comprehensive income are subject to impairment.

Financial assets at fair value through other comprehensive income are initially recorded at fair value and subsequently also measured at fair value; however, the respective changes are recognized in reserves (other comprehensive income) until the assets are derecognized, at which point the accumulated amount of the potential gains and losses recorded in reserves is transferred to profit and loss under the caption Gains/(losses) from financial assets at fair value through profit and loss. In the specific case of equity instruments, the cumulative gain or loss previously recognized in other equity is not reclassified to profit and loss, being transferred between equity accounts. However, the dividends received from these equity instruments are recognized in the income statement.

Financial assets at amortized cost are initially recorded at acquisition cost and are subsequently measured at amortized cost based on the effective interest rate method. Interest, calculated at the effective interest rate, and dividends are recognized in the income statement.

### **Financial assets at fair value through profit and loss**

An asset recorded at fair value through profit and loss presents the following characteristics:

- the contractual cash flows are not SPPI (fair value through profit and loss mandatorily); or/and
- it is held in a business model that is not intended to obtain only contractual cash flows or to obtain contractual cash flows and its sales proceeds; or,

- it is designated at fair value through profit and loss as a result of applying the fair value option.

These assets are measured at fair value and the respective revaluation gains or losses are recognized in the income statement.

The fair values of investments quoted on active markets are determined based on their current bid price, the price of the last transaction realized or on the amount of the last bid known. For unlisted securities, the Bank establishes fair value using (i) valuation methodologies, including the use of recent arm's length transactions, discounted cash flow techniques and option pricing models customized to reflect the specificities and circumstances of the instruments and (ii) valuation assumptions based on market information.

### Reclassifications

In the event the Bank changes a business model, the financial assets included in that model are reclassified, and the classification and measurement requirements for the new category are applied prospectively as from that date.

### Impairment

The Bank recognizes impairment for expected credit losses ("ECLs") on the following debt instruments:

- Loans and advances to customers;
- Guarantees issued;
- Import documentary credits;
- Confirmed export documentary credits;
- Unused credit lines;
- Deposits and loans and advances to banks ("Money Market");
- Own securities' portfolio.

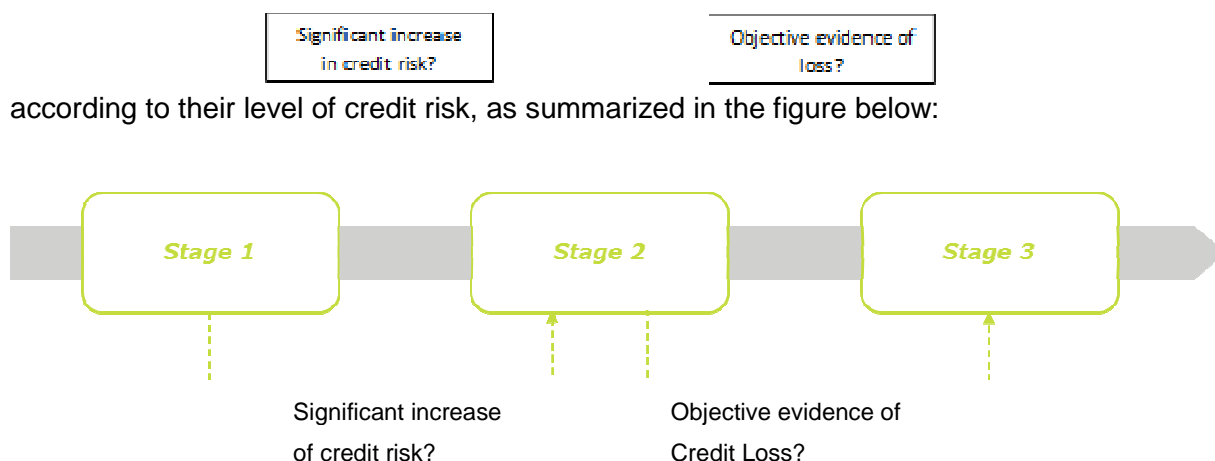
The debt instruments of this universe that are classified at amortized cost or fair value through other comprehensive income are considered in the scope of the impairment calculation.

The impairment losses identified are recorded in the income statement and are subsequently reversed through the income statement if, in a subsequent period, the estimated loss amount decreases.

The approach taken for the calculation of impairment distinguishes between the calculation of expected losses at 12 months - Stage 1 - and the calculation of expected lifetime losses. To determine expected lifetime losses, the approach considers the projection of the contractual cash flows - Stage 2 - or the present value of the expected recoveries - Stage 3. Thus, the model of impairment by Stage is summarized as follows:

- expected loss resulting from a potential loss event occurring within the next 12 months after the calculation date (Stage 1); or
- expected loss, resulting from all potential loss-to-maturity events, applied to the projection of the contractual cash flows (Stage 2); or
- expected loss resulting from the difference between the amount outstanding and the present value of the cash flows estimated to be recovered from the exposure<sup>1</sup> (Stage 3).

Therefore, for the determination of impairment, all exposures are previously classified by Stage



- **Stage 3**

The process of assigning a Stage to an exposure starts by checking whether the Stage 3 criterion applies. If the exposure is classified as in Default - according to the internal definition in force<sup>2</sup> - that exposure is classified as Stage 3.

Thus, the classification of exposures in Stage 3 is based on the occurrence of a default event, with objective evidence of loss being verified at the time as from which a significant change occurs in the creditor/borrower relationship, which subjects the creditor to a monetary loss.

<sup>1</sup> Parameters used to determine recoveries vary, essentially, in function of the risk profile/nature of the exposure

<sup>2</sup> The internal definition of Default is aligned with article 178 of the CRD IV, that prescribes the criteria as material non-performance over 90 days and unlikely to pay

- Stage 2

Exposures are classified as Stage 2 whenever there is a significant increase in the exposure's credit risk. If there is no objective evidence of loss associated with the exposure, the criteria are analysed to determine whether the exposure has suffered a significant increase in credit risk.

The significant increase in credit risk is assessed through qualitative and quantitative indications. Once it is verified that - at least - one of these indications is active, the exposure is classified in Stage 2.

As explained in IFRS 9, the assessment of the significant increase in credit risk also involves comparing the current level of risk of an exposure against its level of risk at origination.

Thus, the Bank assigns to the exposure/borrower an internal credit risk rate, depending on the quality of the respective exposure/borrower, and associated with that rate is a probability of default. On assessing whether the credit risk of an exposure has increased significantly since its initial recognition, the Bank compares, at the current reporting date, the exposure risk to maturity versus the same risk of default on the recognition date of the financial instrument. Depending on whether the change observed is above a defined threshold - relative and/or absolute - the exposure is classified in Stage 2.

In addition to this indication, others are considered and imply, by their verification, the classification in Stage 2 – for example, material non-compliance for more than 30 days, signs of risk in the financial system and an internal credit risk rate above a certain threshold.

- Stage 1

The classification of exposures in Stage 1 depends on:

- (i) the absence of active indications of Stage 3 and Stage 2 classification, mentioned and described above; or,
- (ii) the framing of these exposures under the scope of the low-credit risk exemption. These exposures, if not in Stage 3, are automatically classified in Stage 1.

The Bank calculates impairment, on a collective or individual basis, on the incidence base by means of an initial classification of its respective risk level - Stage 1, 2 or 3 in the collective analysis model, and the going concern or gone concern approach in the individual analysis model.

If, for a given loan, there is no objective evidence of impairment on an individual perspective, such loan is included in a group of loans with similar credit risk characteristics (loan portfolio segment), which is assessed collectively by applying risk factors estimated for the respective segment of the exposure - impairment analysis on a collective basis. For the exposures that are assessed individually and for which, as a result of that analysis, an impairment loss is identified, the corresponding amount calculated prevails over the impairment calculated in the collective analysis. For the individual analysis, the following customers are selected:

- for all customers in default (stage 3), or stage 2 and with no rating assigned, with an exposure higher than Euros 1 million;
- for all customers in stage 2, with an exposure higher than Euros 5 million;
- for all customers in stage 1 and without a rating, with a credit exposure higher than Euros 5 million;
- for all customers belonging to the real estate development or financial holding sectors, with a credit exposure higher than Euros 5 million;
- for all other customers in stage 1 with an exposure higher than Euros 25 million; and
- the following customers are also selected:
  - those identified by the Bank itself based on another criterion that is justified (e.g. activity sector);
  - those which in the past had been attributed specific impairment;
  - those which in the face of some new element that may have repercussions on the calculation of impairment, are proposed for analysis by one of the members of the Impairment Committee or by another Body/Forum.

In the context of the impairment analysis on a collective basis, exposures are grouped based on similar credit risk characteristics in function of the risk assessment defined by the Bank. For each of these homogeneous risk groups, risk factors are estimated and then applied in the scope of the impairment calculation.

### Scenario analysis

As envisaged in the IFRS 9 regulations, the impairment estimate should reflect different expectations of macroeconomic developments, i.e., it should incorporate multiple scenarios. In order to incorporate the effects of future macroeconomic behaviour on loss estimates, forward looking macroeconomic estimates are included in some of the risk parameters used to calculate impairment. In fact, different possible scenarios are considered that give rise to the same number of impairment results.

In this context, the process for the definition of macroeconomic scenarios must consider the following principles:

- Representative scenarios that capture the existing non-linearities (e.g. a baseline scenario, a scenario with more favourable macroeconomic perspectives and a scenario with less favourable macroeconomic perspectives);
- The baseline scenario should be consistent with the inputs used in other exercises in the Bank (e.g.: Planning). This is ensured because the option used for the purpose of calculating impairment was precisely the same as the one used in internal and/or regulatory planning exercises. In fact, the Bank developed macroeconomic regressions for the main loan portfolios, through which the risk parameters are projected, having as explanatory factors the macroeconomic variables (GDP growth, Unemployment Rate, Inflation, Interest Rate, Price Variation of real estate, among other variables) assumed for a given projection time horizon. These models are subject to regular statistical monitoring and have been in use for several years. Thus, it is considered that there is a significant Use Test, a factor that, along with the statistical robustness evidenced by the tests performed and the evident advantage of using a methodology consistent with the Bank's practice in other processes, justified our choice;
- Alternative scenarios to the baseline scenario should not translate extreme scenarios;
- The correlation between the projected variables must be realistic with the economic reality (e.g.: if GDP is increasing, unemployment is expected to be decreasing).

The available macroeconomic scenarios and projections are also likely to occur. Thus, when reviewing/updating the scenarios – with a minimum annual periodicity - the respective probabilities of execution are also reviewed. Once the scenarios are updated, the values of the risk parameters are updated for subsequent consideration in the scope of the impairment calculation. The final impairment calculated will thus result from the sum of the impairment value of each scenario, weighted by the respective probability of execution.

It is also important to mention that there is a specific universe of portfolios where the internal credit risk rates incorporate, through their allocation process, forward-looking information. We refer to the portfolios commonly denominated Low Default Portfolios for which the allocation of the internal credit risk rate is made from a medium- and long-term perspective and incorporates all the available forward-looking information.

Thus, for this universe of portfolios the incorporation of forward-looking information is assured.

### **Write-offs**

A write-off is defined as the derecognition of a financial asset from the Bank's balance sheet, which should only occur when cumulatively:

- (i) The total amount of the loan has been demanded, that is to say, the loans must be fully booked in non-performing loans, with no maturing debt. Exemptions from this requirement are debt restructuring/pardon made under extrajudicial agreements, PERs (Special Recovery Processes) and Insolvencies, where part of the loan may be kept active while the remainder of the loan owed is written off under a judicial/extra-judicial decision;
- (ii) All recovery efforts considered adequate have been developed (and relevant evidence of same gathered) and further attempts to recover the asset are not considered economically viable;
- (iii) Loan recovery expectations are very low, leading to an extreme scenario of total impairment – 100% impairment. This rule is only applicable for contracts without guarantees and provided the entire contract is considered past due. In the remaining cases, it is necessary to ensure that the amount to be written off from the asset is 100% impaired (constituted at least one month prior to the write-off);
- (iv) A definitive agreement is obtained in the context of a restructuring or debt pardon and the remaining balance can no longer be collected;
- (v) It is considered more economical to sell the loan to a third party. At the time of sale, the difference between the sale amount and the carrying value must be 100% provisioned, and at the time of sale the derecognition of the loan sold against the receipt of the funds/assets and consequent utilization of the impairment in the balance sheet will be made.

Receipts subsequent to write-off shall be recorded as write-off recoveries.

### **2.5. Sale and repurchase agreements, securities' loans and short sales**

Securities sold subject to repurchase agreements (repos) at a fixed price or at sales price plus a return are not de-recognized from the balance sheet. The corresponding liability is included in amounts due to banks or to customers, as appropriate. The difference between the sale and repurchase price is treated as interest and deferred over the life of the agreement, using the effective interest rate method.

Securities purchased under agreements to resell (reverse repos) at a fixed price or at purchase price plus a return are not recognized in the balance sheet, with the purchase price paid being recorded as loans and advances to banks or customers, as appropriate. The difference between

the purchase and resale price is treated as interest and deferred over the life of the agreement, using the effective interest rate method.

Securities ceded under loan agreements are not de-recognized, being classified and valued in accordance with the accounting policy described in Note 2.4. Securities received under loan agreements are not recognized in the balance sheet.

Short sales represent securities sold that are not included in the assets of the Bank. These are recorded as a financial liability held for trading, at the fair value of the assets to be returned under the resale agreement. Gains and losses resulting from the respective change in fair value are recognized directly in the income statement.

## 2.6. Financial Liabilities

An instrument is classified as a financial liability when it contains a contractual obligation which settlement is to occur through the transfer of cash or another financial asset, irrespective of its legal form. Financial liabilities are de-recognized when the underlying obligation expires or is cancelled.

Non-derivative financial liabilities include deposits from banks and due to customers, loans, debt securities, other subordinated debt and short sales.

These financial liabilities are recognized (i) initially, at fair value less transaction costs and (ii) subsequently, at amortized cost, using the effective interest rate method, except for short sales and financial liabilities designated at fair value through profit and loss, which are measured at fair value.

The Bank designates, at inception, certain financial liabilities as at fair value through profit and loss when:

- such designation eliminates or significantly reduces an inconsistency of measurement or recognition that would otherwise result;
- the financial liability integrates a group of financial assets or financial liabilities or both, which is managed and measured on a fair value basis, in accordance with the risk management or investment strategy of the Bank; or,
- such financial liabilities contain embedded derivatives and IFRS 9 allows the totality of the hybrid contract to be designated at fair value through profit and loss.

Reclassifications between categories of liabilities are not permitted.



The structured products issued by the Bank - with the exception of structured products in respect of which the embedded derivatives were separated and recorded separately and revalued at fair value - because they always fall into one of the situations described above, follow the valuation method of financial liabilities at fair value through profit and loss.

The fair value of quoted financial liabilities is their quoted price. In the absence of a quoted price, the Bank establishes fair value using valuation techniques based on market information, including the own credit risk of the Group's issuing entity.

Gains or losses arising on the revaluation of liabilities at fair value are recorded in the income statement. However, the change in fair value attributable to changes in credit risk is recognized in other comprehensive income. At the time of the derecognition of the liability, the amount recorded in other comprehensive income related to changes in credit risk is transferred to retained earnings.

The Bank accounts for a substantial modification of the terms of an existing liability or part thereof as an extinction of the original financial liability and the recognition of a new liability. The terms are assumed to be substantially different if the present value of the cash flows under the new terms, including any commissions paid net of any commissions received, and discounted using the original effective interest rate, is at least 10% different from the present value of the remaining discounted cash flows of the original financial liability. The difference between the carrying value of the original liability and the amount of the new liability is recorded in profit and loss.

If the Bank repurchases debt issued, same is annulled from the balance sheet and the difference between the carrying value of the liability and the purchase amount is recorded in profit and loss.

## **2.7. Financial guarantees**

Financial guarantees are contracts that require the issuer to make payments to compensate the holder for losses incurred due to non-compliance of contractual terms of debt instruments, namely payments of the respective principal and/or interest.

Financial guarantees issued are initially recognized at fair value. Subsequently, these guarantees are measured at the higher of (i) the fair value initially recognized and (ii) the amount of any obligations arising under the guarantee contract, measured at the balance sheet date. Any variation of the amount of the obligation associated with financial guarantees issued is recognized in the income statement.

Financial guarantees issued by the Bank usually have a defined maturity and a periodic fee charged in advance, which varies depending on the counterpart's risk, amount and contract period. On that basis, the fair value of the guarantees on the date of initial recognition is roughly equivalent to the initial commission amount received, considering that the agreed conditions are market conditions. Thus, the amount recognized on the acquisition date equals the amount of the initial commission received, which is recognized in the income statement during the period to which it relates. Subsequent commissions are recognized in the income statement in the period to which they relate.

## **2.8. Equity instruments**

An instrument is classified as an equity instrument when it does not contain a contractual obligation for its settlement to be made through the delivery of cash or another financial asset, irrespective of its legal form, but evidences a residual interest in the assets of an entity after deducting all of its liabilities.

Transaction costs directly attributable to the issue of equity instruments are recognized under equity as a deduction from the issue proceeds. Amounts paid or received relating to purchases or sales of equity instruments are recognized in equity, net of transaction costs.

Distributions to holders of an equity instrument are debited directly against equity as dividends when declared.

## **2.9. Offsetting of financial instruments**

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legal possibility of offsetting the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously. The legally enforceable right may not be contingent on future events, and should be executable in the normal course of the Bank's activity, as well as in the event of the default, bankruptcy or insolvency of the Bank or the counterpart.

## **2.10. Assets acquired in recovery of loans and non-current assets held for sale**

Non-current assets or disposal groups (group of assets to be disposed of in a single transaction and directly associated liabilities that include at least one non-current asset) are classified as held for

sale when their carrying value is recovered mainly through a transaction (including those acquired exclusively for the purpose of sale), the assets or disposal groups are available for immediate sale and the sale is highly probable (within one year).

Immediately before the initial classification of the asset (or disposal group) as held for sale, the measurement of the non-current assets (or all assets and liabilities of the disposal group) is carried out in accordance with the applicable IFRS. Subsequently, these assets or disposal groups are remeasured at the lower of the initial recognition value and the fair value less costs to sell, with unrealized losses being recorded in the income statement for the period. When the carrying value corresponds to the fair value less costs to sell, the fair value level of the IFRS 13 hierarchy corresponds to level 3.

In the course of its current lending activity, the Bank incurs in the risk of not being able to recover all of its loans. In the case of loans with mortgage collateral, the Bank proceeds with the execution of same receiving real estate and other assets in settlement of the loan granted. Under the provisions of the General Regime governing Credit Institutions and Financial Companies (RGICSF), Banks are barred, unless authorized by the Bank of Portugal, from acquiring real estate that is not indispensable to their installation and operation or to the pursuit of their corporate purpose (no. 1 of article 112 of the RGICSF), but may acquire real estate in reimbursement of its own loans, with the resulting situations having to be regularized within a period of 2 years which, if there is good reason, may be extended by the Bank of Portugal, under such conditions as it may determine (article 114 of the RGICSF).

Although the objective is the immediate sale of all properties received in settlement of loans, during the 2016 financial year the Bank altered the classification of these properties from Non-current assets held for sale to Other assets, given that the assets are held in the portfolio for longer than one year and, consequently, do not comply with the provisions of IFRS 5 in order to remain in this category. However, the method of accounting did not change, being recorded at initial recognition at the lower of their fair value less expected costs to sell and the carrying value of the loan being recovered. Subsequently, these assets are measured at the lower of the initial recognition value and the fair value less costs to sell and are not amortized. Unrealized losses on these assets, thus determined, are recorded in the income statement.

The valuations of these properties are carried out according to one of the following methodologies, applied according to the specific situation of the property:

- (i) Market Method

The Market Comparison Criterion refers to property transaction values similar and comparable to the property object of the study obtained through market prospecting realized in the area.

(ii) Revenue Method

This method aims to estimate the value of the property through the capitalization of its net rentals, discounted to the present moment, using the discounted cash flow method.

(iii) Cost Method

The Cost Method is a criterion that breaks down the value of the property into its fundamental components: urban land value and the urbanity value; construction value; and indirect costs value.

The valuations are performed by independent entities specializing in this type of service. The valuation reports are analysed internally to measure the suitability of the processes, comparing the sales values with the revalued values of the properties.

## 2.11. Other tangible assets

Other tangible fixed assets of the Bank are measured at cost less accumulated depreciation and impairment losses. The cost includes expenditure that is directly attributable to the acquisition of the assets.

Subsequent costs are recognized only when it is probable that future economic benefits associated with same will flow to the Bank. All other repair and maintenance expenditure is charged to the income statement during the period in which it is incurred.

Land is not depreciated. Depreciation of other tangible assets is calculated using the straight-line method, applied over their estimated useful lives, as follows:

|                                    | <u>Number of years</u> |
|------------------------------------|------------------------|
| Improvements in leasehold property | 10                     |
| Computer equipment                 | 4 to 5                 |
| Furniture                          | 4 to 10                |
| Fixtures                           | 5 to 10                |
| Security equipment                 | 4 to 10                |
| Office equipment                   | 4 to 10                |
| Motor vehicles                     | 4                      |
| Other equipment                    | 5                      |

The useful lives and residual values of the tangible fixed assets are reviewed at each reporting date.

When there is an indication that an asset may be impaired, IAS 36 requires that its recoverable amount be estimated and an impairment loss recognized when the carrying value of the asset exceeds its recoverable amount. Impairment losses are recognized in the income statement, being reversed in subsequent financial years, when the reasons that led to the initial recognition cease to exist. For this purpose, the new depreciated amount shall not exceed that which would be accounted for had impairment losses not been recognized on the assets, considering the depreciation that these would have undergone.

The recoverable amount is determined as the lower of its net selling price and value in use, the latter being determined based on the net present value of the future cash flows arising from the continued use and ultimate disposal of the asset.

On the date of the derecognition of a tangible asset, the gain or loss calculated by the difference between the fair value less costs to sell and the net carrying value is recognized in the income statement in the caption Other operating income/(losses).

## **2.12. Intangible assets**

The costs incurred with the acquisition, production and development of software are capitalized, as are the costs incurred to bring same into use. These costs are amortized using the straight-line method over their expected useful lives, which usually range between 3 to 6 years.

Costs that are directly associated with the development by the Bank of identifiable software, and that will probably generate economic benefits beyond one period, are recognized and recorded as intangible assets.

All remaining costs related to IT services are recognized as an expense as incurred.

## **2.13. Leases**

The Bank classifies its lease operations as finance leases or operating leases taking into consideration the substance of the transaction rather than its legal form, in accordance with IAS 17 – Leases. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. All other leases are classified as operating leases.

## Operating leases

Payments made by the Bank under operating leases are charged to the income statement in the period to which they relate.

## Finance leases

- As lessee

Finance lease contracts are recorded at their inception date, both under assets and liabilities, at the acquisition cost of the leased asset, which is equivalent to the present value of the outstanding lease instalments. Instalments comprise (i) an interest charge, which is recognized in the income statement and (ii) the repayment of principal, which is deducted from liabilities. Finance charges are recognized as costs over the lease period, in order to produce a constant periodic rate of interest on the remaining balance of the liability in each period.

- As lessor

Leasing contracts are recorded in the balance sheet as loans granted for the amount equivalent to the net investment made in the leased assets, together with any estimated non-guaranteed residual value.

Interest included in instalments charged to customers is recorded as interest income, while the repayments of principal, also included in the instalments, are deducted from the amount of the loans granted. The recognition of the interest reflects a constant periodic rate of return on the lessor's net outstanding investment.

## 2.14. Employee benefits

### Variable remuneration paid to employees

The Bank recognizes in costs the short-term benefits attributed to employees who rendered services in the respective accounting period.

- Profit-sharing and bonus plans

The Bank recognizes the estimated costs with profit-sharing pay-outs and bonuses when it has a present, legal or constructive, obligation to make such payments as a result of past events, and can make a reliable estimate of the obligation.

- Obligations with regard to holidays, holiday subsidy and Christmas subsidy

In accordance with the legislation in force in Portugal, employees are annually entitled to one month of holidays and one month of holiday subsidy, this being a right acquired in the year prior to their payment. In addition, employees are annually entitled to one month of Christmas subsidy, which right is acquired throughout the year and settled during the month of December of each calendar year. Hence, these liabilities are recorded in the period in which the employees acquire the right to same, regardless of the date of their respective payment.

## 2.15. Income taxes

BEST is subject to the tax regime laid down in the Corporate Income Tax Code (Código do Imposto sobre o Rendimento das Pessoas Coletivas (CIRC).

Income taxes for the period comprise current and deferred taxes. Income tax is recognized in the income statement except to the extent that it relates to items recognized directly in equity, fact which implies its recognition in equity. Deferred taxes recognized directly in equity relating to the measurement of assets at fair value through other comprehensive income and of cash flow hedges are subsequently recognized in the income statement when the gains or losses giving rise to the income tax are also recognized in the income statement.

Current tax is the tax expected to be paid on the taxable income for the period, calculated using tax rules and tax rates enacted or substantively enacted at the balance sheet date, in each jurisdiction and any adjustments to taxes of prior periods. The tax is recognized in each financial reporting period, based on Management's estimates of the average annual effective tax rate forecast for the entire fiscal year.

Deferred tax is determined on timing differences arising between the carrying values of assets and liabilities for financial reporting purposes and their respective tax base, and is calculated using the tax rates enacted or substantively enacted at the balance sheet date, in each jurisdiction, and that are expected to come to apply when the timing differences reverse.

Deferred tax liabilities are recognized for all taxable timing differences, except for i) the tax non-deductible goodwill; ii) the differences arising on the initial recognition of assets and liabilities that neither affect the accounting nor the taxable income; iii), those that do not result from a business combination, and iv) the differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future.

Deferred tax assets are recognized to the extent that it is probable that future taxable income will be available to absorb the deductible timing differences for tax purposes (including tax losses carried forward).

Deferred tax liabilities are always recorded, regardless of BEST's performance.

The taxable income or tax loss calculated by the Bank can be corrected by the Portuguese tax authorities within four years, except in the case of any tax credit deduction or use, for which the time limit is the exercise of that right (5 or 12 years in the case of tax losses, depending on the financial year). The Board of Directors considers that any corrections, mainly resulting from differences in the interpretation of tax legislation, will not have a material effect at the level of the financial statements.

BEST proceeds, as established in IAS 12, paragraph 74, to offset deferred tax assets and liabilities whenever (i) it has the legally enforceable right to offset current tax assets and current tax liabilities; and (ii) the deferred tax assets and liabilities relate to income tax levied by the same taxing authority on the same taxable entity or different taxable entities that want to settle current tax liabilities and assets on a net basis or to realize the assets and settle the liabilities simultaneously, in each future period in which the deferred tax liabilities or assets are expected to be settled or recovered.

## **2.16. Provisions and Contingent liabilities**

Provisions are recognized when: (i) the Bank has a present, legal or constructive, obligation, (ii) it is probable that its settlement will be required in the future and (iii) a reliable estimate of the obligation can be made.

Provisions related to legal proceedings, opposing the Bank to third parties, are set up in accordance with the internal risk assessments carried out by Management, with the support and advice of its legal consultants.

Where the discounting effect is material, the provision represents the present value of the expected future payments discounted at a rate that considers the risk associated with the obligation.

Provisions are recognized for restructuring when the Bank has approved a detailed and formal restructuring plan and such restructuring has started or has been publicly announced.



A provision for onerous contracts is recognized when the expected benefits to be derived by the Bank from a contract are lower than the unavoidable costs of meeting the obligations under same. This provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net costs of continuing the contract.

If a future outflow of funds is not probable, this situation reflects a contingent liability. Contingent liabilities are always disclosed, except when the likelihood of their occurrence is remote.

## **2.17. Recognition of interest income and expense**

Interest income and expense are recognized in the income statement under interest and similar income and interest expense and similar charges, respectively, for all non-derivative financial instruments measured at amortized cost and for the financial assets at fair value through other comprehensive income, using the effective interest rate method. Interest income and expense arising from financial assets and liabilities at fair value through profit and loss are also included under interest and similar income or interest expense and similar charges, respectively.

The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts throughout the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying value of the financial asset or liability. The effective interest rate is calculated at inception and it is not subsequently revised except with respect to financial assets and liabilities at a variable rate, which is re-estimated periodically considering the estimated future impacts on cash flows resulting from the change in the reference interest rate.

When calculating the effective interest rate, the Bank estimates cash flows considering all the contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees and commissions paid or received that are an integral part of the effective interest rate, transaction costs and all other directly related premiums or discounts.

Interest and similar income includes interest on financial assets for which impairment was recognized. The interest on financial assets classified in Stage 3 are determined applying the effective interest rate method to the net carrying value. When the assets ceases to be included in Stage 3, the interest is calculated based on the gross carrying value.

For derivative financial instruments, excluding those classified as held for risk management purposes (see Note 2.3), the interest component of the changes in their fair value is not separated

and is classified under the caption Net gains/(losses) from financial assets and liabilities at fair value through profit and loss. The interest component of the changes in the fair value of derivatives held for risk management purposes is recognized under the captions Interest and similar income or Interest expense and similar charges.

## 2.18. Recognition of fee and commission income

Fee and commission income is recognized as revenue from contracts with customers in the same measure the performance obligations are met:

- Fees and commissions that are earned on the execution of a significant act, such as loan syndication fees, are recognized as income when the significant act has been completed;
- Fees and commissions earned over the period during which the services are provided are recognized as income in the period to which they relate;
- Fees and commissions that are an integral part of the effective interest rate of a financial instrument are recognized as income using the effective interest rate method.

## 2.19. Recognition of dividend income

Dividend income is recognized when the right to receive the payment is established.

## 2.20. Segmental reporting

Since the Bank's equity or debt securities are not publicly traded, in light of paragraph 2 of IFRS 8 - Operating Segments, the Bank does not disclose information on the segments.

## 2.21. Earnings per share

Basic earnings per share are calculated by dividing the net income available to the shareholders by the weighted average number of ordinary shares in circulation during the period, excluding the average number of ordinary shares purchased by the Bank and held as treasury stock.

For the diluted earnings per share calculation, the weighted average number of ordinary shares in circulation is adjusted to reflect the conversion of all potential dilutive ordinary shares, such as

convertible debt and share options granted to employees. The dilution effect reflects a decrease in the earnings per share and results from the assumption that all convertible debt is converted and that all the options granted are exercised.

## **2.22. Cash and cash equivalents**

For cash flow statement purposes, cash and cash equivalents comprise balances with a maturity of less than three months from the inception date, including cash and deposits with Central Banks and with other credit institutions.

Cash and cash equivalents exclude mandatory deposits with Central Banks.

## **NOTA 3 – MAIN ESTIMATES AND JUDGEMENTS USED IN PREPARING THE FINANCIAL STATEMENTS**

Considering that the current accounting framework requires applying judgements and calculating estimates involving some degree of subjectivity, the use of different parameters or judgements based on different evidence may result in different estimates. The most significant accounting estimates and judgements used are discussed in this Note so as to increase the understanding of how their application affects the Bank's reported results and their disclosure.

### **3.1. Impairment of financial assets at amortized cost and at fair value through other comprehensive income**

The critical judgments with the greatest impact on the recognized amounts of impairment of financial assets at amortized cost and at fair value through other comprehensive income are as follows:

- Assessment of the business model: the classification and measurement of financial assets depends on the results of the SPPI test and the definition of the business model. The Bank determines the business model depending on how it wants to manage financial assets and business objectives. The Bank monitors whether the business model classification is appropriate based on the analysis of the anticipated derecognition of assets at amortized cost or at fair value through other comprehensive income, assessing whether a prospective change is necessary;

- Significant increase in credit risk: as stated in policy 2.4 - Other financial assets, the determination of the transfer of an asset from stage 1 to stage 2 for the purpose of determining its impairment is made on the basis of a significant increase in its credit risk, with IFRS 9 not objectively defining what constitutes a significant increase in credit risk;
- Classification of an exposure as “in default”: the internal definition at BEST of an exposure in default is broadly in line with the regulatory definition in article 178 of the CRR/CRD IV. This same regulation establishes qualitative criteria for the assessment of the state of default – “unlikely to pay” -, criteria which are replicated in the internal definition implemented by the Bank and which result in judgments regarding the high probability that the borrower does not fulfil the obligations under the conditions agreed with the Bank;
- Definition of groups of assets with similar credit risk characteristics: when the expected credit losses are measured in a collective model, the financial instruments are grouped based on the same risk characteristics. The Bank monitors the adequacy of the credit risk characteristics in order to ensure that a proper reclassification of the assets is made, in case of changes in credit risk characteristics;
- Models and assumptions used: the Bank uses several models and assumptions in the measurement of the estimate of expected credit losses. The judgment is applied in the identification of the most appropriate model for each type of asset as well as to determine the assumptions used in these models, including the assumptions related to the main drivers of credit risk. In addition, in compliance with the IFRS 9 regulations that explain the need for the impairment result to consider multiple scenarios, a methodology for incorporating scenario analysis in the risk parameters was implemented. Thus, the collective impairment calculation considers several scenarios with a specific weighting, based on the internal methodology defined for scenario analysis - definition of multiple perspectives of macroeconomic evolution, with a relevant probability of occurrence.

### **3.2. Fair value of derivative financial instruments and other financial assets and liabilities at fair value**

Fair values are based on listed market prices, when available; otherwise, fair value is determined based on the price of recent similar arm’s length transactions, or valuation methodologies, based on the net present value of the estimated future cash flows discounted taking into consideration the market conditions, time value, yield curve and volatility factors of the underlying instruments in conformity with the principles of IFRS 13 – Fair value measurement. These methodologies may require assumptions or judgements in estimating fair values.

Consequently, the use of different methodologies or the use of different assumptions or judgements in applying a particular model might have produced different measurements from those reported and summarized in Notes 32 and 33.

### **3.3. Income taxes**

The Bank is subject to taxes on its income. Significant interpretations and estimates are required in determining the global amount of income taxes. Different interpretations and estimates could result in a different level of income taxes, current and deferred, being recognized in the period and evidenced in Note 26.

The Tax Authorities are entitled to review the Bank's self-assessed tax returns during a period of four years or during the period in which it is possible to deduct tax losses carried forward or tax credits (up to twelve years, depending on the financial year in which they were assessed). Hence, it is possible that additional taxes may be assessed, mainly as a result of differences in interpretation of tax law. However, the Board of Directors of the Bank is confident that there will be no material tax corrections to the income taxes recorded in the financial statements.

### **NOTE 4 – SEGMENTAL REPORTING**

Given that the Bank does not hold treasury stock or debt securities that are publicly traded, in accordance with paragraph 2 of IFRS 8 - Operating Segments, it does not disclose segmental information.

### **NOTE 5 – NET INTEREST INCOME**

This caption comprises:

(thousands of Euros)

|   | 31.12.2018   | 31.12.2017   |
|---|--------------|--------------|
| <b>Interest and similar income</b>                          |              |              |
| Interest from loans and advances to customers               | 2 896        | 3 019        |
| Interest from deposits with and loans and advances to banks | 3 765        | 3 929        |
| Interest from securities                                    | 1 163        | 936          |
| Other interest and similar income                           | -            | 3            |
|   | <b>7 824</b> | <b>7 887</b> |
| <b>Interest expense and similar charges</b>                 |              |              |
| Interest on amounts due to customers                        | 1 233        | 1 030        |
| Interest on deposits from Central Banks and banks           | 9            | -            |
| Other interest expense and similar charges                  | 1            | 2            |
|   | <b>1 243</b> | <b>1 032</b> |
|   | <b>6 581</b> | <b>6 855</b> |

## NOTE 6 – NET FEE AND COMMISSION INCOME

This caption comprises:

(thousands of Euros)

|   | 31.12.2018    | 31.12.2017    |
|---|---------------|---------------|
| <b>Fee and commission income</b>              |               |               |
| From guarantees issued                        | 2 566         | 2 309         |
| From banking services                         | 9 858         | 9 443         |
| From transactions of securities               | 1 681         | 1 976         |
| From commitments to third parties             | 3             | 20            |
| Other fee and commission income               | 898           | 975           |
|   | <b>15 006</b> | <b>14 723</b> |
| <b>Fee and commission expenses</b>            |               |               |
| On transactions of securities                 | 206           | 214           |
| On banking services rendered by third parties | 380           | 648           |
| Other fee and commission expenses             | 4 254         | 4 261         |
|   | <b>4 840</b>  | <b>5 123</b>  |
|   | <b>10 166</b> | <b>9 600</b>  |

## NOTE 7 – NET GAINS/(LOSSES) FROM FINANCIAL ASSETS AND LIABILITIES AT FAIR VALUE THROUGH PROFIT AND LOSS AND FROM FINANCIAL ASSETS AND LIABILITIES AT FAIR VALUE THROUGH PROFIT AND LOSS MANDATORILY

Net gains / (losses) from financial assets and liabilities at fair value through profit and loss have the following breakdown:

(thousands of Euros)

|   | 31.12.2018   |            |            | 31.12.2017 |            |              |
|---|--------------|------------|------------|------------|------------|--------------|
|   | Gains        | Losses     | Total      | Gains      | Losses     | Total        |
| <b>Derivative financial instruments</b>   |              |            |            |            |            |              |
| Exchange rate contracts   | 967          | 615        | 352        | 299        | 564        | ( 265)       |
| Interest rate contracts   | 41           | 39         | 2          | 50         | 42         | 8            |
| Equity/Index contracts  | 158          | 113        | 45         | 206        | 37         | 169          |
|   | <b>1 166</b> | <b>767</b> | <b>399</b> | <b>555</b> | <b>643</b> | <b>( 88)</b> |
| <b>Net gains/(losses) from financial assets at fair value through profit and loss</b>             | <b>1 166</b> | <b>767</b> | <b>399</b> | <b>555</b> | <b>643</b> | <b>( 88)</b> |
| <b>Other financial assets at fair value through profit and loss mandatorily</b>                   |              |            |            |            |            |              |
| Shares  | 94           | -          | 94         | -          | -          | -            |
|   | <b>94</b>    | <b>-</b>   | <b>94</b>  | <b>-</b>   | <b>-</b>   | <b>-</b>     |
| <b>Net gains/(losses) from financial assets at fair value through profit and loss mandatorily</b> | <b>94</b>    | <b>-</b>   | <b>94</b>  | <b>-</b>   | <b>-</b>   | <b>-</b>     |
|   | <b>1 260</b> | <b>767</b> | <b>493</b> | <b>555</b> | <b>643</b> | <b>( 88)</b> |

## NOTE 8 – NET GAINS/(LOSSES) FROM FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

This caption comprises:

(thousands of Euros)

|   | 31.12.2018 |          |            | 31.12.2017 |          |          |
|---|------------|----------|------------|------------|----------|----------|
|   | Gains      | Losses   | Total      | Gains      | Losses   | Total    |
| <b>Securities</b>                       |            |          |            |            |          |          |
| Bonds and other fixed-income securities |            |          |            |            |          |          |
| Of Government/public issuers            | 804        | -        | 804        | -          | -        | -        |
| Shares                                  | -          | -        | -          | 6          | -        | 6        |
|   | <b>804</b> | <b>-</b> | <b>804</b> | <b>6</b>   | <b>-</b> | <b>6</b> |

## NOTE 9 – NET GAINS/(LOSSES) FROM FOREIGN EXCHANGE REVALUATION

This caption comprises:

(thousands of Euros)

|                              | 31.12.2018   |                 |               | 31.12.2017   |                 |            |
|------------------------------|--------------|-----------------|---------------|--------------|-----------------|------------|
|                              | Gains        | Losses          | Total         | Gains        | Losses          | Total      |
| Foreign exchange revaluation | 8 266        | ( 8 612)        | ( 346)        | 5 829        | ( 5 485)        | 344        |
|                              | <b>8 266</b> | <b>( 8 612)</b> | <b>( 346)</b> | <b>5 829</b> | <b>( 5 485)</b> | <b>344</b> |

This caption includes the foreign exchange differences arising from the revaluation of monetary assets and liabilities in accordance with the accounting policy described in Note 2.2.

## NOTE 10 – NET GAINS/(LOSSES) FROM DISPOSAL OF OTHER FINANCIAL ASSETS

This caption comprises:

(thousands of Euros)

|                              | 31.12.2018 | 31.12.2017 |
|------------------------------|------------|------------|
| Securities at amortized cost | 957        | -          |
|                              | <b>957</b> | <b>-</b>   |

## NOTE 11 - OTHER OPERATING INCOME/(LOSSES)

This caption comprises:

(thousands of Euros)

|   | 31.12.2018   | 31.12.2017 |
|---|--------------|------------|
| <b>Other operating income/(losses)</b>    |              |            |
| Direct and indirect taxes                 | ( 24)        | ( 27)      |
| Banking levy                              | ( 126)       | ( 118)     |
| Contributions to the Resolution Fund      | ( 51)        | ( 30)      |
| Contributions to the Sole Resolution Fund | ( 7)         | ( 7)       |
| Non-recurring income from loan operations | 33           | 75         |
| Other                                     | 116          | 159        |
|   | <b>( 59)</b> | <b>52</b>  |



**NOTE 12 – STAFF COSTS**

Staff costs have the following breakdown:

|                          | (thousands of Euros) |              |
|--------------------------|----------------------|--------------|
|                          | 31.12.2018           | 31.12.2017   |
| Wages and salaries       | 3 618                | 3 756        |
| Mandatory social charges | 821                  | 861          |
| Other costs              | 110                  | 163          |
|                          | <b>4 549</b>         | <b>4 780</b> |

The number of Bank employees, by professional category, is analysed as follows:

|                             | 31.12.2018 | 31.12.2017 |
|-----------------------------|------------|------------|
| Top management functions    | 32         | 33         |
| Middle management functions | 15         | 17         |
| Specific functions          | 70         | 68         |
| Administrative functions    | 12         | 13         |
|                             | <b>129</b> | <b>131</b> |

**NOTE 13 – GENERAL AND ADMINISTRATIVE EXPENSES**

This caption comprises:

(thousands of Euros)

|                                  | 31.12.2018   | 31.12.2017   |
|----------------------------------|--------------|--------------|
| Advertising                      | 947          | 984          |
| Communication                    | 1 179        | 1 168        |
| Rentals                          | 932          | 1 040        |
| Travel and entertainment         | 75           | 66           |
| Consumables                      | 26           | 35           |
| Water, energy and fuel           | 32           | 32           |
| Transport                        | 8            | 4            |
| Insurance                        | 31           | 85           |
| Maintenance and related services | 23           | 16           |
| Training                         | 19           | 12           |
| IT services                      | 1 626        | 712          |
| Legal costs                      | 515          | 97           |
| Studies and consultation         | 189          | 6            |
| Electronic payment systems       | 220          | 197          |
| Independent work                 | 146          | 51           |
| Consultants and auditors         | 29           | 74           |
| Assignment of human resources    | 1 303        | 1 283        |
| Other costs                      | 865          | 894          |
|                                  | <b>8 165</b> | <b>6 756</b> |

The fees invoiced during financial years 2018 and 2017 by the Statutory Audit Firm, disclosed in accordance with the provision of article 66-A of the Portuguese Commercial Companies Code, have the following breakdown:

(thousands of Euros)

|  | 31.12.2018 | 31.12.2017 |
|--|------------|------------|
| Statutory audit fees                         | 21         | 36         |
| Other services                               | 22         | -          |
| <b>Total amount of the services invoiced</b> | <b>43</b>  | <b>36</b>  |

## NOTE 14 – EARNINGS PER SHARE

### *Basic earnings per share*

The basic earnings per share is calculated by dividing the net income attributable to shareholders of the Bank by the weighted average number of ordinary shares in circulation during the period.

|   | (thousands of Euros) |             |
|---|----------------------|-------------|
|   | 31.12.2018           | 31.12.2017  |
| Net income attributable to the shareholders of the Bank                                 | 3 564                | 3 014       |
| Weighted average number of ordinary shares (thousands)                                  | 63 000               | 63 000      |
| <b>Basic earnings per share attributable to the shareholders of the Bank (in Euros)</b> | <b>0.06</b>          | <b>0.05</b> |

#### *Diluted earnings per share*

The diluted earnings per share is calculated considering the income attributable to the shareholders of the Bank and the weighted average number of ordinary shares in circulation, adjusted for the effects of all potential dilutive ordinary shares.

As at 31 December 2018 and 2017, the Bank had no potential dilutive ordinary shares, and so the diluted earnings per share is equal to the basic earnings per share.

#### **NOTE 15 – DEPOSITS WITH BANKS**

As at 31 December 2018 and 2017, this caption is analysed as follows:

|                                 | (thousands of Euros) |               |
|---------------------------------|----------------------|---------------|
|                                 | 31.12.2018           | 31.12.2017    |
| Deposits with banks in Portugal |                      |               |
| Demand deposits                 | 13 085               | 20 425        |
|                                 | <b>13 085</b>        | <b>20 425</b> |
| Deposits with banks abroad      |                      |               |
| Other deposits                  | 20 175               | 24 269        |
|                                 | <b>20 175</b>        | <b>24 269</b> |
|                                 | <b>33 260</b>        | <b>44 694</b> |

In accordance with Article 10 of Regulation no. 2818/98 of the European Central Bank, of 1 December, and through Circular Letter no. 204/DMRCF/DMC, of 5 June 2001, the Bank of Portugal authorized BEST to constitute its minimum mandatory reserves indirectly, through NOVO BANCO, S.A.. Quarterly, BEST settles through a deposit account with NOVO BANCO the amount related to the minimum mandatory reserves to be constituted. As at 31 December 2018, the balance of that account amounted to Euros 5 433 thousand (31 December 2017: Euros 4 933 thousand), and had earned interest at an average rate of 0.00% (31 December 2017: 0.00%).

## NOTE 16 – DERIVATIVES HELD FOR TRADING

As at 31 December 2018 and 2017, this caption is analysed as follows:

|   | (thousands of Euros) |            |
|---|----------------------|------------|
|   | 31.12.2018           | 31.12.2017 |
| Derivatives held for trading with a positive fair value | 584                  | 285        |
| Derivatives held for trading with a negative fair value | 647                  | 744        |

As at 31 December 2018 and 2017, the derivatives held for trading may be analysed as follows:

|                                | 31.12.2018 |            |             | 31.12.2017 |            |             |
|--------------------------------|------------|------------|-------------|------------|------------|-------------|
|                                | Notional   | Fair value |             | Notional   | Fair value |             |
|                                |            | Assets     | Liabilities |            | Assets     | Liabilities |
| <b>Exchange rate contracts</b> |            |            |             |            |            |             |
| Forwards                       |            |            |             |            |            |             |
| - buy                          | 43 409     | 222        | 223         | 28 350     | -          | 337         |
| - sell                         | 43 229     |            |             | 28 554     |            |             |
| Currency Swaps                 |            |            |             |            |            |             |
| - buy                          | 41 482     | 221        | 267         | 28 556     | 110        | 176         |
| - sell                         | 41 666     |            |             | 28 350     |            |             |
|                                |            | <u>443</u> | <u>490</u>  |            | <u>110</u> | <u>513</u>  |
| <b>Interest rate contracts</b> |            |            |             |            |            |             |
| Interest Rate Swaps            |            |            |             |            |            |             |
| - buy                          | 3 800      | -          | 19          | 3 800      | -          | 59          |
| - sell                         | 3 800      |            |             | 3 800      |            |             |
|                                |            | <u>-</u>   | <u>19</u>   |            | <u>-</u>   | <u>59</u>   |
| <b>Equity/Index contracts</b>  |            |            |             |            |            |             |
| Equity/Index Options           |            |            |             |            |            |             |
| - buy                          | 7 600      | 141        | 138         | 15 200     | 175        | 172         |
| - sell                         | 7 224      |            |             | 14 476     |            |             |
|                                |            | <u>141</u> | <u>138</u>  |            | <u>175</u> | <u>172</u>  |
| <b>TOTAL</b>                   |            | <u>584</u> | <u>647</u>  |            | <u>285</u> | <u>744</u>  |

As at 31 December 2018 and 2017, the analysis of derivatives held for trading by period to maturity is as follows:

|                    | 31.12.2018    |               |                | 31.12.2017    |               |                |
|--------------------|---------------|---------------|----------------|---------------|---------------|----------------|
|                    | Notional      |               | Net fair value | Notional      |               | Net fair value |
|                    | Buy           | Sell          |                | Buy           | Sell          |                |
| Up to 3 months     | 84 891        | 84 895        | ( 47)          | 56 906        | 56 904        | ( 403)         |
| 3 months to 1 year | 11 400        | 11 024        | ( 16)          | 7 600         | 7 238         | 2              |
| 1 to 5 years       | -             | -             | -              | 11 400        | 11 038        | ( 58)          |
|                    | <u>96 291</u> | <u>95 919</u> | <u>( 63)</u>   | <u>75 906</u> | <u>75 180</u> | <u>( 459)</u>  |

## NOTE 17 – LOANS AND ADVANCES TO BANKS

As at 31 December 2018 and 2017, this caption is analysed as follows:

|  | (thousands of Euros) |                |
|--|----------------------|----------------|
|  | 31.12.2018           | 31.12.2017     |
| <b>Loans and advances to banks in Portugal</b> |                      |                |
| Deposits                                       | 402 041              | 306 690        |
| <b>Impairment losses</b>                       | ( 443)               | -              |
|  | <b>401 598</b>       | <b>306 690</b> |

As at 31 December 2018, the main loans and advances to banks in Portugal bear interest at an average annual interest rate of 1.03% (31 December 2017: 1.21%).

As at 31 December 2018 and 2017, the analysis of loans and advances to banks by period to maturity is as follows:

|                    | (thousands of Euros) |                |
|--------------------|----------------------|----------------|
|                    | 31.12.2018           | 31.12.2017     |
| Up to 3 months     | 96 668               | 66 470         |
| 3 months to 1 year | 299 436              | 232 006        |
| 1 to 5 years       | 5 931                | 7 755          |
| More than 5 years  | 6                    | 459            |
|                    | <b>402 041</b>       | <b>306 690</b> |

The movements occurring up to 31 December 2018 and 2017 in impairment losses on loans and advances to banks are presented as follows:

|   | (thousands of Euros) |         |         |            |
|---|----------------------|---------|---------|------------|
|   | 31.12.2018           |         |         |            |
|   | Stage 1              | Stage 2 | Stage 3 | Total      |
| <b>Balance at 31 December 2017</b>      |                      |         |         | -          |
| Impact of transition to IFRS 9          |                      |         |         | 343        |
| <b>Balance at 1 January 2018</b>        | <b>343</b>           | -       | -       | <b>343</b> |
| Increases due to changes in credit risk | 405                  | -       | -       | 405        |
| Decreases due to changes in credit risk | ( 306)               | -       | -       | ( 306)     |
| Other movements                         | 1                    | -       | -       | 1          |
| <b>Closing balance</b>                  | <b>443</b>           | -       | -       | <b>443</b> |

## NOTE 18 – LOANS AND ADVANCES TO CUSTOMERS

As at 31 December 2018 and 2017, this caption is analysed as follows:

|   | (thousands of Euros) |                 |
|---|----------------------|-----------------|
|   | 31.12.2018           | 31.12.2017      |
| <b>Domestic loans and advances</b>              |                      |                 |
| Corporate                                       |                      |                 |
| Current account loans and advances              | 30 127               | 30 351          |
| Overdrafts                                      | 4                    | 23              |
| Individuals                                     |                      |                 |
| Consumer and other loans                        | 106 355              | 119 236         |
|   | <b>136 486</b>       | <b>149 610</b>  |
| <b>Foreign loans and advances</b>               |                      |                 |
| Corporate                                       |                      |                 |
| Current account loans and advances              | 99                   | 99              |
| Individuals                                     |                      |                 |
| Consumer and other loans                        | 5 214                | 10 731          |
|   | <b>5 313</b>         | <b>10 830</b>   |
| <b>Past due loans and advances and interest</b> |                      |                 |
| Up to 3 months                                  | 17                   | 9               |
| 3 months to 1 year                              | 56                   | 67              |
| 1 to 3 years                                    | 14                   | 555             |
| More than 3 years                               | 95                   | 745             |
|   | <b>182</b>           | <b>1 376</b>    |
|   | <b>141 981</b>       | <b>161 816</b>  |
| <b>Impairment losses</b>                        | <b>( 825)</b>        | <b>( 2 089)</b> |
|   | <b>141 156</b>       | <b>159 727</b>  |

The fair value of the Loans and advances to customers' portfolio is evidenced in Note 32.

As at 31 December 2018 and 2017, the analysis of loans and advances to customers by period to maturity is as follows:

|                    | (thousands of Euros) |                |
|--------------------|----------------------|----------------|
|                    | 31.12.2018           | 31.12.2017     |
| Up to 3 months     | 59 283               | 63 531         |
| 3 months to 1 year | 70 395               | 74 311         |
| 1 to 5 years       | 4 683                | 14 781         |
| More than 5 years  | 7 438                | 7 817          |
| Undetermined       | 182                  | 1 376          |
|                    | <b>141 981</b>       | <b>161 816</b> |

The movements occurring in impairment losses of loans and advances to customers, shown as an adjustment to the asset amount, were as follows:

| (thousands of Euros)                    |            |            |              |              |
|---|------------|------------|--------------|--------------|
| 31.12.2018                              |            |            |              |              |
|   | Stage 1    | Stage 2    | Stage 3      | Total        |
| <b>Balance at 31 December 2017</b>      |            |            |              | <b>2 089</b> |
| Impact of transition to IFRS 9          |            |            |              | 62           |
| <b>Balance at 1 January 2018</b>        | <b>527</b> | <b>234</b> | <b>1 390</b> | <b>2 151</b> |
| Financial assets derecognized           | -          | -          | ( 1 081)     | ( 1 081)     |
| Increases due to changes in credit risk | 71         | 443        | 38           | 552          |
| Decreases due to changes in credit risk | ( 467)     | ( 146)     | ( 183)       | ( 796)       |
| Utilization during period               | -          | -          | ( 1)         | ( 1)         |
| Other movements                         | 280        | ( 273)     | ( 7)         | -            |
| <b>Closing balance</b>                  | <b>411</b> | <b>258</b> | <b>156</b>   | <b>825</b>   |

| (thousands of Euros)                   |              |
|--|--------------|
| 31.12.2017                             |              |
| <b>Opening balance</b>                 | <b>2 461</b> |
| Allocations/(reversals) for period     | ( 371)       |
| Foreign exchange differences and other | ( 1)         |
| <b>Closing balance</b>                 | <b>2 089</b> |

Loans and advances to customers distributed by rate typology are as follows:

| (thousands of Euros) |                |                |
|----------------------|----------------|----------------|
|                      | 31.12.2018     | 31.12.2017     |
| Fixed rate           | 75 365         | 85 101         |
| Variable rate        | 66 616         | 76 715         |
|                      | <b>141 981</b> | <b>161 816</b> |

## NOTE 19 – SECURITIES' PORTFOLIO

As at 31 December 2018 and 2017, this caption is analysed as follows:

(thousands of Euros)

|  | 31.12.2018    | 31.12.2017    |
|--|---------------|---------------|
| Amortized cost                                 | 19 851        | -             |
| Fair value through profit and loss mandatorily | 851           | -             |
| Fair value through other comprehensive income  | 47 452        | 81 603        |
| <b>Total securities' portfolio</b>             | <b>68 154</b> | <b>81 603</b> |

The detail of the securities at amortized cost and at fair value through profit and loss mandatorily is as follows:

(thousands of Euros)

|   | 31.12.2018    | 31.12.2017 |
|---|---------------|------------|
| <b>Securities at amortized cost</b>                                 |               |            |
| Bonds and other fixed-income securities                             |               |            |
| Of other issuers  | 20 222        | -          |
| Impairment  | ( 371)        | -          |
|   | <b>19 851</b> | <b>-</b>   |
| <b>Securities at fair value through profit and loss mandatorily</b> |               |            |
| Shares  | 851           | -          |
|   | <b>851</b>    | <b>-</b>   |

The detail of the securities at fair value through other comprehensive income is as follows:

(thousands of Euros)

|   | 31.12.2018          |                     |               |                |                     |
|---|---------------------|---------------------|---------------|----------------|---------------------|
|   | Cost <sup>(1)</sup> | Fair value reserves |               | Carrying value | Impairment reserves |
|   |                     | Positive            | Negative      |                |                     |
| Bonds and other fixed-income securities |                     |                     |               |                |                     |
| Of Government/public issuers            | 46 113              | 966                 | -             | 47 079         | ( 5)                |
| Shares                                  | 550                 | 2                   | ( 179)        | 373            | -                   |
| <b>Balance at 31 December 2018</b>      | <b>46 663</b>       | <b>968</b>          | <b>( 179)</b> | <b>47 452</b>  | <b>( 5)</b>         |

<sup>(1)</sup> Acquisition cost relating to shares and other equity instruments and amortized cost relating to debt securities



(thousands of Euros)

| 31.12.2017                              |                     |                     |              |                     |                |
|---|---------------------|---------------------|--------------|---------------------|----------------|
|   | Cost <sup>(1)</sup> | Fair value reserves |              | Impairment reserves | Carrying value |
|   |                     | Positive            | Negative     |                     |                |
| Bonds and other fixed-income securities |                     |                     |              |                     |                |
| Of Government/public issuers            | 39 992              | 1 195               | -            | -                   | 41 187         |
| Of other issuers                        | 39 130              | 18                  | -            | -                   | 39 148         |
| Shares                                  | 1 034               | 263                 | ( 29)        | -                   | 1 268          |
| Other variable-income securities        | 167                 | -                   | -            | ( 167)              | -              |
| <b>Balance at 31 December 2017</b>      | <b>80 323</b>       | <b>1 476</b>        | <b>( 29)</b> | <b>( 167)</b>       | <b>81 603</b>  |

<sup>(1)</sup> Acquisition cost relating to shares and other equity instruments and amortized cost relating to debt securities

According to the accounting policy described in Note 2.4, the Bank regularly assesses whether there is any objective evidence of impairment in its securities' portfolio following the judgment criteria described in Note 3.1.

The detail of the securities given as collateral by the Bank is presented in Note 30.

As at 31 December 2018 and 2017, the analysis of the securities' portfolio by period to maturity, is as follows:

| (thousands of Euros)  |               |               |
|---|---------------|---------------|
|   | 31.12.2018    | 31.12.2017    |
| <b>Securities at amortized cost</b>                                 |               |               |
| Up to 3 months  | 20 222        | -             |
|   | <u>20 222</u> | <u>-</u>      |
| <b>Securities at fair value through profit and loss mandatorily</b> |               |               |
| Undetermined  | 851           | -             |
|   | <u>851</u>    | <u>-</u>      |
| <b>Securities at fair value through other comprehensive income</b>  |               |               |
| Up to 3 months  | 724           | 40 210        |
| 1 to 5 years  | 364           | 28 299        |
| More than 5 years   | 45 991        | 11 826        |
| Undetermined  | 373           | 1 268         |
|   | <u>47 452</u> | <u>81 603</u> |
|   | <b>68 525</b> | <b>81 603</b> |

The movements occurring in impairment losses of securities at amortized cost, were as follows:

(thousands of Euros)

|   | 31.12.2018 |            |            |
|---|------------|------------|------------|
|   | Stage 1    | Stage 2    | Total      |
| <b>Balance at 31 December 2017</b>      |            |            | -          |
| Impact of transition to IFRS 9          |            |            | 379        |
| <b>Balance at 1 January 2018</b>        | -          | 379        | 379        |
| Increases due to changes in credit risk | 184        | 3 325      | 3 509      |
| Decreases due to changes in credit risk | ( 60)      | ( 2 499)   | ( 2 559)   |
| Utilization during period               | ( 96)      | ( 840)     | ( 936)     |
| Other movements                         | 3          | ( 25)      | ( 22)      |
| <b>Closing balance</b>                  | <b>31</b>  | <b>340</b> | <b>371</b> |

The movements occurring in impairment losses of securities at fair value through other comprehensive income, were as follows:

(thousands of Euros)

|   | 31.12.2018 |          |          |          |
|---|------------|----------|----------|----------|
|   | Stage 1    | Stage 2  | Stage 3  | Total    |
| <b>Balance at 31 December 2017</b>      |            |          |          | 167      |
| Impact of transition to IFRS 9          |            |          |          | ( 162)   |
| <b>Balance at 1 January 2018</b>        | 5          | -        | -        | 5        |
| Increases due to changes in credit risk | 8          | -        | -        | 8        |
| Decreases due to changes in credit risk | ( 5)       | -        | -        | ( 5)     |
| Utilization during period               | ( 2)       | -        | -        | ( 2)     |
| Other movements                         | ( 1)       | -        | -        | ( 1)     |
| <b>Closing balance</b>                  | <b>5</b>   | <b>-</b> | <b>-</b> | <b>5</b> |

The detail of the securities by fair value hierarchy is presented in Note 32.

During the 2018 financial year, the Bank received dividends in the amount of Euros 30 thousand from the portfolio of financial assets at fair value through other comprehensive income (2017 financial year: Euros 80 thousand).

## NOTE 20 – OTHER TANGIBLE FIXED ASSETS

As at 31 December 2018 and 2017, this caption is analysed as follows:

(thousands of Euros)

|  | 31.12.2018   | 31.12.2017   |
|--|--------------|--------------|
| <b>Real estate property</b>              |              |              |
| Improvements in leasehold property       | 951          | 1 077        |
|  | <b>951</b>   | <b>1 077</b> |
| <b>Equipment</b>                         |              |              |
| Computer equipment                       | 2 967        | 1 883        |
| Furniture                                | 1 509        | 1 518        |
| Office equipment                         | 110          | 110          |
| Fixtures                                 | 431          | 508          |
| Security equipment                       | 65           | 65           |
| Other                                    | 1            | 1            |
|  | <b>5 083</b> | <b>4 085</b> |
| <b>Tangible fixed assets in progress</b> | <b>53</b>    | <b>-</b>     |
|  | <b>6 087</b> | <b>5 162</b> |
| <b>Accumulated depreciation</b>          | ( 4 813)     | ( 4 811)     |
|  | <b>1 274</b> | <b>351</b>   |

The movement in this caption was as follows:

(thousands of Euros)

|   | Real estate<br>property | Equipment    | Fixed assets<br>in progress | Total        |
|---|-------------------------|--------------|-----------------------------|--------------|
| <b>Acquisition cost</b>                   |                         |              |                             |              |
| <b>Balance at 31 December 2016</b>        | <b>1 077</b>            | <b>4 070</b> | <b>1</b>                    | <b>5 148</b> |
| Additions                                 | -                       | 6            | 8                           | 14           |
| Disposals/write-offs                      | -                       | ( 1)         | -                           | ( 1)         |
| Transfers                                 | -                       | 9            | ( 9)                        | -            |
| Other                                     | -                       | 1            | -                           | 1            |
| <b>Balance at 31 December 2017</b>        | <b>1 077</b>            | <b>4 085</b> | <b>-</b>                    | <b>5 162</b> |
| Additions                                 | -                       | 1 085        | 53                          | 1 138        |
| Disposals/write-offs                      | ( 126)                  | ( 87)        | -                           | ( 213)       |
| <b>Balance at 31 December 2018</b>        | <b>951</b>              | <b>5 083</b> | <b>53</b>                   | <b>6 087</b> |
| <b>Accumulated depreciation</b>           |                         |              |                             |              |
| <b>Balance at 31 December 2016</b>        | <b>863</b>              | <b>3 656</b> | <b>-</b>                    | <b>4 519</b> |
| Depreciation for the period               | 89                      | 203          | -                           | 292          |
| <b>Balance at 31 December 2017</b>        | <b>952</b>              | <b>3 859</b> | <b>-</b>                    | <b>4 811</b> |
| Depreciation for the period               | 77                      | 139          | -                           | 216          |
| Disposals/write-offs                      | ( 126)                  | ( 88)        | -                           | ( 214)       |
| <b>Balance at 31 December 2018</b>        | <b>903</b>              | <b>3 910</b> | <b>-</b>                    | <b>4 813</b> |
| <b>Carrying value at 31 December 2018</b> | <b>48</b>               | <b>1 173</b> | <b>53</b>                   | <b>1 274</b> |
| <b>Carrying value at 31 December 2017</b> | <b>125</b>              | <b>226</b>   | <b>-</b>                    | <b>351</b>   |

## NOTE 21 – INTANGIBLE ASSETS

As at 31 December 2018 and 2017, this caption is analysed as follows:

|   | (thousands of Euros) |            |
|---|----------------------|------------|
|   | 31.12.2018           | 31.12.2017 |
| <b>Acquired from third parties</b>          |                      |            |
| Software - Automatic data processing system | 3 768                | 3 768      |
| <b>Accumulated amortization</b>             | ( 3 768)             | ( 3 768)   |
|   | -                    | -          |

The movement in this caption was as follows:

|   | (thousands of Euros)  |          |
|---|---|----------|
|   | Intangible assets<br>Software - Automatic<br>data processing system | Total    |
| <b>Acquisition cost</b>                   |   |          |
| <b>Balance at 31 December 2016</b>        | 11 693  | 11 693   |
| Write-offs/disposals                      | ( 7 925)  | ( 7 925) |
| <b>Balance at 31 December 2017</b>        | 3 768   | 3 768    |
| <b>Balance at 31 December 2018</b>        | 3 768   | 3 768    |
| <b>Accumulated amortization</b>           |   |          |
| <b>Balance at 31 December 2016</b>        | 11 612  | 11 612   |
| Amortization for the period               | 81  | 81       |
| Write-offs/disposals                      | ( 7 925)  | ( 7 925) |
| <b>Balance at 31 December 2017</b>        | 3 768   | 3 768    |
| <b>Balance at 31 December 2018</b>        | 3 768   | 3 768    |
| <b>Carrying value at 31 December 2018</b> | -   | -        |
| <b>Carrying value at 31 December 2017</b> | -   | -        |

## NOTE 22 – OTHER ASSETS

As at 31 December 2018 and 2017, the caption Other assets is analysed as follows:

(thousands of Euros)

|                                       | 31.12.2018   | 31.12.2017   |
|---------------------------------------|--------------|--------------|
| Public sector administration          | 416          | 66           |
| Other debtors                         | 1 415        | 523          |
| Accrued income (i)                    | 1 928        | 2 142        |
| Prepayments                           | 414          | 327          |
| Real estate                           | -            | 30           |
| Other transactions pending settlement | 155          | 440          |
| Other assets                          | 15           | 14           |
|                                       | <b>4 343</b> | <b>3 542</b> |
| Impairment losses                     | -            | ( 2)         |
|                                       | <b>4 343</b> | <b>3 540</b> |

<sup>(1)</sup> Commissions receivable from Fund Managing Companies

Security deposit accounts refer to margin accounts in respect of derivative product operations contracted on organized markets in the name of the Bank's customers. The amounts relating to these operations are initially advanced by the customers, being recorded in the caption Other liabilities - Creditors for futures and options contracts (Note 27).

The movements in impairment losses were as follows:

(thousands of Euros)

|                        | 31.12.2018 | 31.12.2017 |
|------------------------|------------|------------|
| Opening balance        | 2          | -          |
| Allocations for period | -          | 2          |
| Utilization for period | ( 2)       | -          |
| <b>Closing balance</b> | <b>-</b>   | <b>2</b>   |

## NOTE 23 – DEPOSITS FROM BANKS

The caption Deposits from banks is presented as follows

(thousands of Euros)

|                 | 31.12.2018    | 31.12.2017    |
|-----------------|---------------|---------------|
| <b>Domestic</b> |               |               |
| Deposits        | 2 094         | 1 344         |
| Other funds     | 8             | -             |
|                 | <b>2 102</b>  | <b>1 344</b>  |
| <b>Foreign</b>  |               |               |
| Deposits        | 5 055         | 2 940         |
| Other funds     | 13 199        | 14 926        |
|                 | <b>18 254</b> | <b>17 866</b> |
|                 | <b>20 356</b> | <b>19 210</b> |

As at 31 December 2018 and 2017, the analysis of deposits from banks by period to maturity is as follows:

|                | (thousands of Euros) |               |
|----------------|----------------------|---------------|
|                | 31.12.2018           | 31.12.2017    |
| Up to 3 months | 20 356               | 19 210        |
|                | <b>20 356</b>        | <b>19 210</b> |

## NOTE 24 – DUE TO CUSTOMERS

The caption Due to customers, by nature, has the following breakdown:

|                  | (thousands of Euros) |                |
|------------------|----------------------|----------------|
|                  | 31.12.2018           | 31.12.2017     |
| Demand deposits  | 360 595              | 319 506        |
| Time deposits    | 180 415              | 168 472        |
| Savings accounts | 565                  | 672            |
| Other funds      | 4 271                | 5 240          |
|                  | <b>545 846</b>       | <b>493 890</b> |

As at 31 December 2018 and 2017, the analysis of the caption Due to customers by period to maturity is as follows:

(thousands of Euros)

|                             | 31.12.2018     | 31.12.2017     |
|-----------------------------|----------------|----------------|
| <b>Repayable on demand</b>  | <b>360 595</b> | <b>319 506</b> |
| <b>With agreed maturity</b> |                |                |
| Up to 3 months              | 164 026        | 142 396        |
| 3 months to 1 year          | 15 301         | 22 796         |
| 1 to 5 years                | 5 924          | 9 192          |
|                             | <b>185 251</b> | <b>174 384</b> |
|                             | <b>545 846</b> | <b>493 890</b> |

## NOTE 25 – PROVISIONS

As at 31 December 2018 and 2017, the caption Provisions has the following breakdown:

(thousands of Euros)

|                                    | Provisions for<br>guarantees and<br>commitments | Other provisions | Total        |
|------------------------------------|---|------------------|--------------|
| <b>Balance at 31 December 2016</b> | <b>22</b>                                       | <b>1 527</b>     | <b>1 549</b> |
| Allocations/(reversals) for period | ( 4)  | 916              | 912          |
| Other                              | 1   | ( 1)             | -            |
| <b>Balance at 31 December 2017</b> | <b>19</b>                                       | <b>2 442</b>     | <b>2 461</b> |
| Impact on transition to IFRS 9     | 68  | -                | 68           |
| <b>Balance at 1 January 2018</b>   | <b>87</b>                                       | <b>2 442</b>     | <b>2 529</b> |
| Allocations/(reversals) for period | 24  | 37               | 61           |
| Other                              | -   | 1                | 1            |
| <b>Balance at 31 December 2018</b> | <b>111</b>                                      | <b>2 480</b>     | <b>2 591</b> |

As regards provisions for guarantees and commitments assumed, the movement of the provision is detailed as follows:

(thousands of Euros)

|                                    | 31.12.2018 |           |         |            |
|------------------------------------|------------|-----------|---------|------------|
|                                    | Stage 1    | Stage 2   | Stage 3 | Total      |
| <b>Balance at 31 December 2017</b> |            |           |         | <b>19</b>  |
| Impact on transition to IFRS 9     |            |           |         | 68         |
| <b>Balance at 1 January 2018</b>   | <b>78</b>  | <b>9</b>  | -       | <b>87</b>  |
| Allocations for period             | 55         | 16        | -       | 71         |
| Repositions for period             | ( 37)      | ( 10)     | -       | ( 47)      |
| Other                              | 3          | ( 3)      | -       | -          |
| <b>Closing balance</b>             | <b>99</b>  | <b>12</b> | -       | <b>111</b> |

Other provisions include provisions for ongoing legal proceedings in the amount of Euros 2 113 thousand (31 December 2017: Euros 2 251 thousand). The amount of these provisions results from a prudent evaluation carried out by the Bank with reference to the balance sheet date, considering the latest developments in the processes.

## NOTE 26 – INCOME TAXES

The Bank is subject to taxation under the Corporate Income Tax Code (“Imposto sobre o Rendimento das Pessoas Coletivas” (IRC)) and the corresponding Surcharges (“Derrama”).

Income taxes (current or deferred) are recognized in the income statement except in cases where the underlying transactions have been reflected in other equity captions. In these situations, the corresponding tax is also reflected in equity, not affecting the net income for the period.

The current income tax for the financial year ended 31 December 2018 was determined based on the nominal IRC tax rate and Municipal Surcharge in force, increased by an additional State Surcharge (“Derrama Estadual”) levied depending on the taxable income determined (3%, for taxable income between Euros 1.5 million and Euros 7.5 million; 5% for taxable income between Euros 7.5 million and Euros 35 million and 9% for taxable income in excess of Euros 35 million).

Deferred taxes are calculated based on the tax rates anticipated to be in force at the date of the reversal of the timing differences, which correspond to the rates enacted or substantively enacted at the balance sheet date. On this basis, for the financial years ended 31 December 2018 and 2017, the deferred tax calculation was, broadly, calculated based on an aggregate rate of 26%, resulting from the sum of the corporate income tax rate (21%), approved by Law no. 82-B/2014, of 31 December, the Municipal Surcharge rate of 1.5% and an average estimated rate of 3.5% for the State Surcharge.

In financial year 2018, Regulatory Decree no. 13/2018, of 28 December, was applied so as to reproduce the general regime that was in force on 31 December 2017, extending, to 2018, the general regime of impairment losses for credit risk applicable in 2017 and in previous years. In this manner, the framework resulting from Notice no. 3/95 of the Bank of Portugal was extended for tax purposes.

In 2018, the Bank adopted IFRS 9 - Financial Instruments. However, there is no transitional regime in this area establishing the tax treatment to be given to transitional adjustments resulting on the



adoption of this standard. Consequently, the tax treatment of these adjustments reflects the Bank's interpretation of the application of the general rules of the IRC Code.

The Portuguese Tax Authorities are entitled to review the annual tax returns of the Bank for a period of four years. Hence, it is possible that some additional taxes may be assessed, mainly as a result of differences in interpretation of tax law. However, Management is confident that no additional material tax charges will arise.

Deferred tax assets and liabilities recognized in the balance sheet as at 31 December 2018 and 2017, may be analysed as follows:

|  | (thousands of Euros) |            |               |               |            |               |
|--|----------------------|------------|---------------|---------------|------------|---------------|
|  | Assets               |            | Liabilities   |               | Net        |               |
|  | 31.12.2018           | 31.12.2017 | 31.12.2018    | 31.12.2017    | 31.12.2018 | 31.12.2017    |
| Financial instruments                                | 143                  | 8          | ( 252)        | ( 384)        | ( 109)     | ( 376)        |
| Impairment losses of loans and advances to customers | 293                  | 189        | -             | -             | 293        | 189           |
| Provisions   | 30                   | 5          | -             | -             | 30         | 5             |
| <b>Deferred tax assets/(liabilities)</b>             | <b>466</b>           | <b>202</b> | <b>( 252)</b> | <b>( 384)</b> | <b>214</b> | <b>( 182)</b> |
| Offsetting of deferred tax assets/liabilities        | ( 252)               | ( 202)     | 252           | 202           | -          | -             |
| <b>Net deferred tax assets/(liabilities)</b>         | <b>214</b>           | <b>-</b>   | <b>-</b>      | <b>( 182)</b> | <b>214</b> | <b>( 182)</b> |

The tax recognized in the income statement and reserves during financial years 2018 and 2017 had the following origins:

|  | (thousands of Euros)                     |                           |  |                           |
|--|--|---------------------------|--|---------------------------|
|  | 31.12.2018                               |                           | 31.12.2017                               |                           |
|  | Recognized in<br>the income<br>statement | Recognized in<br>reserves | Recognized in<br>the income<br>statement | Recognized in<br>reserves |
| Financial instruments                                | 2  | ( 171)                    | -  | 394                       |
| Impairment losses of loans and advances to customers | 1  | -                         | 164                                      | -                         |
| Provisions   | ( 7)                                     | -                         | 1  | -                         |
| Deferred taxes                                       | ( 4)                                     | ( 171)                    | 165                                      | 394                       |
| Current taxes  | 1 277                                    | -                         | 1 218                                    | -                         |
| <b>Total tax recognized</b>                          | <b>1 273</b>                             | <b>( 171)</b>             | <b>1 383</b>                             | <b>394</b>                |

The movements in the deferred tax balance sheet captions affected the following accounts:

|  | (thousands of Euros) |               |
|--|----------------------|---------------|
|  | 31.12.2018           | 31.12.2017    |
| <b>Opening balance</b>                     | <b>( 182)</b>        | <b>378</b>    |
| <b>Deferred tax recognized in</b>          |                      |               |
| Income statement                           | 4                    | ( 165)        |
| Fair value reserves                        | 171                  | ( 394)        |
| Impact IFRS 9                              | 198                  | -             |
| Other reserves                             | 23                   | ( 1)          |
| <b>Closing balance - Asset/(Liability)</b> | <b>214</b>           | <b>( 182)</b> |

Current tax liabilities recognized in the balance sheet as at 31 December 2018 and 2017, may be analysed as follows:

|                              | (thousands of Euros) |            |
|------------------------------|----------------------|------------|
|                              | 31.12.2018           | 31.12.2017 |
| <b>Liabilities</b>           |                      |            |
| Corporate income tax payable | 730                  | 432        |
|                              | <u>730</u>           | <u>432</u> |

The reconciliation of the corporate income tax rate may be analysed as follows:

|  | (thousands of Euros) |              |             |              |
|--|----------------------|--------------|-------------|--------------|
|  | 31.12.2018           |              | 31.12.2017  |              |
|  | %                    | Amount       | %           | Amount       |
| <b>Profit/(loss) before income tax</b>         |                      | <b>4 837</b> |             | <b>4 397</b> |
| Tax rate                                       | 26.0                 |              | 26.0        |              |
| Income tax calculated based on tax rate        |                      | 1 258        |             | 1 143        |
| Non-deductible costs                           | 0.3                  | 13           | 0.7         | 32           |
| Autonomous taxation                            | 0.6                  | 31           | 0.8         | 37           |
| Other  | (0.6)                | ( 29)        | 3.5         | 171          |
| <b>Effective tax rate/Corporate income tax</b> | <b>26.3</b>          | <b>1 273</b> | <b>31.5</b> | <b>1 383</b> |

Following the enactment of Law no. 55-A/2010, of 31 December, a Banking Levy (“Contribuição sobre o Sector Bancário”) was created, being levied on the average annual liability calculated based on the balance sheet, net of own funds and the deposits covered by the Deposits Guarantee Fund and on the notional value of derivative financial instruments. The Banking Levy is not eligible as a tax cost, and its regime has been being extended. As at 31 December 2018, the Bank recognized the amount of Euros 126 thousand (31 December 2017: Euros 118 thousand) as Banking Levy cost, pursuant to Law no. 114/2017, of 29 December. The cost recognized was calculated and paid based on the maximum rate of 0.110% that is levied on the average annual liability calculated based on the balance sheet, net of own funds and deposits covered by the

Deposits Guarantee Fund, approved by Law no. 7-A/2016, of 30 March and by Ordinance no. 165-A/2016, of 14 June.

## NOTE 27 – OTHER LIABILITIES

As at 31 December 2018 and 2017, the caption Other liabilities is analysed as follows:

|                                       | (thousands of Euros) |              |
|---------------------------------------|----------------------|--------------|
|                                       | 31.12.2018           | 31.12.2017   |
| Public sector administration          | 561                  | 606          |
| Suppliers                             | 1 726                | 961          |
| Captive bank accounts                 | 590                  | 407          |
| Other creditors                       | 108                  | 95           |
| Staff costs                           | 606                  | 625          |
| Other accrued expenses                | 1 014                | 1 006        |
| Deferred income                       | 251                  | 282          |
| Other transactions pending settlement | -                    | 377          |
|                                       | <b>4 856</b>         | <b>4 359</b> |

## NOTE 28 – SHARE CAPITAL

### *Ordinary shares*

As at 31 December 2018 and 2017, the Bank's share capital, amounting to Euros 63 000 thousand, is represented by 63 million shares, with a nominal value of Euro 1 each, was fully subscribed and realized in cash.

In 2002, the Bank increased its share capital from Euros 32 422 thousand to Euros 43 000 thousand through the issuance of 10 578 thousand ordinary shares with a nominal value of Euro 1 each, which were fully subscribed and realized in cash. In February 2003, the Bank undertook a new share capital increase through the issuance of 12 million ordinary shares with a nominal value of Euro 1 each. In 2005, share capital was again increased through the issuance of 6 million ordinary shares and, in 2006, once again, through the issuance of a further 2 million ordinary shares.

The Bank's shareholder structure is as follows:

|  | % Share Capital |                |
|--|-----------------|----------------|
|  | 31.12.2018      | 31.12.2017     |
| NOVO BANCO, S.A.                                       | 100.00%         | 100.00%        |
| GNB - Companhia de Seguros Vida, S.A. <sup>(a)</sup>   | -               | 0.00%          |
| NOVO BANCO dos Açores, S.A. <sup>(a)</sup>             | 0.00%           | 0.00%          |
| Novo Banco Servicios Corporativos, S.L. <sup>(a)</sup> | 0.00%           | 0.00%          |
| GNB - Gestão de Ativos, SGPS, S.A. <sup>(a)</sup>      | 0.00%           | -              |
|  | <b>100.00%</b>  | <b>100.00%</b> |

<sup>(a)</sup> Hold 100 shares

As referred to in Note 1, the Bank integrates the NOVO BANCO Group, as a result of which its financial statements are fully consolidated by NOVO BANCO, with registered office at Avenida da Liberdade, no. 195, in Lisbon.

## NOTE 29 – OTHER RESERVES AND RETAINED EARNINGS

### Legal reserve

The legal reserve can only be used to absorb accumulated losses or to increase share capital. Portuguese legislation applicable to the banking sector (Article 97 of Decree-Law no. 298/92, of 31 December) requires that 10% of the net profit for the period be transferred to the legal reserve until it equals share capital, or the sum of the free reserves constituted plus the retained earnings, if higher.

### Fair value reserves

The fair value reserves represent the amounts of unrealized gains and losses arising on the portfolio of financial assets at fair value through other comprehensive income, net of impairment. The amount of this reserve is presented net of deferred taxes.

The movements in these captions during financial years ended 31 December 2018 and 2017, were as follows:

(thousands of Euros)

|  | Other reserves and Retained earnings |               |                                      | Total Other comprehensive income, Other reserves and Retained earnings |
|--|--------------------------------------|---------------|--------------------------------------|--|
|  | Impairment reserves                  | Legal reserve | Other reserves and Retained earnings |  |
| <b>Balance at 31 December 2016</b>   | -                                    | 5 159         | 3 094                                | 8 253  |
| Distribution of dividends (a)  | -                                    | -             | ( 2 471)                             | ( 2 471)   |
| Constitution of reserves   | -                                    | 274           | 2 472                                | 2 746  |
| Other  | -                                    | -             | ( 1)                                 | ( 1)   |
| <b>Balance at 31 December 2017</b>   | -                                    | 5 433         | 3 094                                | 8 527  |
| Impact on transition to IFRS 9   | -                                    | -             | ( 426)                               | ( 426)   |
| <b>Balance at 1 January 2018</b>   | -                                    | 5 433         | 2 668                                | 8 101  |
| Distribution of dividends  | -                                    | -             | ( 2 712)                             | ( 2 712)   |
| Constitution of reserves (a)   | -                                    | 301           | 2 713                                | 3 014  |
| Impairment reserves of securities at fair value through other comprehensive income | 5                                    | -             | -                                    | 5  |
| Other  | -                                    | -             | 1                                    | 1  |
| <b>Balance at 31 December 2018</b>   | 5                                    | 5 734         | 2 670                                | 8 409  |

(a) As per approval of General Meeting

The fair value reserves are analysed as follows:

(thousands of Euros)

|   | 31.12.2018 |
|---|------------|
| Amortized cost of financial assets at fair value through other comprehensive income | 46 663     |
| Fair value of financial assets at fair value through other comprehensive income     | 47 452     |
| Unrealized gains/(losses) recognized in fair value reserves                         | 789        |
| Deferred taxes  | ( 205)     |
| <b>Fair value reserve attributable to shareholders of the Bank</b>                  | <b>584</b> |

(thousands of Euros)

|   | 31.12.2017   |
|---|--------------|
| Amortized cost of financial assets at fair value through other comprehensive income | 80 323       |
| Accumulated impairment losses recognized  | ( 167)       |
| Amortized cost of available-for-sale financial assets, net of impairment losses     | 80 156       |
| Fair value of securities at fair value through other comprehensive income           | 81 603       |
| Unrealized gains/(losses) recognized in fair value reserves                         | 1 344        |
| Deferred taxes  | ( 273)       |
| <b>Fair value reserve attributable to shareholders of the Bank</b>                  | <b>1 071</b> |

The movement in fair value reserves, net of deferred taxes, may be analysed as follows:

(thousands of Euros)

|   | 31.12.2018  |                             |                           | 31.12.2017  |                             |                           |
|---|---|-----------------------------|---------------------------|---|-----------------------------|---------------------------|
|   | Fair value reserves   |                             |                           | Fair value reserves   |                             |                           |
|   | Financial assets at fair value through other comprehensive income | Reserves for deferred taxes | Total fair value reserves | Financial assets at fair value through other comprehensive income | Reserves for deferred taxes | Total fair value reserves |
| <b>Opening balance</b>                              | 1 447   | ( 376)                      | 1 071                     | ( 70)   | 18                          | ( 52)                     |
| Impact on transition to IFRS 9                      | ( 393)  | 103                         | ( 290)                    | -   | -                           | -                         |
| <b>Balance at 1 January 2018</b>                    | <b>1 054</b>  | <b>( 273)</b>               | <b>781</b>                | <b>( 70)</b>  | <b>18</b>                   | <b>( 52)</b>              |
| Changes in fair value                               | 500   | -                           | 500                       | 1 517   | -                           | 1 517                     |
| Disposals during period                             | -   | -                           | -                         | -   | -                           | -                         |
| Impairment recognized in period                     | ( 765)  | -                           | ( 765)                    | -   | -                           | -                         |
| Deferred taxes recognized in reserves during period | -   | 68                          | 68                        | -   | ( 394)                      | ( 394)                    |
| <b>Closing balance</b>                              | <b>789</b>  | <b>( 205)</b>               | <b>584</b>                | <b>1 447</b>  | <b>( 376)</b>               | <b>1 071</b>              |

## NOTE 30 – CONTINGENT LIABILITIES AND COMMITMENTS

In addition to derivative financial instruments, as at 31 December 2018 and 2017, the off-balance sheet elements included the following:

|  | (thousands of Euros) |                |
|--|----------------------|----------------|
|  | 31.12.2018           | 31.12.2017     |
| <b>Contingent liabilities and guarantees</b> |                      |                |
| Guarantees and standby letters               | 172 338              | 169 264        |
| Assets pledged as collateral                 | 1 670                | 1 653          |
|  | <b>174 008</b>       | <b>170 917</b> |
| <b>Commitments</b>                           |                      |                |
| Revocable commitments                        | 63 881               | 59 717         |
| Irrevocable commitments                      | 1 324                | 1 406          |
|  | <b>65 205</b>        | <b>61 123</b>  |
|  | <b>239 213</b>       | <b>232 040</b> |

Guarantees and standby letters are banking operations that do not imply an outflow from the Bank.

As at 31 December 2018, the caption Assets pledged as collateral includes:

- Securities pledged as collateral to the Securities and Exchange Commission (“Comissão do Mercado de Valores Mobiliários”) in the scope of the Investors Indemnity System (“Sistema de Indemnização aos Investidores” (SII)) in the amount of Euros 1 113 thousand (31 December 2017: Euros 1 102 thousand);

- Securities pledged as collateral to the Deposits Guarantee Fund (“Fundo de Garantia de Depósitos” (FGD)) in the amount of Euros 557 thousand (31 December 2017: Euros 551 thousand).

The commitments, revocable and irrevocable, represent contractual agreements for credit concession entered into with the Bank’s customers (ex. unused credit lines) which, in general, are contracted for fixed periods or with other expiry requirements and, normally, imply the payment of a commission. Practically all credit concession commitments in force require customers to abide by certain requirements that are already verified at the moment of the respective formalization.

Notwithstanding the particular characteristics of these contingent liabilities and commitments, the analysis of these operations follows the same basic principles applied to any other commercial operation, namely that of the solvency of the underlying customer and business, with the Bank requiring such operations to be adequately covered by collateral, when necessary. Since it is expected that the majority of these contingent liabilities and commitments will expire without having being used, the amounts indicated do not necessarily represent future cash flow needs.

Additionally, the liabilities accounted for off-balance sheet relating to banking services rendered are as follows:

|   | (thousands of Euros) |                   |
|---|----------------------|-------------------|
|   | <b>31.12.2018</b>    | <b>31.12.2017</b> |
| <b>Responsibilities related to banking services</b> |                      |                   |
| Deposit and custodianship of securities             | 380 387              | 447 687           |
| Other responsibilities related to banking services  | 13 389               | 16 248            |
|   | <b>393 776</b>       | <b>463 935</b>    |

In Other responsibilities related to banking services are considered the amounts related to customers’ assets invested in funds.

## Fundo de Resolução

Fundo de Resolução is a public legal entity with administrative and financial autonomy, created by Decree-law no. 31-A/2012, of 10 February, which is governed by the General Regime governing Credit Institutions and Financial Companies ("RGICSF") and by its regulation and which mission is to provide financial support for the resolution measures implemented by the Bank of Portugal, while national resolution authority, and to perform all other functions conferred by law in the implementation of such measures.

The Bank, as with the generality of financial institutions operating in Portugal, is one of the institutions participating in the Resolution Fund, making contributions that result from the application of a rate defined annually by the Bank of Portugal based, essentially, on the amount of its liabilities. As at 31 December 2018, the periodic contribution made by the Bank amounted to Euros 51 thousand (31 December 2017: Euros 30 thousand).

As part of its responsibility as supervisory and resolution authority, the Bank of Portugal decided to apply, on 3 August 2014, a resolution measure to BES, under paragraph 5 of Article 145-G of the General Regime governing Credit Institutions and Financial Companies (RGICSF), which consisted of the transfer of most of its activity to NOVO BANCO, created specifically for this purpose, with the capitalization having been assured by the Fundo de Resolução.

To realize the share capital of NOVO BANCO, Fundo de Resolução made available Euros 4 900 million, of which Euros 365 million corresponded to own funds. A loan was also granted by a banking syndicate to Fundo de Resolução, amounting to Euros 635 million, with the share of each credit institution having been weighted depending on various factors, including its respective size. The remaining amount (Euros 3 900 million) came from a reimbursable loan granted by the Portuguese State.

In December 2015, the national authorities decided to sell most of the assets and liabilities associated with the activity of Banif - Banco Internacional do Funchal, SA (Banif) to Banco Santander Totta, S.A. (Santander Totta), for Euros 150 million, also in the scope of the application of a resolution measure. This operation involved an estimated Euros 2 255 million of public funding, aimed at covering future contingencies, financed in Euros 489 million by Fundo de Resolução and in Euros 1 766 million directly by the Portuguese State. In the context of this resolution measure, the assets of Banif identified as problematic were transferred to an asset management vehicle, created for the purpose – Oitante, S.A..



The situation of severe financial imbalance in which BES found itself, in 2014, and BANIF, in 2015, and which justified the application of the resolution measures, created uncertainties related to the risk of litigation involving Fundo de Resolução, which is significant, as well as the risk of an insufficiency of funds to ensure compliance with its responsibilities, namely the short-term repayment of the loans contracted.

It was in this context, in the second half of 2016, that the Portuguese Government reached an agreement with the European Commission to change the terms of the financing granted by the Portuguese State and by the Banks participating in Fundo de Resolução in order to preserve its financial stability, through the promotion of conditions that endow predictability and stability to the contributory efforts to Fundo de Resolução. To this end, an addendum to the financing agreements with Fundo de Resolução was formalized, which introduced a number of changes to the repayment schedule, remuneration rates and other terms and conditions associated with said loans such that these are adjusted to Fundo de Resolução's ability to fully meet its obligations based on its regular revenues, that is, without the need to call on the Banks participating in Fundo de Resolução for special contributions or any other extraordinary contribution.

According to the announcement of 31 March 2017 made by Fundo de Resolução, the revision of the terms of the financing granted by the Portuguese State and by the participant Banks was aimed at ensuring the sustainability and financial equilibrium of Fundo de Resolução, based on a stable, predictable and affordable charge for the banking sector. Based on this revision, Fundo de Resolução assumed that the full payment of its liabilities, as well as its respective remuneration, is assured, without the need for recourse to special contributions or any other type of extraordinary contributions by the banking sector.

Also on 31 March 2017, the Bank of Portugal announced that it had selected Loan Star Funds for the acquisition of NOVO BANCO, which was completed on 18 October 2017, through the injection, by the new shareholder, of Euros 750 million, followed by a new capital injection of Euros 250 million, realized on 21 December 2017. Loan Star Funds came to hold 75% the share capital of NOVO BANCO and Fundo de Resolução the remaining 25%. In addition, the approved conditions include:

- A contingent capitalization mechanism, under which Fundo de Resolução may be called upon to make payments in the event of the materialization of certain cumulative conditions, related to: i) the performance of a restricted set of assets of NOVO BANCO and ii) the evolution of the Bank's capitalization levels. The possible payments to be realized under this contingent mechanism are subject to an absolute maximum limit of Euros 3 890 million.

- An indemnity mechanism in favour of NOVO BANCO if, subject to certain conditions, same comes to be condemned in the payment of any liability, by a final court decision that does not recognize or is contrary to the resolution measure applied by the Bank of Portugal, or to the perimeter of assets and liabilities of NOVO BANCO determined by the resolution measure and subsequent decisions of the Bank of Portugal. In the context of the sales transaction, the respective contractual documents contain specific provisions that have equivalent effects to the aforementioned resolution of the Board of Directors of the Bank of Portugal, of 29 December 2015, although, now, with a contractual origin, for which reason the framework of contingent responsibilities of the Fundo de Resolução is maintained.

Notwithstanding the possibility provided for in the applicable legislation for the call up of special contributions, in view of the renegotiation of the conditions of the loans granted to Fundo de Resolução by the Portuguese State and by a banking syndicate, and of the public announcements made by Fundo de Resolução and the Office of the Finance Minister stating that this possibility will not be used, the present financial statements reflect the expectation of the Board of Directors that the Bank will not be required to make special contributions or any other type of extraordinary contributions to finance the resolution measures applied to BES and Banif, as well as the contingent capitalization mechanism and the indemnity mechanism referred to in the previous paragraphs.

According to the statement made by Fundo de Resolução on 1 March 2019, for the payment to be made to NOVO BANCO within the scope of the contingent capitalization mechanism, the available financial resources, resulting from the contributions paid directly or indirectly by the banking sector, will be used in the first place, with these resources being supplemented by the use of a loan agreed with the Portuguese State in October 2017, with the annual ceiling, then set, of Euros 850 million.

Any changes regarding this subject matter and the application of these mechanisms may have relevant implications on the financial statements of the Bank.

## NOTE 31 – RELATED PARTY TRANSACTIONS

As at 31 December 2018 and 2017, the Bank's transactions with related parties, as well as the respective expense and income recognized during the financial years, are summarized as follows:

|                          | 31.12.2018     |               |                |              |            | 31.12.2017     |               |                |              |              |
|--------------------------|----------------|---------------|----------------|--------------|------------|----------------|---------------|----------------|--------------|--------------|
|                          | Assets         | Liabilities   | Guarantees     | Income       | Expense    | Assets         | Liabilities   | Guarantees     | Income       | Expense      |
| (thousands of Euros)     |                |               |                |              |            |                |               |                |              |              |
| <b>Shareholder</b>       |                |               |                |              |            |                |               |                |              |              |
| NOVO BANCO               | 411 167        | 2 417         | 171 357        | 6 673        | 476        | 323 316        | 1 519         | 168 434        | 5 209        | 777          |
| <b>Related companies</b> |                |               |                |              |            |                |               |                |              |              |
| NOVO BANCO AÇORES        | 1 057          | -             | -              | -            | -          | 735            | -             | -              | -            | -            |
| GNB GA                   | 91             | -             | -              | 219          | -          | 27             | -             | -              | -            | -            |
| GNB VIDA                 | 296            | 23 659        | -              | 752          | 3          | 92             | 27 056        | -              | 905          | 353          |
| EDENRED                  | -              | 15 004        | -              | -            | 5          | -              | -             | -              | -            | -            |
| GNB SEGUROS              | -              | 27            | -              | -            | -          | -              | 27            | -              | -            | -            |
| PRAÇA MARQUÊS            | -              | -             | -              | -            | -          | -              | -             | -              | -            | 410          |
| BES VÉNÉTIE              | -              | -             | -              | -            | -          | -              | -             | -              | 723          | -            |
|                          | <b>412 611</b> | <b>41 107</b> | <b>171 357</b> | <b>7 644</b> | <b>484</b> | <b>324 170</b> | <b>28 602</b> | <b>168 434</b> | <b>6 837</b> | <b>1 540</b> |

Interest generating assets and liabilities contracted with NOVO BANCO Group entities present interest rates between 0% and 7.31% and between 0% and 0.30%, respectively.

As at 31 December 2018 (in accordance with the scope defined in IAS 24) there were no loans and advances granted to the members of the Board of Directors of BEST (31 December 2017: Euros 9 thousand). The Supervisory Board of BEST had no loan responsibilities.

## NOTE 32 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The fair value of the financial assets and liabilities of the Bank measured at fair value, is as follows:

|   | (thousands of Euros)    |  |   |               |
|---|-------------------------|--|---|---------------|
|   | Measured at fair value  |  |   |               |
|   | Quoted Market<br>Prices | Valuation models<br>based on<br>observable market<br>information | Valuation models<br>based on non-<br>observable market<br>information | Fair value    |
|   | (Level 1)               | (Level 2)  | (Level 3)   |               |
| <b>31 December 2018</b>   |                         |  |   |               |
| Derivatives held for trading  | -                       | 584  | -   | 584           |
| Securities' portfolio   | 47 930                  | -  | 373   | 48 303        |
| <i>Securities at fair value through profit and loss mandatorily</i> | 851                     | -  | -   | 851           |
| <i>Securities at fair value through other comprehensive income</i>  | 47 079                  | -  | 373   | 47 452        |
| <b>Financial assets</b>   | <b>47 930</b>           | <b>584</b>   | <b>373</b>  | <b>48 887</b> |
| Financial liabilities held for trading                              | -                       | 647  | -   | 647           |
| <b>Financial liabilities</b>  | <b>-</b>                | <b>647</b>   | <b>-</b>  | <b>647</b>    |

(thousands of Euros)

|  | Measured at fair value |   |   | Fair value    |
|--|------------------------|---|---|---------------|
|  | Quoted Market Prices   | Valuation models based on observable market information | Valuation models based on non-observable market information |               |
|  | (Level 1)              | (Level 2)   | (Level 3)   |               |
|  |                        |   |   |               |
| <b>31 December 2017</b>  |                        |   |   |               |
| Derivatives held for trading                                       | -                      | 285   | -   | 285           |
| Securities' portfolio  | 41 904                 | -   | 39 150  | 81 054        |
| <i>Securities at fair value through other comprehensive income</i> | 41 904                 | -   | 39 150  | 81 054        |
| <b>Financial assets</b>  | <b>41 904</b>          | <b>285</b>  | <b>39 150</b>   | <b>81 339</b> |
| Financial liabilities held for trading                             | -                      | 744   | -   | 744           |
| <b>Financial liabilities</b>                                       | <b>-</b>               | <b>744</b>  | <b>-</b>  | <b>744</b>    |

The Bank determines the fair value of its financial assets and liabilities in accordance with the following hierarchy:

**Quoted market prices (level 1)** – this category includes financial assets with quoted market prices available on official markets and with dealer price quotations provided by entities that usually provide transaction prices for these assets/liabilities traded on active markets.

**Valuation models based on observable market information (level 2)** – consists of the use of internal valuation techniques, namely discounted cash flow models and option pricing models, which imply the use of estimates and require judgements that vary in accordance with the complexity of the financial instruments. Notwithstanding, the Bank uses as inputs in its models observable market data such as interest rate curves, credit spreads, volatility and market indexes. These also include instruments with dealer price quotations but which are not traded on active markets. Additionally, the Bank also uses as observable market variables, those that result from transactions with similar instruments and that are observed with a certain regularity on the market.

**Valuation models based on non-observable market information (level 3)** – consists of the use of internal valuation models or quotations provided by third parties but which imply the use of non-observable market information. The bases and assumptions of the calculation of fair value are in accordance with IFRS 13.

The movement in financial assets valued based on non-observable market information as at 31 December 2018 and 2017, may be analysed as follows:

(thousands of Euros)

|                                       | 31.12.2018    | 31.12.2017    |
|---------------------------------------|---------------|---------------|
| <b>Balance at beginning of period</b> | <b>39 150</b> | <b>4 998</b>  |
| Impact on transition to IFRS 9        | ( 38 739)     | -             |
| <b>Balance at 1 January 2018</b>      | <b>411</b>    | <b>-</b>      |
| Acquisitions                          | -             | 96 227        |
| Sales/Reimbursements                  | -             | ( 62 536)     |
| Changes in value                      | ( 38)         | 461           |
| <b>Balance at end of period</b>       | <b>373</b>    | <b>39 150</b> |

The acquisitions in the 2017 financial year relate to the acquisition of Commercial paper.

The table below shows, for assets included in level 3 of the fair value hierarchy, the main valuation methods used and the impact of the change in the main variables used on the respective valuation, when applicable:

| (thousands of Euros)   |                 |                   |                     |                       |        |                     |        |
|--|-----------------|-------------------|---------------------|-----------------------|--------|---------------------|--------|
| 31.12.2018   |                 |                   |                     |                       |        |                     |        |
| Assets classified under Level 3                                    | Valuation model | Variable analysed | Carrying book value | Unfavourable scenario |        | Favourable scenario |        |
|  |                 |                   |                     | Change                | Impact | Change              | Impact |
| <b>Securities at fair value through other comprehensive income</b> |                 |                   | <b>373</b>          | -                     | -      | -                   | -      |
| Shares   | Other           | (a)               | 373                 | -                     | -      | -                   | -      |
| <b>Total</b>   |                 |                   | <b>373</b>          |                       |        |                     |        |

(a) No sensitivity analysis was carried out for these categories as these include financial assets with an individual immaterial value

| (thousands of Euros)   |                            |                        |                     |                       |                 |                     |            |
|--|----------------------------|------------------------|---------------------|-----------------------|-----------------|---------------------|------------|
| 31.12.2017   |                            |                        |                     |                       |                 |                     |            |
| Assets classified under Level 3                                    | Valuation model            | Variable analysed      | Carrying book value | Unfavourable scenario |                 | Favourable scenario |            |
|  |                            |                        |                     | Change                | Impact          | Change              | Impact     |
| <b>Securities at fair value through other comprehensive income</b> |                            |                        | <b>39 150</b>       |                       | ( 1 524)        |                     | <b>737</b> |
| Bonds of other issuers/Commercial paper                            | Discounted cash flow model | Probability of default | 39 150              | 2 levels              | ( 1 524)        | 2 levels            | 737        |
| <b>Total</b>   |                            |                        | <b>39 150</b>       |                       | <b>( 1 524)</b> |                     | <b>737</b> |

The main assumptions and inputs used in the valuation models, during the financial years ended 31 December 2018 and 2017, are as follows:

#### Interest rate curves

The short-term rates presented reflect benchmark interest rates for the money market, while for the long term the values presented represent the swap interest rates for the respective periods:

(%)

|           | 31.12.2018 |        |        | 31.12.2017 |        |        |
|-----------|------------|--------|--------|------------|--------|--------|
|           | EUR        | USD    | GBP    | EUR        | USD    | GBP    |
| Overnight | -0.4200    | 2.4000 | 0.7650 | -0.4100    | 1.4500 | 0.6450 |
| 1 month   | -0.3630    | 2.7000 | 0.9050 | -0.3680    | 1.6500 | 0.5000 |
| 3 months  | -0.3090    | 2.8700 | 0.9500 | -0.3290    | 1.7600 | 0.7500 |
| 6 months  | -0.2370    | 2.9500 | 1.0700 | -0.2710    | 1.9100 | 0.8400 |
| 9 months  | -0.2295    | 3.0300 | 1.1600 | -0.2170    | 2.0600 | 0.7900 |
| 1 year    | -0.2250    | 2.7440 | 0.9898 | -0.2550    | 1.8790 | 0.6060 |
| 3 years   | -0.0650    | 2.5800 | 1.2193 | 0.0110     | 2.1440 | 0.8837 |
| 5 years   | 0.2010     | 2.5780 | 1.3050 | 0.3150     | 2.2380 | 1.0325 |
| 7 years   | 0.4690     | 2.6210 | 1.3574 | 0.5660     | 2.3000 | 1.1430 |
| 10 years  | 0.8150     | 2.7110 | 1.4365 | 0.8860     | 2.3850 | 1.2735 |
| 15 years  | 1.1690     | 2.7890 | 1.5131 | 1.2480     | 2.4750 | 1.4052 |
| 20 years  | 1.3450     | 2.8190 | 1.5461 | 1.4180     | 2.5170 | 1.4530 |
| 25 years  | 1.3720     | 2.8190 | 1.5491 | 1.4950     | 2.5275 | 1.4447 |
| 30 years  | 1.4050     | 2.8110 | 1.5411 | 1.5010     | 2.5250 | 1.4250 |

#### *Interest rate volatility*

The values presented below refer to the implied volatilities (at the money) used for the valuation of interest rate options:

(%)

|          | 31.12.2018 |       |       | 31.12.2017 |       |       |
|----------|------------|-------|-------|------------|-------|-------|
|          | EUR        | USD   | GBP   | EUR        | USD   | GBP   |
| 1 year   | 16.48      | 11.25 | 33.95 | 12.26      | 15.31 | 52.35 |
| 3 years  | 32.17      | 22.87 | -     | 31.32      | 22.10 | -     |
| 5 years  | 48.20      | 27.29 | 58.01 | 46.25      | 28.62 | 58.67 |
| 7 years  | 57.42      | 28.35 | 61.25 | 54.61      | 30.07 | 63.27 |
| 10 years | 63.34      | 30.20 | -     | 61.27      | 28.18 | -     |
| 15 years | 64.69      | -     | -     | 64.25      | -     | -     |

#### *Foreign exchange rates and volatility*

The foreign exchange rates (European Central Bank) at the balance sheet date and the implied volatilities (at the money) for the main foreign currency pairs used in the valuation of derivatives are presented next:

| Foreign exchange rate pair |            |            | Volatility (%) |          |          |          |        |
|----------------------------|------------|------------|----------------|----------|----------|----------|--------|
|                            | 31.12.2018 | 31.12.2017 | 1 month        | 3 months | 6 months | 9 months | 1 year |
| EUR/USD                    | 1.1450     | 1.1993     | 7.26           | 7.31     | 7.48     | 7.60     | 7.68   |
| EUR/GBP                    | 0.8945     | 0.8872     | 10.87          | 11.20    | 10.87    | 10.76    | 10.32  |
| EUR/CHF                    | 1.1269     | 1.1702     | 5.49           | 5.79     | 6.05     | 6.15     | 6.34   |
| EUR/NOK                    | 9.9483     | 9.8403     | 8.06           | 7.75     | 7.60     | 7.60     | 7.54   |
| EUR/PLN                    | 4.3014     | 4.1770     | 4.85           | 5.13     | 5.45     | 5.73     | 5.91   |
| EUR/RUB                    | 79.7153    | 69.3920    | 13.39          | 13.69    | 13.86    | 14.10    | 14.21  |
| USD/BRL <sup>a)</sup>      | 3.8812     | 3.3127     | 14.91          | 14.68    | 14.51    | 14.49    | 14.46  |
| USD/TRY <sup>b)</sup>      | 5.2915     | 3.7909     | 19.53          | 19.75    | 20.15    | 20.53    | 20.88  |

<sup>a)</sup> Calculated based on the EUR/USD and EUR/BRL rates

<sup>b)</sup> Calculated based on the EUR/USD and EUR/TRY rates

BEST uses in its valuation models the spot rate observed on the market at the moment of the valuation.

#### Equity indexes

The table below presents the evolution of the main equity indexes and the respective volatilities used in the valuation of equity derivatives:

|                  | Quotation  |            |          | Historical volatility |          | Implicit volatility |
|------------------|------------|------------|----------|-----------------------|----------|---------------------|
|                  | 31.12.2018 | 31.12.2017 | % change | 1 month               | 3 months |                     |
| DJ Euro Stoxx 50 | 3 001      | 3 504      | 16.74%   | 18.52                 | 14.74    | -                   |
| PSI 20           | 4 731      | 5 388      | 13.88%   | 16.51                 | 13.28    | -                   |
| IBEX 35          | 8 540      | 10 044     | 17.61%   | 18.62                 | 14.72    | -                   |
| FTSE 100         | 6 728      | 7 688      | 14.26%   | 18.44                 | 14.05    | 20.75               |
| DAX              | 10 559     | 12 918     | 22.34%   | 20.35                 | 16.18    | 21.83               |
| S&P 500          | 2 507      | 2 674      | 6.65%    | 27.31                 | 20.65    | 22.39               |
| BOVESPA          | 87 887     | 76 402     | -13.07%  | 20.70                 | 24.86    | 24.83               |

The Bank uses in its valuation models the spot rate observed on the market at the moment of the valuation.

The main methods and assumptions used in estimating the fair values of financial assets and liabilities measured at amortized cost in the balance sheet, are analysed as follows:

(thousands of Euros)

|                                 | Assets/liabilities recorded at amortized cost | At fair value        |   |   | Total fair value |
|---------------------------------|---|----------------------|---|---|------------------|
|                                 |   | Quoted Market Prices | Valuation models based on observable market information | Valuation models based on non-observable market information |                  |
|                                 |   | (Level 1)            | (Level 2)   | (Level 3)   |                  |
| <b>31 December 2018</b>         |   |                      |   |   |                  |
| Deposits with banks             | 33 260  | -                    | 33 260  | -   | 33 260           |
| Loans and advances to banks     | 401 598                                       | -                    | 401 598   | -   | 401 598          |
| Loans and advances to customers | 141 156                                       | -                    | -   | 142 234   | 142 234          |
| Securities at amortized cost    | 19 851  | -                    | -   | 20 229  | 20 229           |
| <b>Financial assets</b>         | <b>595 865</b>                                | <b>-</b>             | <b>434 858</b>  | <b>162 463</b>  | <b>597 321</b>   |
| Deposits from banks             | 20 356  | -                    | 20 356  | -   | 20 356           |
| Due to customers                | 545 846                                       | -                    | -   | 545 846   | 545 846          |
| <b>Financial liabilities</b>    | <b>566 202</b>                                | <b>-</b>             | <b>20 356</b>   | <b>545 846</b>  | <b>566 202</b>   |

(thousands of Euros)

|  | Assets/liabilities recorded at amortized cost | At fair value        |   |   | Total fair value |
|--|---|----------------------|---|---|------------------|
|  |   | Quoted Market Prices | Valuation models based on observable market information | Valuation models based on non-observable market information |                  |
|  |   | (Level 1)            | (Level 2)   | (Level 3)   |                  |
| <b>31 December 2017</b>                    |   |                      |   |   |                  |
| Deposits with banks                        | 44 694  | -                    | 44 694  | -   | 44 694           |
| Securities at fair value through equity a) | 549   | -                    | -   | 549   | 549              |
| Loans and advances to banks                | 306 690                                       | -                    | 306 690   | -   | 306 690          |
| Loans and advances to customers            | 159 727                                       | -                    | -   | 155 587   | 155 587          |
| <b>Financial assets</b>                    | <b>511 660</b>                                | <b>-</b>             | <b>351 384</b>  | <b>156 136</b>  | <b>507 520</b>   |
| Deposits from banks                        | 19 210  | -                    | 19 210  | -   | 19 210           |
| Due to customers                           | 493 890                                       | -                    | -   | 493 890   | 493 890          |
| <b>Financial liabilities</b>               | <b>513 100</b>                                | <b>-</b>             | <b>19 210</b>   | <b>493 890</b>  | <b>513 100</b>   |

a) Assets at acquisition cost, net of impairment. These assets refer to equity instruments issued by unquoted entities for which no recent transactions were identified on the market nor is it possible to reliably estimate their fair value

### *Cash and deposits with Central Banks, Deposits with banks, Loans and advances to banks and Deposits from banks*

Considering the short-term nature of these financial instruments, their carrying value is a reasonable estimate of their fair value.

### *Loans and advances to customers*

The fair value of loans and advances to customers is estimated based on the discounting of the expected future cash flows of capital and interest, assuming that the instalments are paid on the dates contractually defined. The expected future cash flows of loans with similar credit risk characteristics, such as, for example, housing loans, are estimated on a portfolio basis. The



discount rates used by the Bank are the current interest rates used in loans with similar characteristics at the balance sheet date.

#### *Securities at amortized cost*

The fair value of securities at amortized cost is estimated in accordance with the valuation methods used for securities' portfolios at fair value, as indicated in the accounting policy defined in Note 2.4..

#### *Deposits from Central Banks*

Considering the short-term nature of these financial instruments, their carrying value is a reasonable estimate of their fair value.

#### *Due to customers and other loans*

The fair value of the demand deposits corresponds to the nominal amount of same. The fair value of the term deposits and other funds not at sight is estimated based on the discounting of the expected future cash flows of capital and interest, assuming that the instalments are paid on the dates contractually defined. The discount rates used by the Bank are the current interest rates used in instruments with similar characteristics at the balance sheet date. Considering that the interest rates applicable to these instruments are renewed for periods substantially lower than one year, the differences between the fair value and carrying value are not material.

### **NOTE 33 – ACTIVITY RISK MANAGEMENT**

Banco Best takes advantages of the synergies inherent to its shareholding structure, maintaining a lightweight operational structure and subcontracting to the NOVO BANCO Group a number of services and other back-office functions whenever economies of scale can be achieved through the use of shared services. In this sense, NOVO BANCO and/or Group companies are the leading providers of outsourced services to BEST.

The Risk Management function therefore integrates the Global Risk Department of NOVO BANCO and aims to ensure an effective implementation of the risk management system through the continuous monitoring of its adequacy and effectiveness, seeking to identify, assess, monitor and control all material risks to which the Bank is exposed, both internally and externally. In this context, BEST participates in the various relevant risk function committees, namely the Risk Committee and the Assets and Liabilities Management Committee.

The Bank is exposed to the following risks arising from the use of financial instruments:

- Credit risk;
- Market risk;
- Liquidity risk;
- Operational risk.

#### *Credit risk*

Credit risk represents the potential financial loss arising from the failure of a borrower or counterpart to honour its contractual obligations established with the Bank in the scope of its lending activity. Credit risk is essentially present in traditional banking products – loans, guarantees issued and other contingent liabilities – and in trading products – swaps, forwards and options (counterpart risk).

The loan portfolio management is an ongoing process that requires interaction between the various teams responsible for risk management throughout the consecutive stages of the loan process. This approach is complemented with the continuous introduction of improvements in the methodologies and in the risk assessment and control tools, as well as in the procedures and in the decision-making processes.

The risk profile of the Bank is analysed on a regular basis by the Risk Committee, especially as regards the evolution of credit exposure and credit losses. The observance of approved credit limits and the correct application of the mechanisms associated with the approval of credit lines during the day-to-day activity of the commercial structure are also subject to periodic analysis.

BEST's maximum credit risk exposure is analysed as follows:

|   | (thousands of Euros) |                |
|---|----------------------|----------------|
|   | 31.12.2018           | 31.12.2017     |
| Deposits with and loans and advances to banks               | 434 858              | 351 384        |
| Derivatives held for trading                                | 584                  | 285            |
| Securities at fair value through other comprehensive income | 47 079               | 80 335         |
| Securities at amortized cost                                | 19 851               | -              |
| Loans and advances to customers                             | 141 156              | 159 727        |
| Other assets  | 3 343                | 2 378          |
| Guarantees and standby letters                              | 172 227              | 169 245        |
| Revocable and irrevocable commitments                       | 65 205               | 61 123         |
|   | <b>884 303</b>       | <b>824 477</b> |

For financial assets recognized in the balance sheet, the maximum exposure to credit risk is represented by the carrying value, net of impairment. For the off-balance sheet elements, the maximum exposure of the guarantees is the maximum amount that the Bank would have to pay if the guarantees were executed. For loan commitments and other credit-related commitments of an irrevocable nature, the maximum exposure is the total amount of the commitments assumed.

Impairment is calculated on a collective or individual basis in accordance with the accounting policy defined in Note 2.4. In the cases where the value of the collateral, net of haircuts (differentiated by type of collateral) equals or exceeds the exposure, the impairment may be nil. Thus, the Bank does not have past due financial assets for which it has not carried out an assessment as to their recovery and consequent recognition of the respective impairment, when verified.

The following table presents the assets that are impaired, or past due but not impaired:

(thousands of Euros)

|   | 31.12.2018                    |                           |          |                |            |              |
|---|-------------------------------|---------------------------|----------|----------------|------------|--------------|
|   | Neither past due nor impaired | Past due but not impaired | Impaired | Total exposure | Impairment | Net exposure |
| Deposits with and loans and advances to banks               | 435 301                       | -                         | -        | 435 301        | ( 443)     | 434 858      |
| Securities at fair value through other comprehensive income | 47 079                        | -                         | -        | 47 079         | -          | 47 079       |
| <i>Debt instruments - Government/public issuers</i>         | 47 079                        | -                         | -        | 47 079         | -          | 47 079       |
| Securities at amortized cost                                | 20 222                        | -                         | -        | 20 222         | ( 371)     | 19 851       |
| <i>Debt instruments - other issuers</i>                     | 20 222                        | -                         | -        | 20 222         | ( 371)     | 19 851       |
| Loans and advances to customers                             | 141 790                       | 15                        | 173      | 141 978        | ( 825)     | 141 153      |

(thousands of Euros)

|   | 31.12.2017                    |                           |          |                |            |              |
|---|-------------------------------|---------------------------|----------|----------------|------------|--------------|
|   | Neither past due nor impaired | Past due but not impaired | Impaired | Total exposure | Impairment | Net exposure |
| Deposits with and loans and advances to banks               | 351 384                       | -                         | -        | 351 384        | -          | 351 384      |
| Securities at fair value through other comprehensive income | 80 335                        | -                         | -        | 80 335         | -          | 80 335       |
| <i>Debt instruments - Government/public issuers</i>         | 41 187                        | -                         | -        | 41 187         | -          | 41 187       |
| <i>Debt instruments - other issuers</i>                     | 39 148                        | -                         | -        | 39 148         | -          | 39 148       |
| Loans and advances to customers                             | 160 351                       | 16                        | 1 449    | 161 816        | ( 2 089)   | 159 727      |

Impaired exposures correspond to (i) exposures with objective evidence of loss ("Exposure in default", according to the internal definition of default - corresponding to Stage 3); and (ii) exposures classified as having specific impairment after being assessed individually for impairment.

Exposures classified as non-impaired relate to (i) all exposures that present no signs of a significant deterioration of credit risk - exposures classified as Stage 1; (ii) exposures that, although presenting signs of a significant deterioration of credit risk, have neither objective evidence of impairment nor specific impairment after being assessed individually for impairment.

The following table shows the assets that are impaired or past due without impairment, disaggregated by the respective maturity or ageing (if past due):

(thousands of Euros)

| 31.12.2018         |  |          |   |          |                                 |            |
|--------------------|--|----------|---|----------|---------------------------------|------------|
|                    | Securities at fair value through other comprehensive income - Debt instruments |          | Deposits with and loans and advances to banks |          | Loans and advances to customers |            |
|                    | Past due but not impaired  | Impaired | Past due but not impaired                     | Impaired | Past due but not impaired       | Impaired   |
| <b>Past due</b>    |  |          |   |          |                                 |            |
| Up to 3 months     | -  | -        | -   | -        | 14                              | 3          |
| 3 months to 1 year | -  | -        | -   | -        | 1                               | 38         |
| 1 to 3 years       | -  | -        | -   | -        | -                               | 30         |
| 3 to 5 years       | -  | -        | -   | -        | -                               | 7          |
| More than 5 years  | -  | -        | -   | -        | -                               | 89         |
|                    | -  | -        | -   | -        | <b>15</b>                       | <b>167</b> |
| <b>Not yet due</b> |  |          |   |          |                                 |            |
| 3 months to 1 year | -  | -        | -   | -        | -                               | 5          |
| 1 to 3 years       | -  | -        | -   | -        | -                               | 1          |
| 3 to 5 years       | -  | -        | -   | -        | -                               | -          |
| More than 5 years  | -  | -        | -   | -        | -                               | -          |
|                    | -  | -        | -   | -        | -                               | <b>6</b>   |
|                    | -  | -        | -   | -        | <b>15</b>                       | <b>173</b> |

(thousands of Euros)

| 31.12.2017         |  |          |   |          |                                 |              |
|--------------------|--|----------|---|----------|---------------------------------|--------------|
|                    | Securities at fair value through other comprehensive income - Debt instruments |          | Deposits with and loans and advances to banks |          | Loans and advances to customers |              |
|                    | Past due but not impaired  | Impaired | Past due but not impaired                     | Impaired | Past due but not impaired       | Impaired     |
| <b>Past due</b>    |  |          |   |          |                                 |              |
| Up to 3 months     | -  | -        | -   | -        | 14                              | 7            |
| 3 months to 1 year | -  | -        | -   | -        | 1                               | 66           |
| 1 to 3 years       | -  | -        | -   | -        | 1                               | 554          |
| 3 to 5 years       | -  | -        | -   | -        | -                               | 273          |
| More than 5 years  | -  | -        | -   | -        | -                               | 460          |
|                    | -  | -        | -   | -        | <b>16</b>                       | <b>1 360</b> |
| <b>Not yet due</b> |  |          |   |          |                                 |              |
| 3 months to 1 year | -  | -        | -   | -        | -                               | 3            |
| 1 to 3 years       | -  | -        | -   | -        | -                               | 19           |
| 3 to 5 years       | -  | -        | -   | -        | -                               | 41           |
| More than 5 years  | -  | -        | -   | -        | -                               | 26           |
|                    | -  | -        | -   | -        | -                               | <b>89</b>    |
|                    | -  | -        | -   | -        | <b>16</b>                       | <b>1 449</b> |

The following table shows the assets that are impaired or past due without impairment, disaggregated by the respective Stage of impairment:

(thousands of Euros)

|                                 | 31.12.2018 |           |            |            |
|---------------------------------|------------|-----------|------------|------------|
|                                 | Stage 1    | Stage 2   | Stage 3    | Total      |
| Loans and advances to customers | 5          | 10        | 173        | 188        |
|                                 | <b>5</b>   | <b>10</b> | <b>173</b> | <b>188</b> |

In relation to assets that are not past due or impaired, the distribution by rating level is presented below. For debt instruments, the rating attributed by the Rating agencies is considered, for loans and advances to customers and for cash and cash equivalents and loans and advances to banks the internal rating and scoring models are used, based on which a risk rating is attributed that is reviewed periodically. For the purpose of presenting the information, the ratings were aggregated into five large risk groups, with the last group including unrated exposures.

(thousands of Euros)

|   | 31.12.2018         |                    |                    |   |         |         |
|---|--------------------|--------------------|--------------------|---|---------|---------|
|   | Prime + High grade | Upper Medium grade | Lower Medium grade | Non-investment grade Speculative + Highly speculative | Other   | Total   |
| Deposits with and loans and advances to banks               | -                  | -                  | -                  | -   | 435 301 | 435 301 |
| Securities at fair value through other comprehensive income | -                  | -                  | 47 079             | -   | -       | 47 079  |
| <i>Debt instruments - Government/public issuers</i>         | -                  | -                  | 47 079             | -   | -       | 47 079  |
| Securities at amortized cost                                | -                  | -                  | -                  | -   | 20 222  | 20 222  |
| <i>Debt instruments - other issuers</i>                     | -                  | -                  | -                  | -   | 20 222  | 20 222  |
| Loans and advances to customers                             | 132                | 73 573             | 24 398             | 15 303  | 28 384  | 141 790 |

(thousands of Euros)

|   | 31.12.2017         |                    |                    |   |         |         |
|---|--------------------|--------------------|--------------------|---|---------|---------|
|   | Prime + High grade | Upper Medium grade | Lower Medium grade | Non-investment grade Speculative + Highly speculative | Other   | Total   |
| Deposits with and loans and advances to banks               | -                  | -                  | -                  | -   | 351 384 | 351 384 |
| Securities at fair value through other comprehensive income | -                  | -                  | 41 187             | -   | 39 148  | 80 335  |
| <i>Debt instruments - Government/public issuers</i>         | -                  | -                  | 41 187             | -   | -       | 41 187  |
| <i>Debt instruments - other issuers</i>                     | -                  | -                  | -                  | -   | 39 148  | 39 148  |
| Loans and advances to customers                             | 490                | 83 018             | 25 536             | 13 261  | 38 046  | 160 351 |

As at 31 December 2018 and 2017, the detail of gross loans and advances to customers and impairment recognized by segment was as follows:

(thousands of Euros)

| Segment                    | 31.12.2018                     |            |                      |            |                |            |                |          |            |            |            |            |                          |            |     |
|----------------------------|--------------------------------|------------|----------------------|------------|----------------|------------|----------------|----------|------------|------------|------------|------------|--------------------------|------------|-----|
|                            | Performing                     |            |                      |            |                |            | Non-performing |          |            |            |            |            | Total loans and advances |            |     |
|                            | Active or with delay < 30 days |            | With delay > 30 days |            | Total          |            | Days of delay  |          |            |            | Total      |            | Exposure                 | Impairment |     |
|                            | Exposure                       | Impairment | Exposure             | Impairment | Exposure       | Impairment | <= 90 days     |          | > 90 days  |            | Exposure   | Impairment |                          |            |     |
| Corporate                  | 30 233                         | 147        | -                    | -          | 30 233         | 147        | -              | -        | -          | -          | -          | -          | -                        | 30 233     | 147 |
| Housing loans              | -                              | -          | -                    | -          | -              | -          | -              | -        | -          | -          | -          | -          | -                        | -          | -   |
| Other loans to individuals | 111 531                        | 522        | 38                   | 1          | 111 569        | 523        | 10             | 2        | 169        | 153        | 179        | 155        | 111 748                  | 678        |     |
| <b>Total</b>               | <b>141 764</b>                 | <b>669</b> | <b>38</b>            | <b>1</b>   | <b>141 802</b> | <b>670</b> | <b>10</b>      | <b>2</b> | <b>169</b> | <b>153</b> | <b>179</b> | <b>155</b> | <b>141 981</b>           | <b>825</b> |     |

(thousands of Euros)

| Segment                    | 31.12.2017                     |            |                      |            |                |            |                |          |              |              |              |              |                          |              |
|----------------------------|--------------------------------|------------|----------------------|------------|----------------|------------|----------------|----------|--------------|--------------|--------------|--------------|--------------------------|--------------|
|                            | Performing                     |            |                      |            |                |            | Non-performing |          |              |              |              |              | Total loans and advances |              |
|                            | Active or with delay < 30 days |            | With delay > 30 days |            | Total          |            | Days of delay  |          |              |              | Total        |              | Exposure                 | Impairment   |
|                            | Exposure                       | Impairment | Exposure             | Impairment | Exposure       | Impairment | <= 90 days     |          | > 90 days    |              | Exposure     | Impairment   |                          |              |
| Corporate                  | 30 479                         | 246        | -                    | -          | 30 479         | 246        | -              | -        | 2            | 2            | 2            | 2            | 30 481                   | 248          |
| Housing loans              | -                              | -          | -                    | -          | -              | -          | -              | -        | -            | -            | -            | -            | -                        | -            |
| Other loans to individuals | 129 780                        | 463        | 98                   | -          | 129 878        | 463        | 18             | 9        | 1 439        | 1 369        | 1 457        | 1 378        | 131 335                  | 1 841        |
| <b>Total</b>               | <b>160 259</b>                 | <b>709</b> | <b>98</b>            | <b>-</b>   | <b>160 357</b> | <b>709</b> | <b>18</b>      | <b>9</b> | <b>1 441</b> | <b>1 371</b> | <b>1 459</b> | <b>1 380</b> | <b>161 816</b>           | <b>2 089</b> |

As at 31 December 2018 and 2017, the breakdown of the loans and advances to customers' portfolio and year of production was as follows:

(thousands of Euros)

| <b>31.12.2018</b>  |                      |               |                        |                            |                |                        |                      |                |                        |
|--------------------|----------------------|---------------|------------------------|----------------------------|----------------|------------------------|----------------------|----------------|------------------------|
| Year of production | Corporate            |               |                        | Other loans to individuals |                |                        | Total                |                |                        |
|                    | Number of operations | Amount        | Impairment constituted | Number of operations       | Amount         | Impairment constituted | Number of operations | Amount         | Impairment constituted |
| 2004 and prior     | 3                    | -             | -                      | 10 763                     | 892            | 22                     | 10 766               | 892            | 22                     |
| 2005               | -                    | -             | -                      | 455                        | 380            | 5                      | 455                  | 380            | 5                      |
| 2006               | -                    | -             | -                      | 577                        | 435            | 9                      | 577                  | 435            | 9                      |
| 2007               | -                    | -             | -                      | 487                        | 1 016          | 96                     | 487                  | 1 016          | 96                     |
| 2008               | 1                    | -             | -                      | 385                        | 351            | 17                     | 386                  | 351            | 17                     |
| 2009               | 1                    | 4             | -                      | 360                        | 918            | 7                      | 361                  | 922            | 7                      |
| 2010               | 1                    | 352           | 5                      | 1 035                      | 1 620          | 10                     | 1 036                | 1 972          | 15                     |
| 2011               | 2                    | -             | -                      | 1 488                      | 5 559          | 33                     | 1 490                | 5 559          | 33                     |
| 2012               | 9                    | 5 109         | 35                     | 1 010                      | 8 373          | 32                     | 1 019                | 13 482         | 67                     |
| 2013               | 10                   | 1 165         | 2                      | 1 182                      | 5 502          | 28                     | 1 192                | 6 667          | 30                     |
| 2014               | 15                   | 1 512         | 4                      | 1 001                      | 13 015         | 59                     | 1 016                | 14 527         | 63                     |
| 2015               | 21                   | 5 333         | 40                     | 684                        | 10 902         | 57                     | 705                  | 16 235         | 97                     |
| 2016               | 14                   | 4 257         | 20                     | 501                        | 18 954         | 113                    | 515                  | 23 211         | 133                    |
| 2017               | 27                   | 8 813         | 32                     | 505                        | 29 457         | 136                    | 532                  | 38 270         | 168                    |
| 2018               | 24                   | 3 688         | 9                      | 411                        | 14 374         | 54                     | 435                  | 18 062         | 63                     |
| <b>Total</b>       | <b>128</b>           | <b>30 233</b> | <b>147</b>             | <b>20 844</b>              | <b>111 748</b> | <b>678</b>             | <b>20 972</b>        | <b>141 981</b> | <b>825</b>             |

(thousands of Euros)

| <b>31.12.2017</b>  |                      |               |                        |                            |                |                        |                      |                |                        |
|--------------------|----------------------|---------------|------------------------|----------------------------|----------------|------------------------|----------------------|----------------|------------------------|
| Year of production | Corporate            |               |                        | Other loans to individuals |                |                        | Total                |                |                        |
|                    | Number of operations | Amount        | Impairment constituted | Number of operations       | Amount         | Impairment constituted | Number of operations | Amount         | Impairment constituted |
| 2004 and prior     | 2                    | 1             | -                      | 17 910                     | 828            | 71                     | 17 912               | 829            | 71                     |
| 2005               | -                    | -             | -                      | 629                        | 437            | 23                     | 629                  | 437            | 23                     |
| 2006               | -                    | -             | -                      | 718                        | 487            | 12                     | 718                  | 487            | 12                     |
| 2007               | -                    | -             | -                      | 671                        | 1 040          | 105                    | 671                  | 1 040          | 105                    |
| 2008               | 1                    | -             | -                      | 554                        | 805            | 188                    | 555                  | 805            | 188                    |
| 2009               | 2                    | 3             | -                      | 560                        | 1 185          | 111                    | 562                  | 1 188          | 111                    |
| 2010               | 2                    | 313           | 8                      | 1 516                      | 2 696          | 194                    | 1 518                | 3 009          | 202                    |
| 2011               | 6                    | 15            | -                      | 2 925                      | 8 957          | 258                    | 2 931                | 8 972          | 258                    |
| 2012               | 12                   | 5 134         | 24                     | 2 127                      | 11 791         | 424                    | 2 139                | 16 925         | 448                    |
| 2013               | 12                   | 1 312         | 5                      | 2 546                      | 10 145         | 92                     | 2 558                | 11 457         | 97                     |
| 2014               | 21                   | 2 055         | 7                      | 1 806                      | 17 858         | 84                     | 1 827                | 19 913         | 91                     |
| 2015               | 33                   | 5 990         | 54                     | 1 630                      | 13 535         | 56                     | 1 663                | 19 525         | 110                    |
| 2016               | 20                   | 4 506         | 83                     | 677                        | 25 685         | 94                     | 697                  | 30 191         | 177                    |
| 2017               | 39                   | 11 152        | 67                     | 644                        | 35 886         | 129                    | 683                  | 47 038         | 196                    |
| <b>Total</b>       | <b>150</b>           | <b>30 481</b> | <b>248</b>             | <b>34 913</b>              | <b>131 335</b> | <b>1 841</b>           | <b>35 063</b>        | <b>161 816</b> | <b>2 089</b>           |

As at 31 December 2018 and 2017, the breakdown of gross loans and advances to customers and impairment assessed individually and collectively, by segment, was as follows:

(thousands of Euros)

|                            | 31.12.2018                           |            |                                      |            |                |            |
|----------------------------|--------------------------------------|------------|--------------------------------------|------------|----------------|------------|
|                            | Individual Assessment <sup>(1)</sup> |            | Collective Assessment <sup>(2)</sup> |            | Total          |            |
|                            | Exposure                             | Impairment | Exposure                             | Impairment | Exposure       | Impairment |
| Corporate                  | -                                    | -          | 30 233                               | 147        | 30 233         | 147        |
| Other loans to individuals | -                                    | -          | 111 748                              | 678        | 111 748        | 678        |
| <b>Total</b>               | -                                    | -          | <b>141 981</b>                       | <b>825</b> | <b>141 981</b> | <b>825</b> |

<sup>(1)</sup> Loans and advances for which the final impairment was determined and approved by the Impairment Committee

<sup>(2)</sup> Loans and advances for which the final impairment was determined automatically by the Impairment model

(thousands of Euros)

|                            | 31.12.2017                           |              |                                      |            |                |              |
|----------------------------|--------------------------------------|--------------|--------------------------------------|------------|----------------|--------------|
|                            | Individual Assessment <sup>(1)</sup> |              | Collective Assessment <sup>(2)</sup> |            | Total          |              |
|                            | Exposure                             | Impairment   | Exposure                             | Impairment | Exposure       | Impairment   |
| Corporate                  | 2                                    | 2            | 30 479                               | 246        | 30 481         | 248          |
| Other loans to individuals | 1 107                                | 1 095        | 130 228                              | 746        | 131 335        | 1 841        |
| <b>Total</b>               | <b>1 109</b>                         | <b>1 097</b> | <b>160 707</b>                       | <b>992</b> | <b>161 816</b> | <b>2 089</b> |

<sup>(1)</sup> Loans and advances for which the final impairment was determined and approved by the Impairment Committee

<sup>(2)</sup> Loans and advances for which the final impairment was determined automatically by the Impairment model

In the case of loans analysed by the Impairment Committee for which the impairment determined automatically by the Impairment model has not been changed, these are included and presented in the "Collective assessment".

As at 31 December 2018 and 2017, the detail of the gross loans and advances to customers' exposure and the impairment assessed individually and collectively, by geography, was as follows:

(thousands of Euros)

| Country        | 31.12.2018            |            |                       |            |                |            |
|----------------|-----------------------|------------|-----------------------|------------|----------------|------------|
|                | Individual Assessment |            | Collective Assessment |            | Total          |            |
|                | Exposure              | Impairment | Exposure              | Impairment | Exposure       | Impairment |
| PORTUGAL       | -                     | -          | 136 524               | 776        | 136 524        | 776        |
| LUXEMBOURG     | -                     | -          | 7                     | -          | 7              | -          |
| UNITED KINGDOM | -                     | -          | 105                   | -          | 105            | -          |
| SPAIN          | -                     | -          | 1 606                 | 32         | 1 606          | 32         |
| IRELAND        | -                     | -          | 154                   | 1          | 154            | 1          |
| OTHER          | -                     | -          | 3 585                 | 16         | 3 585          | 16         |
| <b>Total</b>   | -                     | -          | <b>141 981</b>        | <b>825</b> | <b>141 981</b> | <b>825</b> |

(thousands of Euros)

| Country        | 31.12.2017            |              |                       |            |                |              |
|----------------|-----------------------|--------------|-----------------------|------------|----------------|--------------|
|                | Individual Assessment |              | Collective Assessment |            | Total          |              |
|                | Exposure              | Impairment   | Exposure              | Impairment | Exposure       | Impairment   |
| PORTUGAL       | 1 038                 | 1 026        | 149 723               | 965        | 150 761        | 1 991        |
| LUXEMBOURG     | -                     | -            | 2                     | -          | 2              | -            |
| UNITED KINGDOM | -                     | -            | 175                   | 1          | 175            | 1            |
| SPAIN          | -                     | -            | 1 826                 | 3          | 1 826          | 3            |
| OTHER          | 71                    | 71           | 8 981                 | 23         | 9 052          | 94           |
| <b>Total</b>   | <b>1 109</b>          | <b>1 097</b> | <b>160 707</b>        | <b>992</b> | <b>161 816</b> | <b>2 089</b> |

The analysis by sector of activity, as at 31 December 2018 and 2017, may be presented as follows:

(thousands of Euros)

|                                    | 31.12.2018                      |               |                              |  |   |             |                              |               |                   |               |
|------------------------------------|---------------------------------|---------------|------------------------------|--|---|-------------|------------------------------|---------------|-------------------|---------------|
|                                    | Loans and advances to customers |               | Derivatives held for trading | Securities at fair value through profit and loss | Securities at fair value through other comprehensive income |             | Securities at amortized cost |               | Guarantees issued |               |
|                                    | Gross amount                    | Impairment    |                              |  | Gross amount  | Impairment  | Gross amount                 | Impairment    | Gross amount      | Impairment    |
| Agriculture, Forestry and Fishery  | 713                             | ( 1)          | -                            | -  | -   | -           | -                            | -             | -                 | -             |
| Food, Beverages and Tobacco        | 153                             | -             | -                            | -  | -   | -           | -                            | -             | -                 | -             |
| Textiles and Clothing              | 2 424                           | ( 2)          | -                            | -  | -   | -           | -                            | -             | -                 | -             |
| Paper and Printing Industry        | 15                              | -             | -                            | -  | -   | -           | -                            | -             | -                 | -             |
| Chemicals and Rubber               | 196                             | -             | -                            | -  | -   | -           | -                            | -             | -                 | -             |
| Non-metallic Minerals              | 120                             | -             | -                            | -  | -   | -           | -                            | -             | -                 | -             |
| Production of Transport Material   | 44                              | -             | -                            | -  | -   | -           | -                            | -             | -                 | -             |
| Construction and Public Works      | 8 792                           | ( 95)         | -                            | -  | -   | -           | 14 977                       | ( 340)        | -                 | -             |
| Wholesale and Retail Trade         | 5 342                           | ( 11)         | -                            | -  | -   | -           | 5 245                        | ( 31)         | 735               | ( 47)         |
| Tourism                            | 1 719                           | ( 1)          | -                            | -  | -   | -           | -                            | -             | -                 | -             |
| Transport and Communication        | -                               | -             | -                            | -  | -   | -           | -                            | -             | -                 | -             |
| Financial Activities               | 48                              | -             | 584                          | 851  | 373   | -           | -                            | -             | 171 357           | ( 26)         |
| Real Estate Activities             | 6 179                           | ( 27)         | -                            | -  | -   | -           | -                            | -             | -                 | -             |
| Services Provided to Companies     | 2 473                           | ( 8)          | -                            | -  | -   | -           | -                            | -             | -                 | -             |
| Public Administration and Services | 1 761                           | ( 2)          | -                            | -  | 47 079  | ( 5)        | -                            | -             | -                 | -             |
| Other community service activities | 254                             | -             | -                            | -  | -   | -           | -                            | -             | -                 | -             |
| Loans to individuals               | 111 748                         | ( 678)        | -                            | -  | -   | -           | -                            | -             | -                 | -             |
| Other                              | -                               | -             | -                            | -  | -   | -           | -                            | -             | 246               | ( 38)         |
| <b>TOTAL</b>                       | <b>141 981</b>                  | <b>( 825)</b> | <b>584</b>                   | <b>851</b>                                       | <b>47 452</b>   | <b>( 5)</b> | <b>20 222</b>                | <b>( 371)</b> | <b>172 338</b>    | <b>( 111)</b> |

(thousands of Euros)

|                                    | 31.12.2017                      |                 |                              |   |               |                   |              |   |
|------------------------------------|---------------------------------|-----------------|------------------------------|---|---------------|-------------------|--------------|---|
|                                    | Loans and advances to customers |                 | Derivatives held for trading | Securities at fair value through other comprehensive income |               | Guarantees issued |              |   |
|                                    | Gross amount                    | Impairment      |                              | Gross amount  | Impairment    | Gross amount      | Impairment   |   |
| Agriculture, Forestry and Fishery  | 544                             | ( 6)            | -                            | -   | -             | -                 | -            | - |
| Food, Beverages and Tobacco        | 261                             | ( 1)            | -                            | -   | -             | -                 | -            | - |
| Textiles and Clothing              | 3 998                           | ( 4)            | -                            | -   | -             | -                 | -            | - |
| Paper and Printing Industry        | 61                              | -               | -                            | -   | -             | -                 | -            | - |
| Chemicals and Rubber               | 335                             | -               | -                            | -   | -             | -                 | -            | - |
| Non-metallic Minerals              | 502                             | ( 1)            | -                            | -   | -             | -                 | -            | - |
| Production of Transport Material   | -                               | -               | -                            | -   | -             | -                 | -            | - |
| Construction and Public Works      | 78                              | ( 2)            | -                            | 14 978  | -             | -                 | -            | - |
| Wholesale and Retail Trade         | 3 860                           | ( 19)           | -                            | 9 225   | -             | 814               | ( 2)         | - |
| Tourism                            | 2 098                           | ( 7)            | -                            | -   | -             | -                 | -            | - |
| Financial Activities               | 73                              | -               | 285                          | 1 435   | ( 167)        | 168 434           | ( 17)        | - |
| Real Estate Activities             | 11 017                          | ( 170)          | -                            | -   | -             | -                 | -            | - |
| Services Provided to Companies     | 5 370                           | ( 11)           | -                            | 14 944  | -             | -                 | -            | - |
| Public Administration and Services | 1 977                           | ( 18)           | -                            | 41 188  | -             | -                 | -            | - |
| Other community service activities | 144                             | ( 9)            | -                            | -   | -             | -                 | -            | - |
| Loans to individuals               | 131 335                         | ( 1 841)        | -                            | -   | -             | -                 | -            | - |
| Other                              | 88                              | -               | -                            | -   | -             | 16                | -            | - |
| <b>TOTAL</b>                       | <b>161 816</b>                  | <b>( 2 089)</b> | <b>285</b>                   | <b>81 770</b>   | <b>( 167)</b> | <b>169 264</b>    | <b>( 19)</b> |   |



The Bank identifies and marks credit agreements restructured due to financial difficulties of the customer whenever there are changes to the terms and conditions of a contract in which the customer defaulted, or it is foreseeable that it will default, on a financial obligation. A change to the terms and conditions of the contract is deemed to exist when (i) there are contractual changes to the customer's benefit, such as extension of the term, introduction of grace periods, rate reduction or partial debt pardon; (ii) there is a new loan operation for the settlement of existing debt (total or partial); or (iii) the new terms of the contract are more favourable than those applied to other customers with the same risk profile.

The demarcation of a loan restructured due to financial difficulties of the customer can only occur after a minimum period of two years from the date of the restructuring, provided that the following conditions are cumulatively met: (i) regular payment of principal and interest; (ii) the customer has no past due principal or interest; and (iii) there was no new loan restructuring in that period.

The amounts of credit restructured due to financial difficulties of the customer as at 31 December 2018 and 2017 are as follows:

|                            | (thousands of Euros) |              |
|----------------------------|----------------------|--------------|
|                            | 31.12.2018           | 31.12.2017   |
| Corporate                  | 1 749                | 1 782        |
| Other loans to individuals | 732                  | 1 901        |
| <b>Total</b>               | <b>2 481</b>         | <b>3 683</b> |

Below are the details of the restructuring measures applied to restructured loans and advances until 31 December 2018 and 2017:

| Measure   | (thousands of Euros) |              |            |                  |           |            |                  |              |            |
|---|----------------------|--------------|------------|------------------|-----------|------------|------------------|--------------|------------|
|   | 31.12.2018           |              |            |                  |           |            |                  |              |            |
|   | Performing           |              |            | Non-performing   |           |            | Total            |              |            |
|   | No. transactions     | Exposure     | Impairment | No. transactions | Exposure  | Impairment | No. transactions | Exposure     | Impairment |
| New loan in total or partial payment of existing loan | 3                    | 13           | 1          | 2                | 7         | 4          | 5                | 20           | 5          |
| Extension of repayment period                         | 2                    | 10           | -          | 7                | 12        | 12         | 9                | 22           | 12         |
| Change of the lease payment plan                      | 2                    | 16           | -          | -                | -         | -          | 2                | 16           | -          |
| Other   | 10                   | 2 420        | 11         | 3                | 3         | 2          | 13               | 2 423        | 13         |
| <b>Total</b>  | <b>17</b>            | <b>2 459</b> | <b>12</b>  | <b>12</b>        | <b>22</b> | <b>18</b>  | <b>29</b>        | <b>2 481</b> | <b>30</b>  |

| Measure   | (thousands of Euros) |              |            |                  |            |            |                  |              |            |
|---|----------------------|--------------|------------|------------------|------------|------------|------------------|--------------|------------|
|   | 31.12.2017           |              |            |                  |            |            |                  |              |            |
|   | Performing           |              |            | Non-performing   |            |            | Total            |              |            |
|   | No. transactions     | Exposure     | Impairment | No. transactions | Exposure   | Impairment | No. transactions | Exposure     | Impairment |
| New loan in total or partial payment of existing loan | 9                    | 41           | 2          | 3                | 8          | 2          | 12               | 49           | 4          |
| Extension of repayment period                         | 3                    | 16           | 1          | 11               | 18         | 18         | 14               | 34           | 19         |
| Change of the lease payment plan                      | 2                    | 17           | -          | -                | -          | -          | 2                | 17           | -          |
| Other   | 16                   | 3 466        | 11         | 27               | 117        | 107        | 43               | 3 583        | 118        |
| <b>Total</b>  | <b>30</b>            | <b>3 540</b> | <b>14</b>  | <b>41</b>        | <b>143</b> | <b>127</b> | <b>71</b>        | <b>3 683</b> | <b>141</b> |

### Market risk

Market risk represents the possible loss resulting from an adverse change in the value of financial instruments due to fluctuations in interest rates, foreign exchange rates, share prices and commodity prices.

Market risk management is integrated within the balance sheet management through the Asset and Liability Committee (ALCO), constituted at top management level. This committee is responsible for defining policies for the structuring and composition of the balance sheet, and for controlling exposure to interest rate, foreign exchange rate and liquidity risk.

The main measure of market risk is the assessment of potential losses under adverse market conditions, for which the Value at Risk (VaR) valuation methodology is used. The Bank's VaR model uses the Monte Carlo simulation, based on a confidence level of 99% and an investment period of 10 days. Volatilities and correlations are historical, based on an observation period of one year. As a complement to VaR, stress testing has been developed, permitting an assessment of the impact of potential losses higher than those considered by VaR.

(thousands of Euros)

|                        | 31.12.2018   |                |              |             | 31.12.2017   |                |               |              |
|------------------------|--------------|----------------|--------------|-------------|--------------|----------------|---------------|--------------|
|                        | December     | Period average | Maximum      | Minimum     | December     | Period average | Maximum       | Minimum      |
| Exchange rate risk     | 13.07        | 18.96          | 62.12        | 5.36        | 20.08        | 45.18          | 115.30        | 15.39        |
| Interest rate risk     | 0.05         | 0.17           | 0.11         | 0.15        | 0.24         | 0.39           | 0.05          | 0.86         |
| Shares and Commodities | 0.88         | 1.05           | 0.61         | 0.70        | 2.62         | 1.43           | -             | 2.16         |
| Volatility             | 0.13         | 0.14           | 0.03         | 0.19        | 0.05         | 0.06           | -             | 0.00         |
| Diversification effect | -0.80        | -1.25          | -0.65        | -0.95       | -2.93        | -1.64          | -0.07         | -2.73        |
| <b>Total</b>           | <b>13.33</b> | <b>19.06</b>   | <b>62.21</b> | <b>5.45</b> | <b>20.05</b> | <b>45.42</b>   | <b>115.28</b> | <b>15.68</b> |

As at 31 December 2018, BEST has a VaR of Euros 13 thousand (31 December 2017: Euros 20 thousand) for its trading positions.

Following the recommendations of the European Banking Authority explicit in document EBA/GL/2015/08, BEST calculates its exposure to interest rate risk based on the shocks prescribed, classifying the notional amounts of all balance and off-balance captions sensitive to interest rates, which are not part of the trading portfolio, by re-pricing intervals.

(thousands of Euros)

|  | 31.12.2018       |               |                  |                 |                    |                  |                   |
|--|------------------|---------------|------------------|-----------------|--------------------|------------------|-------------------|
|  | Eligible amounts | Not sensitive | Up to 3 months   | 3 to 6 months   | 6 months to 1 year | 1 to 5 years     | More than 5 years |
| Loans to and deposits with banks         | 433 347          | -             | 129 317          | 35 475          | 263 100            | 5 455            | -                 |
| Loans and advances to customers          | 141 438          | -             | 66 738           | 53 732          | 16 563             | 3 854            | 551               |
| Securities                               | 67 431           | 1 225         | 19 851           | 364             | -                  | -                | 45 991            |
| <b>Total</b>                             |                  |               | <b>215 906</b>   | <b>89 571</b>   | <b>279 663</b>     | <b>9 309</b>     | <b>46 542</b>     |
| Deposits from banks                      | 20 349           | -             | 20 349           | -               | -                  | -                | -                 |
| Due to customers                         | 540 983          | -             | 334 713          | 26 073          | 36 828             | 143 369          | -                 |
| <b>Total</b>                             |                  |               | <b>355 062</b>   | <b>26 073</b>   | <b>36 828</b>      | <b>143 369</b>   | <b>-</b>          |
| Balance sheet GAP (Assets - Liabilities) | 79 659           |               | (139 156)        | 63 498          | 242 835            | (134 060)        | 46 542            |
| Off-Balance sheet                        | -                |               | -                | -               | -                  | -                | -                 |
| <b>Structural GAP</b>                    | <b>79 659</b>    |               | <b>(139 156)</b> | <b>63 498</b>   | <b>242 835</b>     | <b>(134 060)</b> | <b>46 542</b>     |
| <b>Accumulated GAP</b>                   |                  |               | <b>(139 156)</b> | <b>(75 658)</b> | <b>167 177</b>     | <b>33 117</b>    | <b>79 659</b>     |

(thousands of Euros)

|  | 31.12.2017       |               |                 |                |                    |                  |                   |
|--|------------------|---------------|-----------------|----------------|--------------------|------------------|-------------------|
|  | Eligible amounts | Not sensitive | Up to 3 months  | 3 to 6 months  | 6 months to 1 year | 1 to 5 years     | More than 5 years |
| Loans to and deposits with banks         | 350 357          | -             | 111 368         | 43 335         | 187 899            | 7 755            | -                 |
| Loans and advances to customers          | 161 261          | -             | 77 411          | 61 809         | 15 672             | 5 177            | 1 192             |
| Securities                               | 80 539           | 1 268         | 39 147          | 367            | -                  | 27 931           | 11 826            |
| <b>Total</b>                             |                  |               | <b>227 926</b>  | <b>105 511</b> | <b>203 571</b>     | <b>40 863</b>    | <b>13 018</b>     |
| Deposits from banks                      | 19 209           | -             | 19 209          | -              | -                  | -                | -                 |
| Due to customers                         | 488 334          | -             | 268 145         | 37 443         | 35 956             | 146 790          | -                 |
| <b>Total</b>                             |                  |               | <b>287 354</b>  | <b>37 443</b>  | <b>35 956</b>      | <b>146 790</b>   | <b>-</b>          |
| Balance sheet GAP (Assets - Liabilities) | 83 346           |               | (59 428)        | 68 068         | 167 615            | (105 927)        | 13 018            |
| Off-Balance sheet                        | -                |               | -               | -              | -                  | -                | -                 |
| <b>Structural GAP</b>                    | <b>83 346</b>    |               | <b>(59 428)</b> | <b>68 068</b>  | <b>167 615</b>     | <b>(105 927)</b> | <b>13 018</b>     |
| <b>Accumulated GAP</b>                   |                  |               | <b>(59 428)</b> | <b>8 640</b>   | <b>176 255</b>     | <b>70 328</b>    | <b>83 346</b>     |

The model used to monitor the sensitivity of BEST's banking portfolio to interest rate risk is based on the duration model and considers a scenario of a 100 bp parallel shift in the interest rate curve for all maturities and non-parallel scenarios of changes in the yield curve above 1 year of 50 bp.

(thousands of Euros)

|                    | 31.12.2018                  |                             |                                |                                | 31.12.2017                  |                             |                                |                                |
|--------------------|-----------------------------|-----------------------------|--------------------------------|--------------------------------|-----------------------------|-----------------------------|--------------------------------|--------------------------------|
|                    | Parallel increase of 100 bp | Parallel decrease of 100 bp | Increase after 1 year of 50 bp | Decrease after 1 year of 50 bp | Parallel increase of 100 bp | Parallel decrease of 100 bp | Increase after 1 year of 50 bp | Decrease after 1 year of 50 bp |
| At 31 December     | (2 423)                     | 2 423                       | (244)                          | 244                            | (373)                       | 373                         | 543                            | (543)                          |
| Average for period | (1 870)                     | 1 870                       | (223)                          | 223                            | 119                         | (119)                       | 550                            | (550)                          |
| Maximum for period | (2 953)                     | 2 953                       | 604                            | (604)                          | 1 046                       | (1 046)                     | 821                            | (821)                          |
| Minimum for period | (322)                       | 322                         | (74)                           | 74                             | (282)                       | 282                         | 399                            | (399)                          |

The following table presents the average balances, interest charges and average interest rates for the Bank's major financial assets and liabilities' categories, for the financial years ended 31 December 2018 and 2017:

(thousands of Euros)

|                                 | 31.12.2018                 |                     |                       | 31.12.2017                 |                     |                       |
|---------------------------------|----------------------------|---------------------|-----------------------|----------------------------|---------------------|-----------------------|
|                                 | Average balance for period | Interest for period | Average interest rate | Average balance for period | Interest for period | Average interest rate |
| Monetary assets                 | 387 733                    | 3 764               | 0.96%                 | 344 619                    | 3 930               | 1.12%                 |
| Loans and advances to customers | 154 507                    | 2 894               | 1.85%                 | 149 242                    | 3 021               | 2.00%                 |
| Securities                      | 70 664                     | 1 163               | 1.62%                 | 52 939                     | 936                 | 1.74%                 |
| Differential applications       | -                          | -                   | -                     | -                          | -                   | 0.00%                 |
| <b>Financial assets</b>         | <b>612 904</b>             | <b>7 821</b>        | <b>1.26%</b>          | <b>546 800</b>             | <b>7 887</b>        | <b>1.42%</b>          |
| Monetary liabilities            | 19 735                     | 8                   | 0.04%                 | 18 747                     | 2                   | 0.01%                 |
| Due to customers                | 522 160                    | 1 232               | 0.23%                 | 458 211                    | 1 030               | 0.22%                 |
| Differential liabilities        | 71 009                     | -                   | -                     | 69 842                     | -                   | -                     |
| <b>Financial liabilities</b>    | <b>612 904</b>             | <b>1 240</b>        | <b>0.20%</b>          | <b>546 800</b>             | <b>1 032</b>        | <b>0.19%</b>          |
| <b>Net interest income</b>      |                            | <b>6 581</b>        | <b>1.06%</b>          |                            | <b>6 855</b>        | <b>1.24%</b>          |

Regarding foreign exchange risk, the breakdown of assets and liabilities by currency, as at 31 of December of 2018 and 2017, is analysed as follows:

|                          | 31.12.2018   |                 |              | 31.12.2017 |          |              |
|--------------------------|--------------|-----------------|--------------|------------|----------|--------------|
|                          | Spot         | Forward         | Net exposure | Spot       | Forward  | Net exposure |
| USD UNITED STATES DOLLAR | 1 840        | ( 1 747)        | 93           | 514        | -        | 514          |
| GBP GREAT BRITAIN POUND  | 139          | -               | 139          | ( 120)     | -        | ( 120)       |
| DKK DANISH KRONE         | 53           | -               | 53           | 36         | -        | 36           |
| JPY JAPANESE YEN         | 30           | -               | 30           | 77         | -        | 77           |
| CHF SWISS FRANC          | 81           | -               | 81           | 105        | -        | 105          |
| SEK SWEDISH KRONE        | 22           | -               | 22           | 60         | -        | 60           |
| NOK NORWEGIAN KRONE      | 46           | -               | 46           | 28         | -        | 28           |
| CAD CANADIAN DOLLAR      | 120          | -               | 120          | 69         | -        | 69           |
| AUD AUSTRALIAN DOLLAR    | 58           | -               | 58           | 90         | -        | 90           |
| PLN POLISH ZLOTY         | 12           | -               | 12           | 25         | -        | 25           |
| TRY TURKISH LIRA         | 8            | -               | 8            | 24         | -        | 24           |
| OTHER                    | 53           | -               | 53           | 54         | -        | 54           |
|                          | <b>2 462</b> | <b>( 1 747)</b> | <b>715</b>   | <b>962</b> | <b>-</b> | <b>962</b>   |

Note: Asset/(liability)

### Liquidity risk

Liquidity risk derives from the potential inability to fund assets while satisfying commitments on their due dates without incurring in excessive losses.

Liquidity risk can be divided into two types:

- Asset liquidity (market liquidity risk) – consists of the inability to sell a particular asset due to lack of liquidity on the market, which results in extending the bid/offer spread or in the application of a haircut to the market value.
- Funding liquidity (funding liquidity risk) – consists of the inability to, within the desired timeframe and currency, fund assets on the market and/or refinance debt falling due. This inability can be reflected in a significant increase in the financing cost or in the demand for collateral to obtain funds. Difficulty in (re)financing can lead to asset sales, even if incurring in significant losses. The risk of (re)financing should be minimized through an adequate diversification of funding sources and maturities.

Banks are subject to liquidity risk as an inherent part of their business involves transforming maturities (long-term lenders and short-term depositors), with a prudent management of liquidity risk being, therefore, critical.

At BEST, analysis and decision making are carried out based on the reports that allow it not only to identify the negative mismatch, but also to make a dynamic coverage of same. Following the repeal by the regulator of Instruction no. 13/2009 and its replacement by the ITS (Implementing Technical Standards) reports, the position at the end of 2018 has already been calculated according to the current rules, namely by calculating the net contractual deficit and the counterbalancing capacity:

| (thousands of Euros)  |                  |                 |                   |                |                |                    |                  |
|---|------------------|-----------------|-------------------|----------------|----------------|--------------------|------------------|
| 31.12.2018  |                  |                 |                   |                |                |                    |                  |
|   | Eligible amounts | Up to 7 days    | 7 days to 1 month | 1 to 3 months  | 3 to 6 months  | 6 months to 1 year | More than 1 year |
| <b>OUTFLOWS</b>   |                  |                 |                   |                |                |                    |                  |
| Behavioural outflows of deposits                                | 565 669          | 4 665           | 1 179             | 3 144          | 4 716          | 9 431              | 542 534          |
| Exchange rate swaps and Derivatives                             | 84 945           | -               | -                 | 84 909         | 36             | -                  | -                |
| <b>Total Outflows</b>   | <b>650 614</b>   | <b>4 665</b>    | <b>1 179</b>      | <b>88 053</b>  | <b>4 752</b>   | <b>9 431</b>       | <b>542 534</b>   |
| <b>INFLOWS</b>  |                  |                 |                   |                |                |                    |                  |
| Behavioural inflows of loans and advances                       | 574 914          | 3 473           | 56 732            | 41 448         | 40 857         | 273 865            | 158 539          |
| Exchange rate swaps and Derivatives                             | 84 925           | -               | -                 | 84 905         | 20             | -                  | -                |
| Securities in own portfolio maturing and Other inflows          | 66 206           | -               | -                 | -              | -              | -                  | 66 206           |
| <b>Total Inflows</b>  | <b>726 045</b>   | <b>3 473</b>    | <b>56 732</b>     | <b>126 353</b> | <b>40 877</b>  | <b>273 865</b>     | <b>224 745</b>   |
| Net contractual deficit   | 75 432           | ( 1 192)        | 55 554            | 38 301         | 36 125         | 264 433            | ( 317 789)       |
| <b>Accumulated contractual deficit</b>                          | <b>-</b>         | <b>( 1 192)</b> | <b>54 362</b>     | <b>92 663</b>  | <b>128 788</b> | <b>393 221</b>     | <b>75 432</b>    |
| <b>REBALANCING CAPACITY</b>                                     |                  |                 |                   |                |                |                    |                  |
|   | Opening stock    | Up to 7 days    | 7 days to 1 month | 1 to 3 months  | 3 to 6 months  | 6 months to 1 year | More than 1 year |
| Negotiable and non-negotiable assets eligible for central banks | 45 537           | -               | -                 | -              | -              | -                  | ( 44 685)        |
| Net change in rebalancing capacity                              | -                | -               | -                 | -              | -              | -                  | ( 44 685)        |
| <b>Accumulated rebalancing capacity</b>                         | <b>45 537</b>    | <b>45 537</b>   | <b>45 537</b>     | <b>45 537</b>  | <b>45 537</b>  | <b>45 537</b>      | <b>852</b>       |

(thousands of Euros)

|   | 31.12.2017       |                  |                   |               |                |                    |                  |
|---|------------------|------------------|-------------------|---------------|----------------|--------------------|------------------|
|   | Eligible amounts | Up to 7 days     | 7 days to 1 month | 1 to 3 months | 3 to 6 months  | 6 months to 1 year | More than 1 year |
| <b>ASSETS</b>   |                  |                  |                   |               |                |                    |                  |
| Deposits with and loans and advances to banks and Central Banks | 350 358          | 44 695           | 56 673            | 10 000        | 43 335         | 187 899            | 7 755            |
| Loans and advances to customers                                 | 159 899          | 218              | 463               | 2 836         | 2 960          | 1 582              | 151 840          |
| Securities  | 78 887           | -                | -                 | 39 147        | -              | -                  | 39 739           |
| Other net assets  | ( 26)            | ( 26)            | -                 | -             | -              | -                  | -                |
| Off-balance sheet (Commitments and Derivatives)                 | 240              | -                | -                 | 228           | 12             | -                  | -                |
| <b>Total</b>  |                  | <b>44 887</b>    | <b>57 136</b>     | <b>52 211</b> | <b>46 307</b>  | <b>189 481</b>     | <b>199 334</b>   |
| <b>LIABILITIES</b>  |                  |                  |                   |               |                |                    |                  |
| Deposits from banks, Central Banks and Other loans              | 19 209           | 19 209           | -                 | -             | -              | -                  | -                |
| Due to customers  | 488 333          | 35 360           | 4 947             | 9 828         | 2 121          | 162                | 435 915          |
| Other short-term liabilities                                    | 10 606           | 10 606           | -                 | -             | -              | -                  | -                |
| Off-balance sheet (Commitments and Derivatives)                 | 277              | -                | -                 | 226           | 29             | 21                 | -                |
| <b>Total</b>  |                  | <b>65 175</b>    | <b>4 947</b>      | <b>10 054</b> | <b>2 150</b>   | <b>183</b>         | <b>435 915</b>   |
| <b>GAP (Assets - Liabilities)</b>                               |                  | <b>( 20 288)</b> | <b>52 189</b>     | <b>42 157</b> | <b>44 156</b>  | <b>189 299</b>     |                  |
| <b>Accumulated GAP</b>  |                  | <b>( 20 288)</b> | <b>31 901</b>     | <b>74 058</b> | <b>118 215</b> | <b>307 514</b>     |                  |
| <b>Net Assets Buffer &gt; 12 months</b>                         |                  |                  |                   |               |                |                    | <b>35 466</b>    |

The 1-year accumulated net outflows went from Euros 307.5 million on 31 December 2017 to a 1-year net contractual surplus of Euros 393.2 million at 31 December 2018, with a counterbalancing capacity at the end of 2018 of Euros 45.5 million, there being a buffer of net assets at the end of 2017 of Euros 35.5 million.

In order to anticipate possible negative impacts, internal liquidity stress scenarios are tested, which are representative of the types of crises that may occur, based on idiosyncratic scenarios (characterized by a loss of confidence in the Bank), and market scenarios.

The Bank continues to follow all legislative changes in order to comply with its regulatory obligations, namely in relation to Basel III liquidity ratios - Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). The LCR aims to promote the resilience of Banks to short-term liquidity risk by ensuring that these hold liquid assets of a high quality, in sufficient value to survive a severe stress scenario over a period of 30 days, while the NSFR aims to ensure that Banks maintain a stable funding for their off-balance sheet assets and operations, for a period of one year. These ratios were adopted by the European Union, with the LCR having a limit of 100% since 1 January 2018.

### *Operational risk*

Operational risk represents the risk of losses, on results or equity, resulting from failures or weaknesses in internal procedures, information systems, and human behaviour or caused by external events, including legal risks. Operational risk is therefore understood to be the sum of the following risks: operational, information systems, compliance and reputational.

To manage operational risk, a system was developed and implemented standardizing, systematizing and regulating the frequency of actions with the objective of identifying, monitoring, controlling and mitigating said risk. The system is supported at the organizational level by a unit within the Global Risk Department exclusively dedicated to this task as well as Operational Risk Management Representatives designated by each of the relevant departments and subsidiaries, whose responsibility it is to comply with the procedures established and the day-to-day management of this Risk in their areas of competency.

#### *Capital Management and Solvency and Leverage Ratios*

The main objectives of capital management are to ensure compliance with the Bank's strategic objectives in matters pertaining to capital adequacy, respecting and complying with the own funds minimum requirements defined by the supervisory entities.

The definition of the strategy in terms of capital adequacy is made by the Executive Commission and is integrated in the global definition of the Bank's objectives.

In prudential terms, the Bank is subject to the Bank of Portugal's supervision, which, under the Capital Adequacy Directive of the EU, establishes the prudential rules to be observed by the institutions under its supervision. These rules define the minimum own funds to capital ratio (solvency ratio) in relation to the risks assumed, and that the institutions have to comply with.

The European Parliament and Council approved, on 26 June 2013, Directive 2013/36/EU and Regulation (EU) no. 575/2013 that now regulate, in the European Union, the access to the credit institution and investment company activity and determine the prudential requirements to be observed by those entities as from 1 January 2014, respectively. The Regulation also foresees the need for institutions to report to the supervisor their leverage ratio. This legislation transposes into the European legal order the recommendations of the Basel Committee, generally designated Basel III.

Currently, under the new Basel III legal framework, the equity elements of BEST, for the purpose of determining the solvency ratio, are divided into: Core Own Funds (Common Equity Tier I), Level 1 Own Funds (or Tier I), Level 2 Own Funds (or Tier II) and Total Own Funds, as follows:

- Common Equity Tier I: This category includes, essentially, realized share capital, share premiums, eligible reserves and the net income for the period retained, when audited. The following balance sheet amounts are deductible from Common Equity Tier I: eligible

intangible assets, negative actuarial deviations arising on liabilities for post-employment benefits to employees, the surplus value of deferred tax assets and of shareholdings in financial entities and, when applicable, the net loss for the period.

- Tier I: In addition to the amounts considered as Common Equity Tier I, this category includes, when applicable, preference shares and hybrid capital instruments.
- Tier II: Incorporates, essentially, when applicable, subordinated eligible debt.

BEST's equity is essentially composed of Common Equity Tier I elements. The leverage ratio considers the amount of level 1 own funds.

The following table presents a summary of the calculations of the capital adequacy and ratio requirements of BEST as at 31 December 2018 and 2017:

|  | (thousands of Euros) |                 |              |
|--|----------------------|-----------------|--------------|
|  | 31.12.2018           | 31.12.2017      |              |
| Realized ordinary share capital, Share premiums and Treasury stock                             | 62 992               | 62 992          |              |
| Reserves and Retained earnings   | 9 001                | 9 607           |              |
| Net income for the period attributable to shareholders of the Bank                             | 3 564                | 3 014           |              |
| <b>A - Own Funds</b>   | <b>75 557</b>        | <b>75 613</b>   |              |
| Net income for the period attributable to shareholders of the Bank not eligible <sup>(1)</sup> | ( 3 564)             | ( 3 014)        |              |
| Additional valuation adjustments   | ( 50)                | ( 75)           |              |
| Transition period IFRS 9   | 810                  | -               |              |
| Other  | ( 247)               | ( 214)          |              |
| <b>B - Regulatory adjustments to own funds</b>   | <b>( 3 050)</b>      | <b>( 3 303)</b> |              |
| <b>C - Tier 1 core own funds - CET I (A+B)</b>   | <b>72 506</b>        | <b>72 310</b>   |              |
| <b>F - Tier II own funds</b>   | -                    | -               |              |
| Operational risk   | 26,521               | 25,981          |              |
| <b>H - Risk weighted assets</b>  | <b>180 050</b>       | <b>212 748</b>  |              |
| <b>Solvency ratios</b>   |                      |                 |              |
| CET I  | <b>(C/H)</b>         | <b>40.3%</b>    | <b>34.0%</b> |
| Tier I   | <b>(E/H)</b>         | <b>40.3%</b>    | <b>34.0%</b> |
| Solvency   | <b>(G/H)</b>         | <b>40.3%</b>    | <b>34.0%</b> |
| <b>Leveraging ratio<sup>(2)</sup></b>  | <b>10.5%</b>         | <b>11.3%</b>    |              |

<sup>(1)</sup> Component of the net income for the period retained and incorporated in the subsequent period

<sup>(2)</sup> The leveraging ratio results from dividing the Tier 1 by the exposure measure determined under the CRR

## NOTE 34 – TRANSITION ADJUSTMENTS TO IFRS 9

On 24 July 2014, in response to the challenge posed by the G20 following the global financial crisis, the International Accounting Standards Board (IASB) issued the final version of IFRS 9 - Financial



Instruments ("IFRS 9"). This new standard is effective for annual periods beginning on or after 1 January 2018 and replaced IAS 39 - Financial Instruments: Recognition and Measurement ("IAS 39"). As allowed by the transitional provisions of IFRS 9, the Bank did not restate the comparative values in its financial statements following the adoption of IFRS 9. The impacts on the separate financial statements of the Bank were recognized in retained earnings and, therefore, in the regulatory capital reported.

IFRS 9 incorporates significant changes to IAS 39 essentially at 3 levels: (i) new rules for the classification, recognition and measurement of financial assets in accordance with the business model of the Bank and the characteristics of the contractual cash flows of these assets; (ii) new concepts in the methodology and measurement of impairment of financial assets, calculated on an expected loss basis ("ECL" – Expected Credit Loss); and (iii) new hedge accounting requirements more aligned with entities' risk management practices.

The impacts on the Bank's separate financial statements arising from the adoption of this new standard were estimated by reference to 1 January 2018, based on information available at that date and the definition of a set of assumptions. Based on these estimates, the adoption of IFRS 9 resulted in a decrease in the net equity of the Bank as at 1 January 2018 of approximately Euros 0.7 million.

There is no transitional regime in this area establishing the tax treatment to be given to transitional adjustments with regard to this standard. Consequently, the tax treatment of these adjustments resulted from the Bank's interpretation of the application of the general rules of the IRC Code.

During 2018, the Bank continued to review, refine and validate the methodologies developed to comply with the new requirements of IFRS 9 and accompanied any guidance from national and international regulators regarding the application of said standard.

a) Classification and measurement of financial assets

The criteria for the classification of financial assets will depend both on the business management model and on the characteristics of the contractual cash flows of these assets. Consequently, the asset can be measured at amortized cost, at fair value with changes recognized in other comprehensive income (revaluation reserves) or in the income statement (results of assets and liabilities at fair value through profit and loss), depending on the business model in which it is inserted and the characteristics of the contractual cash flows. In addition, IFRS 9, in line with IAS 39, also establishes the option to, under certain

conditions, designate a financial asset at fair value with changes being recognized in the income statement. The Bank considers the following criteria for the classification of its debt financial assets:

- Amortized cost: a debt financial instrument that (i) is managed under a business model which purpose is to maintain financial assets in the portfolio and receive all of their contractual cash flows and (ii) that has contractual cash flows on specific dates which correspond exclusively to the payment of principal and interest on the principal outstanding;
- Fair value with changes recognized in other comprehensive income: a debt financial instrument that (i) is managed under a business model which objective is achieved either through the receipt of contractual cash flows and/or through the sale of the financial assets and (ii) contemplates contractual clauses that give rise to cash flows that correspond exclusively to the payment of principal and interest on the principal outstanding;
- Fair value with changes recognized in profit and loss: all other debt financial instruments should be measured at fair value through profit and loss.

With respect to the remaining financial instruments, specifically equity and derivative instruments, these will, by definition, be classified at fair value through profit and loss. For equity instruments, there is the irrevocable option to designate that all changes in fair value are recognized in other comprehensive income. This irrevocable classification will imply that, on the disinvestment/realization of this financial asset, the amounts recognized in equity are not recycled to the income statement for the year.

With the entry into force of IFRS 9, in terms of the measurement and classification of financial instruments, we highlight that:

- (i) loans and advances to banks and Loans and advances to customers receivable continue to be measured at amortized cost. There was no impact on the reclassification of loans to fair value through profit and loss or other comprehensive income;
- (ii) the debt instruments classified as available for sale were generally measured at fair value with changes recognized in other comprehensive income, having been transferred to the fair value category with changes recognized in other comprehensive income. The classification and measurement of these financial assets had no impact on the net equity of the Bank;

(iii) equity instruments are classified and measured at fair value through profit and loss, except when the Bank irrevocably decides, for non-trading assets, to classify these assets at fair value with changes recognized in other comprehensive income. The reclassification of equity instruments available for sale to fair value through profit and loss had no impact on the net equity of the Bank, while the reclassification to fair value with changes recognized in other comprehensive income had a negative impact of about Euros 0.2 million on the net equity of the Bank.

In summary, by reference to 1 January 2018, the impact on the shareholders' equity of the Bank of the new requirements of IFRS 9 regarding the classification and measurement of financial assets amounted to a negative Euros 0.2 million, including impairment.

The classification and measurement of financial liabilities under IAS 39 remains substantially the same under IFRS 9. However, it should be noted that, in most situations, changes in the fair value of financial liabilities designated at fair value through profit and loss, arising from the entity's own credit risk, are recognized in equity (other comprehensive income) rather than in profit and loss as required by IAS 39, unless this accounting treatment generates an accounting mismatch. Subsequent reclassifications of these changes to profit and loss are not permitted, even when repurchasing these liabilities.

b) Expected Credit Loss Impairment Model

The expected credit loss impairment model recommended by IFRS 9 is applicable to all financial assets valued at amortized cost, to financial assets equivalent to debt instruments valued at fair value with changes recognized in equity (other comprehensive income), to receivables from leasing and to financial guarantees and credit commitments not measured at fair value.

The most significant change of this new standard is the introduction of the expected loss concept to the detriment of the incurred loss concept on which the Bank's impairment model is based to meet the requirements of IAS 39. This conceptual change is introduced together with new classification and measurement requirements of expected credit impairment losses, with financial assets subject to impairment being required to be classified into different Stages depending on the evolution of their credit risk as from the date of initial recognition and not in relation to credit risk at the reporting date:

“Stage 1”: financial assets are classified in Stage 1 whenever there is no significant increase in credit risk as from the date of their initial recognition. For these assets, the expected credit impairment loss resulting from the probability of the occurrence of default events during the 12 months subsequent to the reporting date, or up to the estimated residual maturity, if this is lower than 12 months after the reporting date, will be recognized in the income statement for the year;

“Stage 2”: financial assets for which there has been a significant increase in credit risk as from the date of their initial recognition are classified in Stage 2. For these financial assets, expected credit impairment losses are recognized over the assets’ lifetime. However, interest will continue to be calculated on the gross amount of the asset; and

“Stage 3”: assets classified in this Stage present objective evidence of impairment, on the reporting date, as a result of one or more events that have already occurred and that have resulted in a loss. In this case, the expected credit impairment loss for the expected residual life of the financial assets will be recognized in the income statement for the financial year. Interest is calculated on the net book value of the assets.

#### Measurement

In spite of the changes made in the impairment model, in particular, the widening of the criteria that determine the existence of a significant increase in credit risk, impairment losses determined on the assets classified in Stages 1 and 2, generally, largely replace the impairment recognized on a collective basis for financial assets as foreseen under the scope of IAS 39. In turn, the impairment losses on the assets classified in Stage 3 replace, to a certain extent, the impairment recognized on a collective basis for the financial assets already in impairment as provided for in IAS 39.

Impairment for expected credit losses under IFRS 9 is affected by a number of risk factors, such as, among others, the probability of default ("PD"), the loss given default ("LGD"), the exposure at the default date ("EAD"), as well as the expected life of the financial asset.

PD represents the likelihood that a loan will not be repaid and will enter into default, within the 12-month horizon for Stage 1, or during its expected lifetime, if this is less than 12 months, and during its expected lifetime for Stage 2. PD models are based on existing historical information, incorporating current market conditions and reasonable and bearable information on future economic conditions.

LGD is the estimated value to be recovered in the event of default and is also modelled on historical data and reasonable and bearable information on future and current economic conditions, where appropriate. LGD methodologies take into account the value of collateral received.

EAD represents an estimate of the amount of credit at the time the default event can occur. For off-balance sheet exposures and unused commitments, the EAD includes an estimate of additional amounts to be used up to the time of default.

### Movement between Stages

The transition of financial assets from Stage 1 to Stage 2 occurs at a time when their credit risk increases significantly compared to that on the date of their initial recognition. The determination of the significant increase in credit risk is based on the analysis of the internal and external quantitative and/or qualitative indicators used by the Bank in the normal management of credit risk, thus forcing a greater linkage of the accounting requirements to the credit risk management policies implemented by the Bank.

Specifically, the Bank established thresholds for significant increases in credit risk of an absolute and relative nature in the PD for the remaining lifetime compared with on initial recognition.

Generally, financial asset transitions from Stage 2 to Stage 3 occur when these assets enter into default, i.e.: (i) material default for more than 90 consecutive days is verified; and/or (ii) evidence of indicators that show that the contractual obligations associated with such assets are unlikely to be met – “unlikeliness to pay”. This default definition is consistent with the definition used in the current credit risk management policies of the Bank.

### Forward-looking information

According to this new model recommended by IFRS 9, the measurement of expected losses will also require the inclusion of forward looking information, including future trends and scenarios, namely macroeconomic data. In this context, estimates of expected credit impairment losses will include multiple macroeconomic scenarios which probability will be evaluated considering past events, the current situation and future macroeconomic trends.

For the more material portfolios, the Bank will adopt sophisticated credit modelling approaches in the measurement of expected credit losses, leveraging, whenever possible, on the existing AIRB (Advanced Internal Rating Based) models. For the remaining portfolios, and depending on the materiality of each portfolio, the Bank will develop new models or use simplified approaches.

In summary, by reference to 1 January 2018, the impact on the shareholders' equity of the Bank of the new requirements of IFRS 9 for impairment amounts to circa Euros - 0.8 million.

#### Impacts on the internal control system and governance structure

In order to ensure that in the measurement of impairment there are adequate controls and validations, the Group has made changes to the existing governance model. As part of this process, new controls are being developed/implemented in the main areas impacted by IFRS 9, such as the development and weighting of macroeconomic scenarios, the determination of a significant increase in credit risk, and data and credit risk systems.

#### c) Hedge accounting

The new hedge accounting model of IFRS 9 aims not only to simplify the process of creating and maintaining hedging relationships, but also to align the accounting of these relationships with the risk management activities of each institution, to increase the eligibility of a larger number of hedged instruments and hedging instruments, and also types of risk. IFRS 9 includes new requirements for hedge accounting that have two main objectives: (i) the simplification of the current needs and (ii) the alignment of hedge accounting with the entity risk management.

#### Estimated impacts on capital

The adoption of IFRS 9 also had an impact on the Bank's capital, in particular, by the early increase in the stock of impairment provisions under the new model of expected credit losses compared with the losses incurred approach of IAS 39 and consequent accounting reference.

On 12 December 2017, the European Union, through Regulation (EU) No. 2017/2395 of the European Parliament, amending Regulation (EU) No. 575/2013, established a transitional regime

with the aim of reducing the impact of the adoption of IFRS 9 on financial institutions' own funds. The abovementioned regulation allows financial institutions to defer the impact resulting from the adoption of IFRS 9, with the Bank having decided to adopt said transitional regime.

The Bank determined an impact on the CET 1 ratio of approximately +5 bp.

#### Bank Implementation Strategy

The Bank defined a global work structure aimed at adapting its internal processes to the rules contained in IFRS 9.

Regarding the governance structure of the IFRS 9 implementation project, the Bank created a committee with the responsibility of overseeing this project, as well as assuring that all areas relevant to this project are involved, for the success of same. Consequently, the Accounting, Consolidation and Taxation Department, the Treasury and Finance Department, the Global Risk Department, the Rating Department and the Information Systems Department are involved in this committee. Whenever found necessary, other departments of the Bank are involved in the project.

## NOTE 35 – RECENTLY ISSUED ACCOUNTING STANDARDS AND INTERPRETATIONS

### I – Applicable in 2018

The standards presented below became effective as from 1 January 2018. None of the standards had a material impact on the financial statements of the Bank, with some having been incorporated in the Bank's financial statements with reference to 31 December 2018:

#### **IFRS 15 Revenue from contracts with customers**

This standard applies to all revenue from contracts with customers, replacing the following existing standards and interpretations: IAS 11 - Construction Contracts, IAS 18 - Revenue, IFRIC 13 - Customer Loyalty Programs, IFRIC 15 - Construction agreements of real estate, IFRIC 18 - Transfers of customer assets and SIC 31 - Revenue - Swap operations involving advertising services. The standard applies to all revenue from customer contracts unless the contract falls within the scope of IAS 17 (or IFRS 16 – Leases, when it is applied). It also provides a template for the recognition and measurement of sales of some non-financial assets, including disposals of property, equipment and intangible assets.

This standard highlights the principles that an entity must apply when it measures and recognizes revenue. The basic principle is that an entity must recognize revenue for an amount that reflects the consideration it expects to be entitled to in exchange for the goods and services promised under the contract. The principles of this standard should be applied in five steps: (1) identify the contract with the customer; (2) identify the performance obligations of the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations of the contract; and (5) recognize the revenue when the entity meets a performance obligation.

The standard requires an entity to apply professional judgment in applying each of the model steps, taking into account all relevant facts and circumstances. This rule also specifies how to account for incremental expenses in obtaining a contract and expenses directly related to the performance of a contract.

### **Clarifications to IFRS 15**

In April 2016, the IASB issued amendments to IFRS 15 to address various matters related to the implementation of the standard. The following amendments are introduced:

- Clarify when a product or service promised is distinct under the contract;
- Clarify how to apply the principal versus agent guidance, including the unit of measurement for the evaluation, how to apply the control principle in a service transaction and how to restructure the indicators;
- Clarify when an entity's activities significantly affect the intellectual property (IP) to which the customer is entitled and which is one of the factors in determining whether the entity recognizes the revenue from a license over time or at a point in time;
- Clarify the scope of sales-based and usage-based royalty exemptions related to IP licenses (royalty constraint) when there are no other goods or services promised in the contract;
- Add two practical opportunities to the transition requirements of IFRS 15: (a) full contracts in the full retrospective approach and (b) amendments to contracts on the transition.

### **IFRIC 22 Transactions in foreign currency and advance consideration**

This interpretation clarifies that in determining the spot exchange rate to be used in the initial recognition of an asset, a cost or a revenue (or of part) associated with the derecognition of non-monetary assets or liabilities related to advance consideration, the transaction date is the date on which the entity initially recognizes the non-monetary asset or liability related to the advance consideration. If there are multiple payments or receipts of an advance consideration, the entity shall determine the date of the transaction for each payment or receipt.



An entity may apply this interpretation on a full retrospective application basis. Alternatively, it may apply this interpretation prospectively to all assets, costs and revenue that fall within its scope that are initially recognized on or after:

- (i) The beginning of the reporting period in which the entity applies the interpretation for the first time; or
- (ii) The beginning of the reporting period presented as the comparative period in the financial statements for the year in which the entity applies the interpretation for the first time.

## **IFRS 2 Classification and measurement of share-based payment transactions - Amendments to IFRS 2**

The IASB issued amendments to IFRS 2 in relation to the classification and measurement of share-based payment transactions. These amendments address three key areas:

### Vesting conditions - their effects on the measurement of cash-settled share-based payment transactions

- The amendments clarify that the methodology used to account for vesting conditions, when measuring equity-settled share-based payment transactions, also applies to cash-settled share-based payment transactions.

### Classification of share-based payment transactions with net settlement option, to comply with withholding tax obligations

- This amendment adds an exception to deal, specifically, with the situation in which a net settlement is designed to comply with an entity's tax obligation, or other type of regulation, with respect to withholding at source from the employee to meet a tax-related obligation, related to a share-based payment transaction;
- This amount is then transferred, usually in cash, to the tax authorities on behalf of the employee. To comply with this obligation, the terms of the share-based payment arrangement may allow or require the entity to retain a number of equity instruments equivalent to the monetary value of the employee's tax liability, from the total equity instruments that would otherwise be issued to the employee on the vesting of the share-based payment (known as the net share settlement option);
- When a transaction meets this criterion, it is not divided into two components, but classified as a whole as an equity-settled share-based payment transaction, if it would have been so classified had there been no net share settlement option.

### Accounting for a change in the terms and conditions of a share-based payment transaction that changes its classification from cash-settled to equity-settled

- The amendment clarifies that if the terms and conditions of a cash-settled share-based payment transaction are changed, as a result of which it becomes an equity-settled share-based payment transaction, the transaction is accounted for as an equity-settled share-based payment transaction as from the date of such change;
- Any difference (be it a debit or a credit) between the carrying value of the derecognized liability and the amount recognized in equity on the date of the change is immediately recognized in the profit and loss for the year.

### **Transfers of investment property (amendments to IAS 40)**

The amendments clarify when an entity must transfer a property, including properties under construction or development to, or out of, investment properties. The amendments determine that the change in use occurs when the property complies, or fails to comply, with the definition of investment property, and there is evidence of change in use. A simple change in the management body's intention for the use of the property is not evidence of change in use.

### **Annual improvements for the 2014-2016 cycle**

In the annual improvements for the 2014-2016 cycle, the IASB has introduced the following improvements that should be applied retrospectively and are effective as from 1 January 2018 (another improvement related to IFRS 12 became effective as from 1 January 2017).

#### **IFRS 1 First-time adoption of IFRS**

This improvement has eliminated the short-term exemption for first-time adopters in paragraphs E3-E7 of IFRS 1, because it had already served its purpose (which was related to the exemptions from certain disclosures of financial instruments under IFRS 7, exemptions at the level of employee benefits and exemptions at the level of investment entities).

#### **IAS 28 Clarification that the measurement of investees at fair value through profit and loss is a choice that is made on an investment-by-investment basis**

The improvement has clarified that:

- An entity that is a venture capital entity, or another qualifying entity, may choose, at initial recognition and on an investment-by-investment basis, to measure its investments in associates and/or joint ventures at fair value through profit and loss;
- If an entity that is not itself an investment entity holds an interest in an associate or joint venture that is an investment entity, the entity may, in applying the equity method, choose to maintain the fair value that those investees apply in measuring their subsidiaries. This option is taken separately for each investment on the latest

date between (a) the initial recognition of the investment in that investee; (b) such investee becoming an investment entity; and (c) such investee becoming a parent company.

## **II - Applicable to 2018 only if early adopted and provided that the early adoption is disclosed and the remaining conditions required are met**

### **IFRS 16 - Leases**

The scope of IFRS 16 includes leases of all assets, with some exceptions. A lease is defined as a contract, or part of a contract, that transfers the right of use of an asset (the underlying asset) for a period of time in exchange for an amount.

IFRS 16 requires lessees to account for all leases based on a single on-balance sheet model in a similar way as the treatment that IAS 17 gives to finance leases. The standard recognizes two exceptions to this model: (1) low-value leases (e.g. personal computers) and short-term leases (i.e. with a lease term under 12 months). At the start of the lease, the lessee will recognize the liability related to the lease payments (i.e. the lease liability) and the asset that represents the right to use the underlying asset during the lease period (i.e. the right of use or ROU). Lessees will have to separately recognize the cost of the interest on the lease liability and the depreciation of the ROU. Lessees should also remeasure the lease liability upon the occurrence of certain events (such as a change in the lease period, a change in future payments that results from a change in the reference rate or of the rate used to determine such payments). The lessee will recognize the amount of the remeasurement of the lease liability as an adjustment in the ROU.

The lessor's accounting remains substantially unchanged from the current treatment under IAS 17. The lessor continues to classify all leases using the same principles of IAS 17 and distinguishing between two types of leases: operating and finance leases.

The standard was endorsed on 31 October 2017 and should be applied for financial years beginning on or after 1 January 2019.

The Bank assessed the estimated impact that the initial application of IFRS 16 will have on its financial statements, as described below. The impacts arising from the adoption of IFRS 16 as at 1 January 2019 may change as:

- the Bank has not yet finalized the tests and the evaluation of the controls over the new IT systems;

and

- the new accounting policies are subject to change until the Bank presents its first financial statements that include the date of the initial application.

i. Leases in which the Bank presents itself as lessee

The Bank will recognize the new assets and liabilities for its operating leases of branches and their facilities (central services). The nature of the expenses related to these operating leases will change, as IFRS 16 replaces linear operating lease expenses into depreciation for assets under rights of use and interest charges related to the lease liabilities.

Previously, the Bank recognized operating lease expenses linearly over the term of the lease contract, and recognized assets and liabilities only to the extent that it observed a difference in the time period between lease payments and the expense recognition.

ii. Leases in which the Bank presents itself as lessor

No significant impacts are expected for lease contracts in which the Bank appears as lessor. However, a number of additional disclosures will be required next year.

iii. Transition

The Bank plans to apply IFRS 16 initially as at 1 January 2019, using the simplified retrospective approach, without the restatement of comparative information. The transition approach used allows for the selection of a number of practical procedures for the non-application of IFRS 16, namely: (i) Short-term leases, lease contracts with a lease term under 12 months (including renewal options); and ii) Low-value leases, lease contracts which asset value corresponds to  $\leq$  Euros 5,000.

The Bank plans to apply the practical procedure regarding the definition of a lease on the transition date, that is, it will apply IFRS 16 to all contracts entered into before 1 January 2019 and identified as a lease in accordance with IAS 17 and IFRIC 4. Thus, for leases previously classified as operating leases under IAS 17, the right of use asset is measured at an amount equal to the lease liability, adjusted for the amount of any prepaid or increased lease payments related to that lease, recognized in the balance sheet immediately prior to the date of initial application. Thus, as at 1 January 2019, the impact on retained earnings will be nil.

The Bank has already made an initial assessment of the potential impacts on its financial statements; however, it has not yet consolidated its assessment in order to assess the amount of the impacts to be included in the financial statements. The actual impact of applying IFRS 16 in the financial statements in the initial period of application will depend on future economic conditions, the development of the Bank's lease contracts' portfolio, its assessment, namely whether it will exercise

any of the renewal options, of the scope that NOVO BANCO chooses in terms of the use of available practical procedures and of the recognition of exceptions.

### **IFRIC 23 - Uncertainties about different treatments of income tax**

In June 2017, the IASB issued IFRIC 23 Uncertainty about different income tax treatments (the Interpretation) which clarifies the application and measurement requirements of IAS 12 Income tax when there is uncertainty as to the treatment to be given to the tax on income.

The Interpretation addresses the accounting of income tax when tax treatments involve uncertainty and affect the application of IAS 12. The Interpretation does not apply to taxes or levies that do not fall within the scope of IAS 12, nor does it specifically include requirements relating to interest or fines associated with the uncertainty of tax treatments.

The Interpretation specifically addresses the following:

- Whether an entity considers the uncertainties of tax treatments separately;
- The assumptions that an entity uses as regards the inspection of the tax treatment by the tax authorities;
- How an entity determines the taxable income (loss), the tax base, unused tax losses, unused tax credits and tax rates;
- How an entity considers changes in facts and circumstances.

An entity must determine whether to consider the uncertainty over each tax treatment separately or together with one or more uncertain tax treatments. The approach that should be followed is the one that best predicts the outcome of the uncertainty.

The Interpretation was endorsed on 23 October 2018 and is applicable for financial years beginning on or after 1 January 2019.

### **Prepayments with negative compensation - Amendments to IFRS 9**

Under IFRS 9, a debt instrument can be measured at amortized cost or at fair value through comprehensive income provided that the implicit cash flows are "only payment of principal and interest on the principle outstanding" (the SPPI criterion) and the instrument is held in a business model that allows for such classification. The amendments to IFRS 9 clarify that a financial asset passes the SPPI criterion regardless of the event or circumstance causing the early termination of the contract and regardless of which party pays or receives reasonable compensation for the early termination of same.

The concluding bases for this amendment clarify that the early termination may be a consequence of a contractual clause or an event that is beyond the control of the parties to the contract, such as a change of laws or regulations leading to early termination.

#### Modification or substitution of a financial liability that does not give rise to the derecognition of such liabilities

In the concluding bases, the IASB also clarifies that the requirements of IFRS 9 for the adjustment of the amortized cost of a financial liability when a modification (or substitution) does not result in its derecognition are consistent with the requirements applied to a modification of an asset that does not result in its derecognition. This means that the gain or loss resulting from the modification of that financial liability that does not result in its derecognition, calculated by discounting the change in the cash flows associated with that liability at the original effective interest rate, is immediately recognized in the income statement.

The IASB made this comment in the concluding bases regarding this amendment as it believes that the current requirements of IFRS 9 provide a good basis for entities to account for the modifications or substitutions of financial liabilities and that no formal change to IFRS 9 is required as regards this matter.

This amendment was endorsed on 22 March 2018 and is effective for financial years beginning on or after 1 January 2019. This amendment should be applied retrospectively. This amendment includes specific requirements to adopt on the transition but only if entities adopt it in 2019 rather than 2018, together with IFRS 9. Early adoption is permitted.

#### **IFRS 10 and IAS 28: Sale or delivery of assets by an investor to its associate or joint venture**

The amendments seek to resolve the conflict between IFRS 10 and IAS 28 when facing loss of control of a subsidiary that is sold or transferred to an associate or joint venture. The amendments to IAS 28 introduce different recognition criteria for the effects of transactions involving the sale or delivery of assets by an investor (including its consolidated subsidiaries) to its associate or joint venture depending on whether the transactions involve, or not, assets that constitute a business, as defined in IFRS 3 - Business Combinations. When the transactions constitute a business combination under the required terms, the gain or loss shall be recognized in full in the income statement for the year of the investor. However, if the transferred asset does not constitute a business, the gain or loss shall continue to be recognized only to the extent that it relates to other (unrelated) investors.

In December 2015, the IASB decided to defer the date of application of this amendment until any amendments that result from the research project underway on the equity method are finalized. The

early application of this amendment is permitted and must be disclosed. The amendments should be applied prospectively.

### III – Not applicable in 2018

#### Not yet endorsed by the EU:

##### **Long-term interests in associates or joint ventures - amendments to IAS 28**

The amendments clarify that an entity shall apply IFRS 9 to long-term interests in associates or joint ventures to which the equity method is not applied but which, in substance, form part of the net investment in that associate or joint venture (long-term interests). This clarification is relevant since it implies that the expected loss model of IFRS 9 should be applied to such investments.

The IASB also clarified that in applying IFRS 9 an entity does not take into account any losses of that associate or joint venture, or impairment losses on the net investment, which are recognized as an adjustment to the net investment arising from the application of IAS 28.

To illustrate how entities should apply the requirements of IAS 28 and IFRS 9 on long-term interests, the IASB published illustrative examples when it issued this amendment.

This amendment is effective for financial years beginning on or after 1 January 2019. The amendment must be applied retrospectively, with some exceptions. Early adoption is permitted and must be disclosed.

##### **Annual improvements for the 2015-2017 cycle**

In the Annual Improvements for the 2015-2017 cycle, the IASB has introduced improvements in four standards, summarized below:

###### **IFRS 3 Business Combinations - Interest previously held in a joint venture**

- The amendments clarify that when an entity obtains control of a joint venture, it must apply the requirements of the business combination in stages, including remeasuring the interest previously held in the assets and liabilities of the joint venture to its fair value.
- In doing so, the acquirer remeasures its interest previously held in that joint venture.
- This amendment is applicable to business combinations for which the acquisition date is on or after the beginning of the first reporting period that begins on or after 1 January 2019. Early adoption is permitted.

**IFRS 11 Joint Arrangements - Interest previously held in a joint venture**

- A party that participates, but does not have joint control, in a joint venture may obtain joint control over a joint venture which business activity is a business as defined under IFRS 3. This amendment clarifies that the interest previously held should not be remeasured.
- This amendment applies to transactions in which the entity obtains joint control that occur on or after the beginning of the first reporting period that begins on or after 1 January 2019. Early adoption is permitted.

**IAS 12 Income tax - income tax consequences of revenue on payments related to financial instruments classified as equity instruments**

- These changes clarify that the dividend income tax consequences are directly associated with the transaction or past event that generated results distributable to shareholders. As a result, the entity recognizes tax-level impacts in the income statement, comprehensive income or other equity instrument in accordance with the entity's past recognition of such transactions or events.
- These amendments apply to financial years beginning on or after 1 January 2019. Early adoption is permitted. When the entity applies these amendments for the first time, it shall apply same to the tax consequences of dividends recognized on or after the beginning of the earliest comparative period.

**IAS 23 Borrowing costs - borrowing costs eligible for capitalization**

- The amendments clarify that an entity treats as part of the global loans any loan originally obtained for the development of the qualifying asset, when substantially all the activities necessary to prepare that asset for its intended use or for sale are complete.
- The amendments are applicable to borrowing costs incurred on or after the commencement of the reporting period in which the entity adopts these amendments.
- These amendments apply to financial years beginning on or after 1 January 2019. Early adoption is permitted.

**Definition of business activity - amendments to IFRS 3**

This amendment clarifies the minimum requirements to be considered a business activity, removes the assessment as to whether market participants are able to replace the missing elements, adds guidance on the assessment as to whether an acquired process is substantive, narrows the



definitions of business activity and output and introduces an optional fair value test of the business activity.

#### Minimum requirements to be considered a business activity

The amendment clarifies that to be considered a business activity, an integrated set of activities must include at least one input and a substantive process that together contribute significantly to the creation of an output. It also clarifies that a business activity can exist without including all inputs and all processes necessary to create outputs. That is, the inputs and processes applied to these inputs "must be able to contribute to the creation of outputs" rather than "have to be able to create outputs".

#### Ability of market participants to replace missing elements

Before the amendment, IFRS 3 foresaw that a business activity did not have to include all inputs or processes that the seller used in the operationalization of the business activity, "if market participants are able to acquire the business activity and continue to execute the productive process, for example, integrating the business activity with its own inputs and processes". The reference to this integration has been eliminated from the standard and the assessment is based on what was acquired in its current state and conditions.

#### Evaluate whether an acquired process is substantive

The amendments clarify that if a set of activities and assets do not have outputs at the acquisition date, an acquired process is considered a substantive one:

- a) If it is critical for the ability to develop and convert inputs acquired into outputs; and
- b) If the inputs acquired include either an organized workforce with the necessary skills, knowledge, or experience in carrying out this process, or other inputs that this organized labour force can develop or convert into outputs.

In contrast, if a set of activities and assets acquired include outputs at the acquisition date, an acquired process must be considered a substantive one:

- a) If it is critical for the ability to continue to produce outputs and the inputs purchased include an organized workforce with the necessary skills, knowledge, or experience to carry out this process; or
- b) If it contributes significantly to the ability to continue producing outputs and/or is considered unique or scarce, or cannot be replaced without significant costs, without significant effort or without significant delays in the capacity to continue producing outputs.

#### Narrower definition of outputs

The amendments narrowed the definition of outputs by focusing on goods or services provided to customers, return on investment (such as dividends or interest) or other revenue from ordinary activities. The definition of business activity in Appendix A of IFRS 3 has been amended accordingly.

#### Optional concentration test

The amendments introduce an optional test of the fair value of the merger to allow for a simplified assessment if a set of acquired activities are not a business activity. Entities may choose to apply this test on a transaction-by-transaction basis. The test is performed if substantially all the fair values of the gross assets acquired are concentrated in a single identifiable asset or in a similar group of identifiable assets. If the test is not complied with, or if the entity chooses not to apply the test to a particular transaction, a detailed assessment will have to be performed applying the standard IFRS 3 requirements.

This amendment is effective for transactions that are deemed to be business combinations or purchases of assets for which the acquisition date occurred on or after the beginning of the first period beginning on or after 1 January 2020. These amendments apply prospectively. Consequently, entities do not have to assess acquisitions that occurred before that date. Early adoption is permitted and must be disclosed.

This amendment will also have an impact on other standards (e.g. where the parent company loses control of the subsidiary and has early adopted the amendment to IFRS 10 and IAS 28 regarding the sale or delivery of assets by an investor to its associate or joint venture - mentioned earlier in Point II of this document).

#### **Definition of materiality - Amendments to IAS 1 and IAS 8**

The purpose of this amendment was to make the definition of "material" consistent across all existing standards and to clarify certain aspects related to its definition. The new definition states that "information is material if its omission, error or concealment can reasonably be expected to influence the decisions that the primary users of the financial statements make on the basis of those financial statements which provide financial information about a given reporting entity".

The amendments clarify that materiality depends on the nature and magnitude of the information, or both. An entity has to assess whether certain information, either individually or in combination with other information, is material in the context of the financial statements.

#### Hidden information

The amendments explain that information is hidden if it is communicated in a way that has the same effects as if it were missing or contained errors. Material information may be hidden, for example, if the information relating to a material item, a material transaction or other material event is dispersed throughout the financial statements, or is disclosed using language that is vague and unclear. Material information may also be hidden if dissimilar items, dissimilar transactions, or dissimilar events are aggregated inappropriately, or conversely, if similar items are disaggregated.

#### New level of materiality (threshold)

The amendments replace the reference to the "may influence" level of materiality, which suggests that any potential influence of users has to be considered, by the "reasonably expected to influence" mention contained in the definition of materiality. In the amended definition it is thus clarified that the assessment of materiality has to take into account only that which can reasonably be expected to influence the economic decisions of the primary users of the financial statements.

#### Primary users of financial statements

The current definition refers to "users" but does not specify their characteristics, the interpretation of which may imply that the entity has to take into account all possible users of the financial statements when deciding what information to disclose. Consequently, the IASB decided to refer only to primary users in the new definition, to address concerns that the term "users" could be interpreted broadly.

This amendment is effective for financial years beginning on or after 1 January 2020. This amendment must be applied prospectively. Early adoption is permitted and must be disclosed.

Note: This amendment also impacts IFRS Practice Statement 2: Making judgments about materiality, which was disclosed in the IFRS Update document issued on 31 December 2017.

### **IAS 19 Changes to the plan, cuts or liquidation of the plan**

This amendment clarifies the accounting treatment to follow in cases where there is a change in the plan, a cut in the plan or the liquidation of the plan.

#### Determining the cost of current services and the net interest

When a defined benefit plan is accounted for in accordance with IAS 19, the standard requires that the cost of current services be measured using actuarial assumptions determined at the date of commencement of that reporting period. Likewise, the net interest is measured multiplying the net liability (asset) of the plan by the discount rate, both determined at the beginning date of that reporting period.

This amendment clarifies that when a change, a cut or the liquidation of the plan occurs during the period, it is required:

- That the cost of the current services for the remaining period be measured using the actuarial assumptions that have been used to remeasure the net liability (asset) of the plan, which reflects the benefits offered by the plan and the plan assets after that event;
- That the net interest for the remaining period after this event be determined using:
  - The net liability (asset) of the plan, which reflects the benefits offered by the plan and the plan assets after that event; and
  - The discount rate used to remeasure that net liability (asset) of the plan. Impact on the requirements to determine the maximum limit of the recognition of the asset.

A change, cut or liquidation of the plan can reduce or eliminate the excess that exists in the defined benefit plan, which may lead to a change in the maximum limit of the recognition of the asset.

This amendment clarifies that any past service cost, or a gain or loss on the liquidation, must first be determined, without considering the maximum limit for the recognition of the asset. This amount is recognized in profit and loss for the period. Subsequently, the effect of the maximum limit for the recognition of the asset after the change, cut or liquidation of the plan must be determined. Any change in that effect, not considering the amounts included in the net interest, is recognized in comprehensive income.

This clarification may lead an entity to recognize past service costs, or a gain or loss on the liquidation, which reduces the excess that has not been recognized in the past. Changes in the effect of the cap on the recognition of the asset cannot offset these amounts.

This amendment applies to changes, cuts or liquidations of plans occurring on or after the beginning of the first annual reporting period beginning on or after 1 January 2019. Early adoption is permitted, which must be disclosed.

### **The conceptual framework for financial reporting**

The conceptual framework establishes a comprehensive set of concepts for:

- Financial reporting;
- The definition of standards;
- The development of consistent accounting principles; and
- Support in the understanding and interpretation of standards.

The revised conceptual framework includes:

- Some new concepts;
- Revised definitions and criteria for the recognition of assets and liabilities; and
- Clarifications on important concepts.

This structure is organized as follows:

- Chapter 1 - The purpose of financial reporting
- Chapter 2 - Qualitative characteristics of useful financial information
- Chapter 3 - Financial statements and the reporting entity
- Chapter 4 - The elements of financial statements
- Chapter 5 - Recognition and derecognition
- Chapter 6 - Measurement
- Chapter 7 - Presentation and disclosure
- Chapter 8 - Concepts of capital and capital maintenance.

The revised conceptual framework for financial reporting is not a standard and none of its concepts prevail over the concepts present in standards or other requirements of any of the standards. It shall apply to entities that develop their accounting principles based on the conceptual framework for financial years beginning on or after 1 January 2020.

#### **IFRS 14 Deferral accounts related to regulated activities**

This standard allows an entity which activities are subject to regulated rates to continue to apply most of its previous accounting policies for deferral accounts related to regulated activities when adopting IFRS for the first time.

The standards cannot be applied by: (i) entities that already prepare financial statements under IFRS; (ii) entities which current accounting regulations do not permit the recognition of regulatory assets and liabilities and (iii) entities which current accounting standards permit the recognition of regulatory assets and liabilities but that have not adopted such policy in their accounts prior to the adoption of IFRS.

Deferral accounts related to regulated activities shall be presented in a separate line of the balance sheet and the movements in these accounts shall be presented in separate lines in the income statement and in the statement of comprehensive income. The nature and risks associated with the entity's regulated rate and the effects of such regulation on its financial statements shall be disclosed.

The amendments are applicable prospectively for financial years beginning on or after 1 January 2016. Early adoption is permitted provided it is properly disclosed.

The European Union (EU) has decided not to launch the endorsement of this intermediate standard and awaits the final standard.

**Already endorsed by the EU:**

There are no standards already in place that enter into force only after 2018 and which early adoption is not allowed.

## ANNEX

### **Adoption of the Financial Stability Forum (FSF) and the Committee of European Banking Supervisors (CEBS) Recommendations relating to the Transparency of Information and the Valuation of Assets**

(Circular Letter no. 97/2008/DSB, of 3 December and Circular Letter no. 58/2009/DSB, of 5 August)

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The Bank of Portugal, through Circular Letter no. 58/2009/DSB, of 5 August 2009, reiterated "the need for institutions to continue to assure adequate compliance with the Financial Stability Forum (FSF) recommendations and the recommendations of the Committee of European Banking Supervisors (CEBS), with regard to the transparency of information and valuation of assets, considering the proportionality principle" contained in Circular Letters nos. 46/2008/DSB, of 15 July 2008, and 97/2008/DSB, of 3 December 2008.

The Bank of Portugal recommended the preparation of a chapter or specific annex on accountability in the financial statements, exclusively dedicated to the aspects mentioned in the respective recommendations of the CEBS and FSF.

In this chapter, we seek to comply with the recommendation of the Bank of Portugal using references to the information presented, either in the Management Report, or in the Notes to the Financial Statements for the 2018 financial year.

#### **I. BUSINESS MODEL**

##### **1. Description of the business model**

In the introduction and in chapter "II – Operations in 2018" of the Management Report, a description is made of the business model of the Bank.

##### **2. Strategies and objectives**

The Bank's strategies and objectives are also disclosed in chapters "II – Operations in 2018" and "V – Outlook" of the Management Report. The Bank neither realized any debt securities issue nor any securitization operation up till 31 December 2018.

##### **3., 4. and 5. Activities carried out and contribution to the business**

In chapter "II – Operations in 2018" of the Management Report, information is presented on the activities carried out and their contribution to the business.

#### **II. RISK AND RISK MANAGEMENT**

##### **6. and 7. Description and nature of the risks incurred**

Note 33 to the Financial Statements contains diverse information that allows the market to perceive the risks incurred by the Bank and the management mechanisms implemented for the monitoring and control of same.

### **III. IMPACT OF THE FINANCIAL TURBULENCE PERIOD ON THE RESULTS**

#### **8., 9., 10. and 11. Qualitative and quantitative description of the results**

During the quadrennial 2010-2014, following the increase in sovereign risk, a substantial widening of the risk premiums occurred with no material impact on the activity and results attributable to the respective financial years. Between 2015 and 2018, this situation had been stabilized, with Portugal having exited the assistance program.

#### **12. Breakdown of the write-downs between realized and unrealized**

Income and expenses related to assets and liabilities held for trading and assets and liabilities at fair value through profit and loss, at fair value through profit and loss mandatorily and at fair value through other comprehensive income, are broken down by financial instrument in Notes 7 and 8 to the financial statements.

#### **13. Financial turbulence in the Bank's share price quotation**

The Bank's shares are not quoted on any regulated market, rendering this point not applicable.

#### **14. Maximum loss risk**

Note 33 to the financial statements discloses information on the losses susceptible of occurring in market stress situations.

#### **15. Debt securities issued and results**

Not applicable due to the Bank not having issued debt securities during financial year 2018.

### **IV. LEVELS AND TYPES OF EXPOSURES AFFECTED BY THE TURBULENCE PERIOD**

#### **16. Nominal and fair value of the exposures**

Note 19 to the financial statements discloses relevant information on the amount of the Bank's exposures.

#### **17. Credit risk mitigating factors**

Not applicable.

#### **18. Information on the Bank's exposures**

The turbulence that resulted from the worsening of the sovereign risk of the peripheral countries of the Eurozone in 2010 and 2011 stabilized and improved significantly in 2012 and 2013, having reached a point of stability between 2014 and 2018.

Banco Best's exposure to public debt of the affected countries (Portugal, Spain, Greece and Ireland) was limited solely to Portugal, in an amount, as at 31 December 2018, of Euros 46.4 million, intended to guarantee the Bank's liabilities in respect of the FGD and SII and the maintenance of the LCR ratio above the regulatory level. These securities had an associated positive fair value reserve totalling Euros 966 thousand.



**19. Movements in the exposures between financial years**

Notes 16, 17, 19, 32 and 33 disclose relevant information on the Bank's exposures, comparing the exposures to the markets as well as the results with reference to financial years 2018 and 2017. The information therein contained is considered sufficient, considering the detail and quantification presented and the fact that no events of material relevance occurred in 2018.

**20. Exposures that have not been consolidated**

Not applicable.

**21. Exposure to mono-line insurance companies and quality of the assets insured**

The Bank has no exposure to mono-line insurance companies.

**V. ACCOUNTING POLICIES AND MEASUREMENT METHODS****22. Structured products**

These situations are covered in Note 2 – Main Accounting Policies.

**23. Special Purpose Entities (SPE) and consolidation**

The Bank neither realized any debt securities issue nor any securitization operation up till 31 December 2018.

**24. and 25. Fair value of financial instruments**

Note 2 to the financial statements refers to the conditions subjacent to the use of the fair value option, as well as the techniques used to value the financial instruments.

**VI. OTHER RELEVANT DISCLOSURE ASPECTS****26. Description of the disclosure policies and principles**

The Bank, in the context of its disclosure policy regarding information of an accounting and financial nature, aims to satisfy all the requirements of a regulatory nature, be they dictated by the accounting standards or by the supervisory and market regulating authorities. At the same time, it seeks to align its disclosures with best market practices considering, on the one hand, the cost of obtaining the relevant information and, on the other, the benefits that this provides to the various users.

From among the information made available to the shareholders, customers, employees, supervisory entities and the public in general, we highlight the Management Report and the Financial Statements and respective Notes to the Financial Statements. The financial statements are prepared based on the International Financial Reporting Standards (IFRS) which confer a high degree of transparency on the information disclosed as well as comparability.

## ANNEX

### Remuneration policy for members of the corporate bodies of BEST

#### 1 Legal and Regulatory Framework

This Remuneration Policy contains the principles and rules for the remuneration of the members of the Corporate Bodies of BEST – Banco Electrónico de Serviço Total, S.A. (“BEST” or “Bank”) and is established in accordance with Article 115-C of the General Regime governing Credit Institutions and Financial Companies. This Policy has been prepared taking into account the regulations and the applicable legislation for this purpose, namely the following:

- General Regime governing Credit Institutions and Financial Companies ("RGICSF");
- EBA/GL/2015/22 - Guidelines on a sound Remuneration Policy, in accordance with Articles 74, No. 3 and 75. No. 2 of Directive 2013/36/EU and on the disclosure of information in accordance with Article 450 of Regulation (EU) No. 575/2013;
- Directive 2013/36/EU of the European Parliament and of the Council;
- Delegated Regulation (EU) No. 604/2014 of the Commission;
- Regulation (EU) No. 575/2013 of the European Parliament and of the Council;
- Notice no. 10/2011 of the Bank of Portugal;
- Portuguese Commercial Companies Code;
- Directive 2014/65/EU (MiFID II) of the European Parliament and of the Council on markets of financial instruments and related regulations.

The regulations and legislation on remuneration establish the adoption and enforcement of remuneration practices consistent with a prudent, sound and effective risk management that do not constitute an incentive to take excessive risks or create situations of conflict of interest with customers.

The present Policy takes into account the objectives of the Bank, the general strategy of the NOVO BANCO Group (“GNB”) which it integrates, its strategy, nature, structure, culture and values and is based on the guiding principles of meritocracy and transparency to achieve the recognition of high performance. In addition, this Policy and its implementation shall respect and encourage the professional conduct of all members and reflect the principles set forth in the Remuneration Policy for Employees regarding equal treatment of customers, best remuneration practices related to the sale of products and prevention of conflicts of interest with customers.

The level of risk that the institution is willing to assume is in line with the internal capital adequacy assessment (ICAAP) process and the risk appetite framework.

#### 2 Scope

The present Remuneration Policy is applicable to the following members of the corporate bodies of BEST:

- Members of the General Meeting Board;
- Members of the Board of Directors;
- Members of the Supervisory Board;
- Statutory Auditor or "ROC".

The Remuneration Policy for Employees is established in a separate document that is subject to approval by the Executive Commission and ratification by the Board of Directors.

#### 3 Governance of the Remuneration Policy

##### 3.1 Summary of Responsibilities

The governance of the Remuneration Policy implies the cooperation of the different functions of the Bank, among which the following stand out:

|  | Shareholders' Meeting | Board of Directors | Executive Commission | ACD & HCD NB | GRO | CO |
|--|-----------------------|--------------------|----------------------|--------------|-----|----|
| Prepare the Remuneration Policy  |                       |                    | ✓                    | ✓            |     | ✓  |
| Propose for approval the Policy and subsequent changes                               |                       | ✓                  |                      |              |     |    |
| Approve the Policy and subsequent changes  | ✓                     |                    |                      |              |     |    |
| Monitor the implementation of the Policy   |                       | ✓                  | ✓                    | ✓            |     | ✓  |
| Provide information that establishes basic rules for Fixed and Variable Remuneration |                       |                    |                      | ✓            | ✓   | ✓  |
| Evaluate the impact of the Variable Remuneration on the risk profile of the Bank     |                       |                    |                      |              | ✓   | ✓  |
| Approve the Remuneration of the Executive Commission and Supervisory Board           | ✓                     |                    |                      |              |     |    |
| Revise and update the Policy   |                       |                    | ✓                    | ✓            |     | ✓  |

### 3.1.1 Board of Directors

In accordance with the general regime and the Articles of Association, the Board of Directors is responsible for:

- Proposing for approval by the Shareholders' Meeting of the Remuneration Policy and its revisions and amendments;
- Monitoring whether the Remuneration Policy is being properly applied and is in line with the general regime, corporate governance and risk profile of the Bank;
- Assessing the achievement of the objectives and the need for ex-post risk adjustment, including the application of mechanisms of reduction (malus) and of reversal (clawback), if applicable.

### 3.1.2 Executive Commission

In accordance with the general regime, the Articles of Association and the delegated powers, the Executive Commission is responsible for:

- Preparing the Remuneration Policy and ensuring its implementation;
- Preparing remuneration decisions (e.g. attribution criteria/rules, amounts) that shall be reviewed by the Board of Directors;
- Coordinating the appropriate involvement of the relevant internal structures and directorates (e.g. human capital, legal, compliance and risk) in their respective areas of expertise and, where appropriate, obtaining external advice;
- Verifying that the existing remuneration policies are updated and, if necessary, making proposals for changes;
- Monitoring whether the Remuneration Policy is being properly applied and is in line with the general regime, corporate governance and risk profile of the Bank;
- Monitoring whether the limits are not being breached;
- Assessing the achievement of performance objectives and the need for ex-post risk adjustment, including the application of reduction (malus) and reversal (clawback) mechanisms, if applicable;
- Reviewing and updating the Remuneration Policy;

### 3.1.3 Global Risk Office

The Global Risk Office shall provide the support requested by the Executive Commission in the performance of its duties, namely:

- Providing effective elements, within the scope of its duties, for the definition of global bonuses, performance criteria and remuneration attribution;
- Assisting in the definition of appropriate risk-adjusted performance measures (including ex-post adjustments) and providing appropriate information to that effect;
- Participating in the evaluation of how the structure of Variable Remuneration affects the risk profile and culture of the institution;

#### 3.1.4 Compliance Office

The Compliance Office shall provide the support requested by the Executive Commission in the performance of its duties, namely:

- Assisting in the preparation and analysis of the Remuneration Policy;
- Providing information, within the scope of its duties, for the definition of global bonuses, performance criteria and remuneration attribution;
- Proposing and monitoring the implementation of compliance indicators used in the eligibility of variable remuneration or incentives;
- Analysing and monitoring the implementation and compliance of the Remuneration Policy with the laws, regulations and internal policies of the institution, such as required regulatory reporting, and report any compliance risks and non-compliance problems with respect to remuneration issues communicated to same;
- Participating in the evaluation of how the structure of Variable Remuneration affects the risk profile and culture of the institution;
- Informing the Executive Commission of any conflict of interest situation that may be relevant to the duties and responsibilities or that may affect the performance of the functions of the Executive Commission or the Supervisory Board;

#### 3.1.5 Accounting and Control Directorate and Human Capital Department of NOVO BANCO

The Accounting and Control Directorate and the Human Capital Department of NOVO BANCO shall provide the support requested by the Executive Commission in the performance of its duties, namely:

- Assisting in the preparation, analysis and implementation of the Remuneration Policy;
- Participating in the preparation and evaluation of the institution's Remuneration Policy, namely the remuneration structure, remuneration levels and incentive schemes;
- Ensuring an adequate internal and external disclosure of the Remuneration Policy.

### 3.2 Approval

The Remuneration Policy for the members of the General Meeting Board, the Board of Directors and the members of the Supervisory Board shall be approved at the Shareholders' Meeting upon proposal of the Board of Directors.

The remuneration of the Statutory Auditor (ROC) shall correspond to a fixed fee under the audit services commitment in the scope of the NOVO BANCO Group.

## 4. Remuneration Components

The Total Remuneration results from the combination of the components of Fixed and Variable Remuneration. This chapter describes the structure and the criteria considered for the attribution of the different components of remuneration.

### 4.1 Members of the General Meeting Board and non-executive members of the Board of Directors

The members of the General Meeting Board and the non-executive members of the Board of Directors are not remunerated. Members who perform executive functions in management bodies of companies in a control and/or group relationship with BEST, or who perform specific functions by appointment of the Board of Directors of BEST, may be remunerated by said companies or by BEST, according to the importance of the functions performed.

#### 4.2 Members of the Supervisory Board

The remuneration of the members of the Supervisory Board is exclusively composed of a fixed remuneration paid monthly (14 salaries).

#### 4.3 Executive Members of the Board of Directors (Executive Commission)

##### 4.3.1 Fixed Remuneration

The fixed remuneration shall take into account the complexity, the level of responsibility and the variety of skills required for the functions performed. The fixed remuneration shall be paid monthly, 14 times a year.

##### 4.3.2 Variable Remuneration

The Variable Remuneration attributed to the Executive Members of the Board of Directors is based on the combination of the Collective Performance Assessment and the performance of the Bank, taking into account quantitative and qualitative criteria implemented through Objectives and Competencies defined according to the applicable Performance Appraisal Process. Variable Remuneration depends on the verification of certain conditions and objectives, is not contractually guaranteed and may be subject to adjustments under the mechanisms provided for in section 4.2.2.3 Risk Adjustment Mechanisms.

###### 4.3.2.1 Criteria/rules for the attribution of Variable Remuneration

The following rules shall apply to Variable Remuneration:

- a) BEST only considers the attribution of Variable Remuneration if the Bank has a positive and consistent performance with sound and effective risk management practices;
- b) The attribution of Variable Remuneration cannot limit the ability of the Bank to strengthen and maintain the necessary capital base;
- c) The total Variable Remuneration (including the employee remuneration) shall be attributed at the end of each year, based on a positive operational performance;
- d) The total Variable Remuneration attributed to any Executive Member of the Board of Directors shall be limited to 100% of the respective fixed remuneration;
- e) The total Variable Remuneration attributed to any Member of the Executive Commission shall be deferred for a minimum period of 3 years, payable on a proportional basis;
- f) 50% of the Variable Remuneration shall consist of remuneration units, the value of which is determined by the financial performance indicators of the Bank. The remuneration units have a financial effect equivalent to the attribution of shares, as permitted by law. These remuneration units shall have a right of acquisition period of 3 years. The remuneration units shall be settled in cash on their due date and shall be attributed reflecting the financial performance indicators of the Bank.

###### 4.3.2.2 Performance Appraisal and Key Performance Indicators

The appraisal of the Executive Members of the Board of Directors shall be made during the period defined annually for the Performance Appraisal Process and considering the performance and objectives defined for the previous year.

The annual Variable Remuneration attribution shall be defined based on the attainment of the corporate key performance indicators ("KPIs") and individual non-financial indicators agreed upon with each Executive Member of the Board of Directors in the scope of the Performance Appraisal Process. KPIs shall be defined based on a combination of the Bank's overall financial performance, on the member's individual areas of responsibility (including the development of employees with direct reportees) and the objectives of the areas they manage.

It is the responsibility of the Board of Directors to define the aforementioned KPIs, their individual weighting, to assess the level of attainment at the end of the year and to define the total annual Variable Remuneration to be attributed to the Executive Members of the Board of Directors. The Executive Members shall be appraised by the President of the Executive Commission and the President of the Executive Commission shall be appraised by the Chair of the Board of Directors.

#### 4.3.2.3 Risk adjustment mechanisms

The Bank shall be able to apply risk adjustment mechanisms to Variable Remuneration, based on risk, through the following mechanisms:

- a. Reduction (Malus): allows the Bank to reduce totally or partially the Variable Remuneration object of deferral and which payment is not yet considered an acquired right;
- b. Reversal (Clawback): allows the Bank to recover amounts already paid or which payment already constitutes a vested right, with the relevant employee being required to return such amounts.

##### 4.3.2.3.1 Rules for applying Malus and Clawback

The aforementioned mechanisms are applicable to the total Variable Remuneration, during the deferral period, and following an extremely significant event attributable individually to the Executive Members of the Board of Directors. The Shareholders' Meeting shall determine the severity of an event and whether the malus or clawback mechanisms are applicable to the Variable Remuneration attributed to the Executive Members of the Board of Directors. Depending on the severity of the event, the Shareholders' Meeting shall decide whether the malus or clawback mechanism is applicable.

Examples of a significant event in which an Executive Member of the Board of Directors may lose the Variable Remuneration include fraud, material breach of confidentiality obligations, individual material regulatory sanctions applied or the member ceases to be deemed suitable (appropriate or prepared) by the supervisory authority, in accordance with applicable laws and regulations, or criminal convictions (other than traffic violations or other offenses for which a non-custodial penalty applies).

#### 4.3.2.4 Rules in case of departure situations

##### 4.3.2.4.1 Rules for departure at the initiative of the Bank

If the term of office of the Executive Member of the Board of Directors is terminated by the Bank without just cause, under Portuguese law, the respective member shall be entitled to receive all deferred amounts of the Variable Remuneration due as at that date subject to malus or clawback adjustments and on the date specified for the payment of each deferred part.

If the term of office of the Executive Member of the Board of Directors is terminated by the Bank with just cause, under Portuguese law, the respective member shall not be entitled to any deferred portion of the Variable Remuneration.

#### 4.3.2.4.2 Rules on the departure at the initiative of the Executive Member of the Board of Directors

If an executive member of the Board of Directors voluntarily resigns before the end of the term of office for which he/she has been appointed, the Shareholders' Meeting shall determine whether the individual member continues to be entitled to any deferred portion of the Variable Remuneration which entitlement has not yet been acquired, subject to the applicable malus or clawback adjustments and on the date specified for the payment of each deferred part. The Shareholders' Meeting shall also consider the imposition of a non-competition agreement and a notice period on making its decision.

#### 4.3.3 Other Benefits

Other benefits such as health insurance, cell phones, etc. are applicable in line with that attributed to the Bank's employees, in accordance with internal regulations.

If any Executive Member of the Board of Directors is an employee of the Bank, he/she may maintain during the term of office the benefits resulting from the employment contract and the regulations applicable before his/her appointment to the Board of Directors, if the applicable laws and regulations do not provide otherwise.

### 5 Conflicts of interest

Conflicts of interest relating to the Remuneration Policy and the Variable Remuneration attributed shall be identified and adequately addressed, namely by defining objective attribution criteria, based on the internal information system, appropriate controls and the "four eyes" principle. The Remuneration Policy shall pursue the objective that no significant conflicts of interest arise for members of the Management and Supervisory Bodies in the performance of their functions.

The Compliance Office is responsible for monitoring adherence to the Remuneration Policy with the objective of preventing conflicts of interest established in applicable laws, regulations and guidelines and shall notify the Chair of the Board of Directors and the Supervisory Board in the event of significant conflicts of interest for members of the Management and Supervisory Bodies in the performance of their functions related to this Remuneration Policy. In the event of conflicts of interest related to the Chair of the Board of Directors and the Supervisory Board, the aforementioned notice shall be sent to the President of the Compliance Committee of NOVO BANCO.

Decisions taken by the Board of Directors regarding any conflicts of interest arising in relation to members of the Board of Directors as well as those relating to the Supervisory Board related to this Remuneration Policy shall be subject to ratification by the Shareholders.

### 6 Review and update of the Policy

An annual review and update of the Remuneration Policy shall be carried out, if necessary, to ensure that it is being properly implemented, the remuneration paid is in line with this Policy, the risk profile and the long-term objectives of the Bank and is compatible with current national and international regulations and with the applicable legal regime.

### 7 Disclosure of information

After approval, this Remuneration Policy shall be disclosed internally to the institution and the Bank shall also adequately disclose the information through the means and channels provided for in the applicable legislation.

## 8 Final Provision

This Policy shall be submitted for approval by the Shareholders' Meeting upon recommendation and approval of the Board of Directors dated as of 20 November 2018.

### **Amounts paid in 2018 to the members of the corporate bodies, including amounts paid, for any reason, to other companies in a group relationship:**

#### a) Board of Directors (Executive Members)

The members of the Board of Directors did not receive any variable remuneration in 2018. The remuneration of the members of the Executive Commission in financial year 2018 includes the fixed remuneration, paid in 14 instalments - or during the period of the year they exercised their functions at BEST - and the complements that are granted to all employees of Banco Best, such as seniority or other subsidies. Maria Madalena Monteiro de Mata Torres Pitta e Cunha, current Chair of the Executive Commission earned a remuneration of Euros 145 752. Marília Boavida Correia Cabral earned a remuneration of Euros 56 770. Pedro Alexandre Lemos Cabral das Neves earned a remuneration of Euros 128 591.

#### b) Supervisory Board

The members of the Supervisory Board did not receive any variable remuneration in 2018. António Joaquim Andrade Gonçalves received a fixed remuneration in attendance fees of Euros 5 600, Isabel Maria Beja Gonçalves Novo received a fixed remuneration in attendance fees of Euros 4 200 and Fernando Jorge Henrique Bernardo also received a fixed remuneration in attendance fees of Euros 4 200.



## ANNEX

### Remuneration policy for employees of Banco Best

#### 1. Legal and Regulatory Framework

This Remuneration Policy contains the principles and rules for the remuneration of the Employees of BEST – Banco Electrónico de Serviço Total, S.A. (“BEST” or “Bank”) and is established in accordance with Article 115-C of the General Regime governing Credit Institutions and Financial Companies.

This Policy has been prepared taking into account the regulations and applicable legislation for this purpose, namely the following:

- General Regime governing Credit Institutions and Financial Companies ("RGICSF");
- EBA/GL/2015/22 - Guidelines on a sound Remuneration Policy, in accordance with Articles 74, No. 3 and 75. No. 2 of Directive 2013/36/EU and on the disclosure of information in accordance with Article 450 of Regulation (EU) No. 575/2013;
- Directive 2013/36/EU of the European Parliament and of the Council;
- Delegated Regulation (EU) No. 604/2014 of the Commission;
- Regulation (EU) No. 575/2013 of the European Parliament and of the Council;
- Notice no. 10/2011 of the Bank of Portugal;
- Portuguese Commercial Companies Code;
- Directive 2014/65/EU (MiFID II) of the European Parliament and of the Council on markets of financial instruments and related regulations;
- Portuguese Securities Code;
- EBA/GL/2016/06 - Guidelines on remuneration policies and practices relating to the sale and supply of retail banking products and services;
- Directive 2014/17/EU of the European Parliament and its respective consequent Portuguese law DL 74-A/2017;
- Report on the risk of conduct and abusive practices on sale of investment products of the Conselho Nacional de Supervisores Financeiros (National Council of Financial Supervisors) of 3 March 2016;
- The list of significant supervised entities and the list of least significant institutions of the European Central Bank.

The regulations and legislation on remuneration establish the adoption and enforcement of remuneration practices consistent with a prudent, sound and effective risk management that do not constitute an incentive to take excessive risks or create situations of conflict of interest with customers.

This Remuneration Policy takes into account the objectives of the Bank, the general strategy of the NOVO BANCO Group (“GNB”) which it integrates, its strategy, nature, structure, culture and values and is based on the guiding principles of meritocracy and transparency to obtain the recognition of high performance, being aligned with the principles foreseen in the Remuneration Policy for Members of the corporate bodies of BEST. In addition, this Remuneration Policy and its implementation shall respect and encourage the professional conduct of all members and reflect the principles of equal treatment of customers, best remuneration practices related to the sale of products and prevention of conflicts of interest with customers.

#### 2 Scope

BEST aims to attract and retain Employees who can contribute positively to achieve the objectives of the Bank, always from a sustainable development perspective and in line with the risk appetite framework and with the intervention of all the stakeholders. This Remuneration Policy also seeks to encourage responsible and ethical professional conduct by all Employees, fair treatment of customers and the prevention of conflicts of interest and mitigation of risks, such as, for example, reputation.

The Remuneration Policy is applicable to all Employees with an employment contract with BEST. The members of the corporate bodies are covered by a specific Remuneration Policy for the Members of the Corporate Bodies of BEST, set down in an autonomous document, with its total consistency with the principles and practices of the present Remuneration Policy being assured.

The employees' on assignment having an employment contract with NOVO BANCO are covered by the Remuneration Policy for Employees of NOVO BANCO for the fixed component of the remuneration and the present Remuneration Policy for the variable component of the remuneration.

### 3 Governance of the Remuneration Policy

#### 3.1 Summary of Responsibilities

The governance of this Remuneration Policy implies the cooperation of different areas, among which the following stand out:

|   | Executive Commission | ACD & HCD NB | GRO | CO |
|---|----------------------|--------------|-----|----|
| Prepare the Remuneration Policy   | ✓                    | ✓            |     | ✓  |
| Approve the Policy and subsequent changes   | ✓                    |              |     |    |
| Map and update Identified Employees   |                      | ✓            |     |    |
| Approve the list of Identified Employees  | ✓                    |              |     |    |
| Provide information that establishes basic rules for Fixed and Variable Remuneration                  |                      | ✓            | ✓   | ✓  |
| Prepare and Propose decisions on Remuneration (for example, attribution criteria/rules, KPI, amounts) | ✓                    | ✓            |     |    |
| Evaluate the impact of the Variable Remuneration on the risk profile of the Bank                      |                      |              | ✓   | ✓  |
| Decide on the Remuneration  | ✓                    |              |     |    |
| Monitor and implement the Policy  | ✓                    | ✓            |     | ✓  |
| Revise and update the Policy  | ✓                    | ✓            |     | ✓  |

##### 3.1.1 Executive Commission

In accordance with the general regime, the Articles of Association and the delegated powers, the Executive Commission is responsible for:

- Approving the Remuneration Policy and ensuring its implementation;
- Adopting decisions on remuneration (e.g. attribution criteria/rules, amounts);
- Monitoring whether the Remuneration Policy is being properly applied and is in line with the general regime, corporate governance and risk profile of the Bank;
- Monitoring whether limits are not being breached;
- Deciding which Employees shall be classified as Identified Employees, based on the criteria set forth in section 4 of the present Policy and decide on possible exclusions or updates;
- Verifying that the existing remuneration policies are up-to-date and, if necessary, making proposals for changes;
- Assessing the achievement of performance objectives and the need for ex-post risk adjustment, including the application of reduction (malus) and reversal (clawback) mechanisms, if applicable;
- Reviewing the Remuneration Policy in accordance with section 8;

##### 3.1.2 Global Risk Office

The Global Risk Office shall provide the support requested by the Executive Commission in the performance of its duties, namely:

- Providing effective elements, within the scope of its duties, for the definition of global bonuses, performance criteria and remuneration attribution;
- Assisting in the definition of appropriate risk-adjusted performance measures (including ex-post adjustments) and providing appropriate information to that effect;

- Participating in the evaluation of how the structure of Variable Remuneration affects the risk profile and culture of the institution;

### 3.1.3 Compliance Office

The Compliance Office shall provide the support requested by the Executive Commission in the performance of its duties, namely:

- Assisting in the preparation and analysis of the Remuneration Policy;
- Providing information, within the scope of its duties, for the definition of global bonuses, performance criteria and remuneration attribution;
- Proposing and monitoring the implementation of compliance indicators used in the eligibility of variable remuneration or incentives;
- Analysing and monitoring the implementation and compliance of the Remuneration Policy with the laws, regulations and internal policies of the institution, such as required regulatory reporting, and report any compliance risks and non-compliance problems with respect to remuneration issues communicated to it, to the Executive Commission or Supervisory Board;
- Participating in the evaluation of how the structure of Variable Remuneration affects the risk profile and culture of the institution;
- Informing the Executive Commission of any conflict of interest situation that may be relevant to the duties and responsibilities or that may affect the performance of the functions of the Executive Commission;

### 3.1.4 Accounting and Control Directorate and Human Capital Department of NOVO BANCO

The Accounting and Control Directorate of Banco Best and the Human Capital Department of NOVO BANCO shall provide the support requested by the Executive Commission in the performance of its duties, namely:

- Assisting in the preparation, analysis and implementation of the Remuneration Policy;
- Participating in the preparation and evaluation of the institution's Remuneration Policy, namely the remuneration structure, remuneration levels and incentive schemes;
- Ensuring an adequate internal and external disclosure of the Remuneration Policy.

## 3.2 Approval

The Policy for Employees of BEST shall be approved by the Executive Commission following a joint proposal of the ACD and CO and subject to subsequent ratification by the Board of Directors.

## 4 Classification of Identified Employees

The Executive Commission is responsible for selecting and approving all Identified Employees whose professional activities have or may have a significant impact on the Bank's risk profile.

In accordance with Articles 3 and 4 of Delegated Regulation (EU) No. 604/2014 of the European Commission, appropriate qualitative and quantitative criteria shall be established to identify the core categories of employees whose professional activities have a significant impact on the risk of the institution.

In addition to the provisions of the Remuneration Policy, BEST may define additional criteria that reflect the risk levels of the different activities in the institution and the impact of the Employees on the risk profile.

### 4.1 Mapping of Identified Employees

Given the operating structure, objectives and business strategy of the Bank, Identified Employees of BEST comprise the following people:

- First line Managers: All Employees responsible for the directorates, structures or areas of the Bank who report directly to the Members of the Executive Commission.
- Other Employees (who are not first-line Managers):
  - Whose total remuneration exceeds, in absolute terms, Euros 250 000 per year, or;
  - Who are included in the 1% of the permanent Employees with the highest total remuneration in the Institution;
 In all cases, provided they have a material impact on the risk profile of the Bank.

The Accounting and Control Directorate shall draw up a list of proposed Identified Employees, corresponding to the categories indicated above, which shall be submitted for approval to the Executive Commission. For the purposes of this Remuneration Policy, only the Employees included in this list shall be considered Identified Employees. This list shall be reviewed annually by the Accounting and Control Directorate and its changes subject to the regime described above.

Nevertheless, the Accounting and Control Directorate shall propose an immediate update whenever there are changes regarding the persons occupying these positions or changes in the organization of the directorates of the Bank, in these cases also following the regime indicated above.

The Accounting and Control Directorate shall communicate to each one of the nominees on the list of Identified Employees their “Identified” status for the purposes of this Remuneration Policy, providing all necessary information and clarifications regarding this statute.

## 5 Remuneration Components

The Total Remuneration results from the combination of the components of Fixed and Variable Remuneration. The present chapter describes the structure and the criteria considered for the attribution of the different components of remuneration.

### 5.1 Fixed Remuneration

The Fixed Remuneration is paid to all Employees of BEST with an employment contract and includes all the amounts received, on a regular and periodic basis, in exchange for the work realized. The Fixed Remuneration component shall reflect the relevant professional experience and organizational responsibility inherent to the function.

Fixed Remuneration may consist of several components, which shall comply with a set of conditions, namely:

- a) Reflect in a non-discretionary manner the level of professional experience and the seniority of the Employees;
- b) Be transparent as regards the individual amount allocated to the Employee;
- c) Be permanent, that is, to remain for the period of time associated with the specific position and organizational responsibilities;
- a) May not be reduced, suspended or cancelled by the Bank;
- b) Do not depend on performance.

The table below describes the various components that make up the Fixed Remuneration of BEST. Without prejudice, the Executive Commission may decide to grant new fixed benefits provided that the rules and principles laid down in the legislation and regulations in force are complied with.

## Components of Fixed Remuneration

| Categories   | Frequency | Description  |
|--|-----------|--|
| Base salary  | 14 months | Amount attributed to employees corresponding to the activity realized in accordance with the normal working hours      |
| Remuneration for exemption from normal working hour limits | 14 months | Amount attributed to employees who are available, as a rule, to realize their activity beyond the normal working hours |

In addition, in accordance with the provisions of the legislation and regulations in force, BEST attributed other benefits or amounts to its Employees, namely:

- a) Meal allowance;
- b) Remuneration for overtime work;
- c) Remuneration for Stand-By;
- d) Displacement allowance;
- e) Reimbursement of expenses and other allowances for trips, travel, transport, accommodation and others equivalent.

### 5.2 Variable Remuneration

As part of the NOVO BANCO Group, considered a Significant Financial Institution, BEST is obliged to comply with a set of specific requirements that shall be considered in the attribution of Variable Remuneration.

The Variable Remuneration depends on the verification of certain conditions and objectives, is not contractually guaranteed and may be subject to adjustments under the mechanisms provided for in section 5.3 (*Risk Adjustment Mechanisms*). Thus, the Variable Remuneration attributed to the Employees of BEST is based on the combination of the performance of each employee, of the respective Directorate and of BEST, taking into account quantitative and qualitative criteria evaluated through Objectives and Competencies.

There are three types of Variable Remuneration for Employees:

- a. Bonus: to be attributed based on minimum criteria of merit and individual and collective performance of each year and only upon verification of certain conditions, being applicable to all employees not covered by the Commercial Incentives and Commercial Campaigns;
- b. Commercial Incentives: these are payments that may have components with a monthly, quarterly, half-yearly or annual frequency and that aim to remunerate the best commercial performances, ensuring the monitoring of abusive sales practices and other qualitative indicators of the activity;
- c. Commercial Campaigns: correspond to the attribution of Awards (in cash or in kind) without a previously defined periodicity or format. The Campaigns and the respective Awards are applicable to the Employees covered by the Commercial Incentives and are considered and evaluated in accordance with the internal rules that apply to the creation, approval, distribution and monitoring of Products and aim to stimulate a specific segment of the commercial offering of the Bank for a limited period of time.

Other commercial incentives or bonuses for specific categories of employees in special circumstances not provided for in this Policy (including incentives that may be agreed by the Bank with third parties) may be attributed on the terms and conditions to be defined and communicated to the relevant Employees, provided that the principles of this Policy and the applicable law are complied with.

In addition, the variable remuneration of all Employees who:

- a. may have an impact on the customer service rendered or the business conduct of BEST, including, but not limited to: (i) customer service personnel, commercial teams or other personnel directly

- involved in the provision of investment or supplementary services; (ii) persons involved in the handling of complaints or in the design and development of products;
- b. are involved in the preparation, marketing and concession of loan contracts to consumers;
- c. are employees directly and indirectly supervising the teams in all of the aforementioned activities.

Shall comply with the following principles:

- a. The appraisal of the underlying performance shall take into account not only quantitative criteria but also qualitative criteria linked to the Employee's compliance with the rules in force in relation to customers, in particular as regards duties of information, the duty to prevent conflicts of interest, keeping records and evidence;
- b. Qualitative criteria cannot be offset by better financial performance and, ultimately, may be exclusively applied for payment purposes;
- c. Identified Employees shall be appraised and remunerated in a way that avoids any conflict with their obligation to act in the interests of customers;
- d. Remuneration cannot be attributed if it is based on the distribution of banking products to non-professional customers, when the employee can propose a different banking product that best matches the needs of that customer;
- e. Remuneration cannot be attributed if it is based on the distribution of financial product packages to non-professional customers, when the package, on an integrated basis, is not adequate to that customer's needs.

#### 5.2.1 Variable Remuneration of Identified Employees

The Performance Indicator used by BEST to calculate the variable component of the Remuneration of Identified Employees shall:

- Consider quantitative and qualitative performance criteria, including financial and non-financial performance, for the Employees, business units and the Bank;
- Be processed in a multi-year framework to ensure that the appraisal process is based on long-term performance and that the effective attribution of the Variable Remuneration (Bonus) part is deferred over the period defined below, taking into account the business cycle of the Bank and its business risks and promoting the retention of the Identified Employees;
- Not encourage excessive risk-taking or abusive product sales;
- Include risk adjustment mechanisms ("Malus" and "Clawback").

##### 5.2.1. Bonus

The following rules shall be applied when attributing Bonuses:

- a. It can only be attributed if the Bank has positive Operating Results in the previous year;
- b. The Bonus attribution and its payment, including the deferred parts, cannot limit the ability of the Bank to strengthen and maintain the required capital base in line with the level of risk that the Bank is willing to assume in accordance with the internal capital adequacy assessment process;
- c. The total budget for bonuses to be attributed each year to Employees shall be defined by the Executive Commission and ratified by the Board of Directors;
- d. Bonuses or deferred parts thereof shall only be paid on the respective dates (until the end of the first half year after the assessment year), provided that it is sustainable in the light of the Bank's overall financial situation and is justified in the light of the Bank's, the Business Unit's and the individual Employee's performance;
- e. The Identified Employees shall only be entitled to the deferred parts of the Bonus, as described below, if their respective employment contract is in effect on the date of the payment of each part;
- f. The Bonus attributed cannot exceed 100% of the Fixed Remuneration component for each Employee;

- g. The Executive Commission shall define the criteria/rules for the attribution of Bonuses, using quantitative and qualitative indicators (KPI);
- h. The Executive Commission shall propose to the Board of Directors the approval of the Identified Employees who are to receive Bonuses.

#### 5.2.1.2 Form of payment

The Variable Remuneration attributed to the Identified Employees, existing and having been approved, shall be paid on a proportional basis over a period of three years, the first payment being made in the year of the attribution and the others in subsequent years, provided that the condition set forth in paragraph e) of point 5.2.1.1 is verified.

Each of the three payments, when due, shall be carried out as follows:

- 50% is paid in cash;
- The other 50% shall consist of remuneration units, the value of which is determined by the financial performance indicators of the Bank. The remuneration units have an effect equivalent to the attribution of shares, as permitted by law.

The remuneration units shall be settled in cash on the due payment date and shall be attributed reflecting the financial performance indicators of the Bank.

#### 5.2.2 Variable Remuneration of Employees Allocated to Business Structures:

##### 5.2.2.1 Commercial Incentives

The Commercial Incentive Program is defined and approved by the Executive Commission and has the following assumptions:

- a. It is applicable to Employees in the commercial areas with assigned customers and to those who supervise directly and indirectly the commercial teams and who are not Identified Employees;
- b. The budget for the commercial incentive program is reviewed annually by the Executive Commission, taking as the maximum reference a value not exceeding 5% of the payroll of the Bank;
- c. Employees eligible for this commercial incentive program are excluded from the Bonus system;
- d. This Incentive Program shall have a frequency as indicated in a specific autonomous document and also attributes a part of the total incentive to the annual attainment of the objectives;
- e. Full details of the Commercial Incentive Program and its method of calculation shall be published in a separate document;
- f. The program includes risk adjustment mechanisms, as described in point 5.3 of the present Remuneration Policy.

##### 5.2.2.2 Commercial Campaigns

When establishing a Commercial Campaign, the responsible Directorates shall take into account the following:

- a. Each campaign and its awards/attribution shall be approved by the Bank's Product Committee;
- b. Campaigns for products related to the MiFID II Regulation and Housing Loans cannot be established;
- c. The commercial campaigns apply to the same group of employees covered by the commercial incentives, and no employee may receive, during a calendar year, a total aggregate amount of awards/attribution in Commercial Campaigns exceeding an amount equivalent to their monthly fixed remuneration.

#### 5.2.3 Variable Remuneration for the Remaining Employees

The Variable Remuneration for this category of Employees (all non-Identified Employees or employees covered by the Commercial Incentives) shall consist of a Bonus and its attribution shall be governed by the rules described in section 5.2.1.1 of the present Remuneration Policy, as applicable.

The Variable Remuneration attributed to the remaining Employees, existing and having been approved, shall be paid until the end of the first half-year of the year following the appraisal, provided that the respective employment contract is in effect on the date of the payment.

### 5.3 Risk adjustment mechanisms

The Bank shall be able to apply risk adjustment mechanisms to Variable Remuneration, based on risk, through the following mechanisms:

- a. Reduction (Malus): allows the Bank to reduce totally or partially the Variable Remuneration object of deferral and which payment is not yet considered an acquired right;
- b. Reversal (Clawback): allows the Bank to recover amounts already paid or which payment already constitutes a vested right, with the relevant employee being required to return such amounts.

#### 5.3.1 Rules for applying Malus and Clawback

##### 5.3.1.1 Application to Identified Employees

The aforementioned mechanisms are applicable to the total Variable Remuneration for Identified Employees, during the deferral period, and following an extremely significant event attributable to an Employee.

The Executive Commission shall determine the severity of an event and whether the Malus or Clawback mechanisms are applicable to the Variable Remuneration attributed to Identified Employees. Depending on the severity of the event, the Executive Commission shall decide whether the malus or clawback mechanism is applicable.

Examples of a significant event in which an Employee shall lose the Variable Remuneration include fraud, material breach of confidentiality obligations, individual material regulatory sanctions applied or, if applicable to that Employee, he/she ceases to be deemed suitable (appropriate or prepared) by the supervisory authority, in accordance with applicable laws and regulations, or criminal convictions (other than traffic violations or other offenses for which a non-custodial penalty applies).

##### 5.3.1.2 Application to Employees Allocated to Business Structures

The Commercial Incentive Program includes a risk adjustment mechanism that seeks to recover any amounts found to have been unduly paid. For this purpose, one of the following events must occur:

- a. Disciplinary procedures or dismissal for just cause following the manipulation of commercial performance results;
- b. Fraudulent sales;
- c. Adulterated records or evidence related to the sales process.

The Compliance Office shall identify such events based on internal information or information forwarded by other Directorates and inform the Accounting and Control Directorate, which in liaison with the Human Capital Department of NOVO BANCO shall ensure that:

- a. The Employee is informed of the detected event and of the amount that is considered unduly paid;
- b. The Employee shall not receive other incentives until the amount unduly paid is offset by positive future performances.

##### 5.3.1.3 Application to all Remaining Employees



The Clawback mechanism shall apply if and when any failure to comply with the rules applicable to the professional practice of the services provided contained in laws, regulations, internal regulations or codes of conduct by the Employee is detected, according to the analysis performed by the Compliance Office and duly communicated to the Accounting and Control Directorate.

The Accounting and Control Directorate shall analyse the aforementioned information transmitted and propose an assessment of the severity of the event and as to whether the Clawback mechanism is applicable to the bonus attributed to the Remaining Employees for approval by the Executive Commission.

#### 5.4 Rules in case of departure situations

##### 5.4.1 Rules for the departure at the initiative of the Bank

If the employment contract is terminated by the Bank without just cause, under Portuguese law, the Employee shall be entitled to receive all deferred amounts of the Bonus, subject to malus or clawback adjustments applicable and on the date specified for each deferred payment.

If the employment contract is terminated by the Bank with just cause, under Portuguese law, the Employee shall not be entitled to any deferred portion of the Bonus.

##### 5.4.2 Rules for the departure at the initiative of the Employee

If the Employee decides to terminate the employment contract, he/she shall not be entitled to any deferred part of the Bonus.

## 6 Conflicts of interest

Conflicts of interest relating to the Remuneration Policy and the remuneration attributed shall be identified and adequately addressed, namely by defining objective attribution criteria, based on the internal information system, appropriate controls and the "four eyes" principle.

The Remuneration Policy shall pursue the objective that no significant conflicts of interest arise for any Employee in the performance of his/her duties, in accordance with the current conflicts of interest policy in force at BEST.

To mitigate the risks associated with conflicts of interest regarding the Remuneration Policy, BEST seeks to:

- a. Take into account the interests of shareholders, the rights and interests of consumers, market practices in terms of remuneration and the state of maturity of the activity;
- b. Not associate remuneration primarily with a quantitative goal of the trade or supply of banking products and services;
- c. Ensure that the forms of remuneration and performance appraisals do not introduce incentives which favour their own interests or the interests of the Bank, to the detriment of their customers;
- d. Avoid promoting the trade or supply of a particular product or category of products in relation to other products, such as products which are more profitable to the institution or to the Employee, to the detriment of the interests of the customer;
- e. Ensure that the Variable Remuneration is not paid through means or methods that aim at or facilitate the non-compliance with the Remuneration Policy. This may include, among other things, the celebration of agreements between the Bank and third parties in which the Employee has a personal or financial interest;
- f. All Employees shall inform the Compliance Office if there is a conflict of interests related to the present Policy;
- g. The aforementioned notification shall be evaluated by the Compliance Office under applicable Portuguese laws and internal regulations such as the Code of Conduct, the Conflicts of Interest Policy, the Related Party Transactions Policy, as well as the Articles of Association of BEST.

The Compliance Office shall inform the Supervisory Board and the Executive Commission of:

- Any communication received on conflicts of interest related to the Remuneration Policy and its evaluation;
- Any situation detected where the Employee's obligation to inform the Compliance Office of a conflict of interest arising from the application of this policy, under the conflict of interest policy, has not been complied with.

## **7 Disclosure of information**

Upon approval, this Remuneration Policy shall be internally disclosed to the institution.

## **8 Review and Update**

An annual review and update of the Policy and its implementation shall be carried out, if necessary, to ensure that it is being properly implemented, that the remuneration paid is in line with this Policy, the risk profile and the long-term objectives of the Bank and is compatible with national and international regulations and with the applicable legal regime.

## **9 Final Provisions**

This Policy was approved by the Executive Commission on 25 October 2018 and approved through ratification by the Board of Directors dated as of 20 November 2018.

### **Amounts paid in 2018 to Identified Employees of Banco Best**

The remuneration earned by Identified Employees in respect of financial year 2018 includes the fixed remuneration, paid in 14 instalments, the complements paid to all employees of the Bank, such as seniority and other subsidies, and the variable remuneration attributed and already paid regarding previous financial years. Identified Employees received a global fixed remuneration of Euros 760 481 and a variable remuneration of Euros zero. Detailing by main business areas, the three Managers of the commercial areas received a global fixed remuneration of Euros 205 533. The nine Managers allocated to the central services areas and employees in control positions received a global fixed remuneration of Euros 554 948.

## **Statutory and Audit Report**

### **REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS**

#### **Opinion**

We have audited the financial statements of BEST- Banco Electrónico de Serviço Total, S.A. (Banco BEST, S.A.), which comprise the Balance Sheet as at 31 December 2018 (which shows total assets of Euros 650,583 thousand and total shareholders' equity of Euros 75,557 thousand, including a net income of Euros 3,564 thousand), the Statement of Income, the Statement of Comprehensive Income, the Statement of Changes in Equity and the Statement of Cash Flows for the year then ended, and the explanatory notes to the financial statements that include a summary of the significant accounting policies.

In our opinion, the accompanying financial statements present fairly in all material respects, the financial position of BEST- Banco Electrónico de Serviço Total, S.A. as at 31 December 2018, its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union.

#### **Bases for the opinion**

We conducted our audit in accordance with International Standards on Auditing (ISA) and other technical and ethical standards and recommendations issued by the Institute of Statutory Auditors. Our responsibilities under those standards are described in the "Auditor's responsibilities for the audit of the financial statements" section below. In accordance with the law we are independent of the entity and we have fulfilled our other ethical responsibilities in accordance with the ethics code of the Institute of Statutory Auditors.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### **Key audit matters**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current year. These matters were addressed in the

context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

We describe below the key audit matters of the current year:

### 1. Impairment of loans and advances to customers

| Description of the main risks of material misstatement  | Summary of our response to the main risks of material misstatement   |
|---|--|
| <p>The balance sheet caption of Loans and advances to customers includes accumulated impairment amounting to Euros 825 thousand (“k€”), with a negative impact having been recognized in the income statement in the caption Impairment losses of loans and advances, net of reversals and recoveries. The gross amount of Loans and advances to customers is Euros 141,981 k€, for which reason the accumulated impairment losses represent 1% of the loans and advances amount.</p>   | <p>We identified and assessed the audit risk that led to the definition of the audit approach to respond to the risk of material misstatement. This approach included (i) a global response with an impact on the manner the audit was carried out and (ii) a specific response that was reflected in the design, and subsequent execution, of additional procedures that included tests of controls and substantive procedures, namely:</p> |
| <p>The detail of the impairment and the accounting policies, methodologies, concepts and assumptions used are disclosed in the explanatory notes to the financial statements (Note 18).</p>   | <ul style="list-style-type: none"> <li>➤ We gained the understanding, evaluated the design and tested the operational effectiveness of the internal control procedures existing in the process to quantify impairment losses on Loans and advances to customers;</li> </ul>  |
| <p>The impairment of loans and advances to customers represents the best estimate of the management body of the Bank of the expected losses from the loan and advances to customers’ portfolio with reference to 31 December 2018. For the calculation of this estimate, the management body of the Bank established assumptions, relied on mathematical models to calculate parameters, interpreted concepts and designed a model to calculate the expected loss. For relevant exposures, it relied on the judgement of specialists for the assessment of the credit risk of the Bank.</p> | <ul style="list-style-type: none"> <li>➤ We realized analytical review tests on the evolution of the balance of Impairment on loans and advances to customers, comparing it with the homologous period and with the expectations formed, of note being the understanding of the changes that have occurred in the Loans and advances to customers’ portfolio and the changes in the impairment assumptions and methodologies;</li> </ul>     |
| <p>Additionally, since 1 January 2018, due to the first-time application of International Financial Reporting Standard 9 - Financial instruments, impairment now reflects the expected credit loss (loss incurred in 2017). This standard introduces two new concepts: the “significant increase in credit risk” and</p>  | <ul style="list-style-type: none"> <li>➤ We selected a sample of customers subject to individual impairment assessment to evaluate the assumptions used by the management body in the quantification of the impairment. This analysis included: the inspection of the information with the business models and the economic and financial situation of the debtors and the reports on the valuation of the collateral;</li> </ul>            |

| <b>Description of the main risks of material misstatement</b>   | <b>Summary of our response to the main risks of material misstatement</b>   |
|---|---|
| <p>“forecasts of future economic conditions”. The impact on the transition are disclosed in the explanatory notes to the financial statements (Note 18).</p> <p>Besides the complexity of the models described, their use requires the processing of a significant volume of data that are not always available on the central systems of the Bank, such as information on the credit risk at the moment of the granting, the date and amount of the first default, the amount of the historical recoveries of loans in default. To overcome limitations that may exist in some data, the management body occasionally relies on practical expediciencies that increase the judgments applied.</p> <p>The use of alternative approaches, models or assumptions may have a material impact on the amount of the impairment estimated.</p> <p>Given the degree of subjectivity and complexity that the estimation of the impairment involves and the materiality of its amount, we consider this matter a key audit matter.</p> | <p>enquires of specialists of the Bank to understand the recovery strategy defined and the assumptions used;</p> <ul style="list-style-type: none"> <li>➤ With the support of specialists in internal risks, we assessed the reasonableness of the parameters used in the calculation of impairment, with the following procedures realized being highlighted: <ul style="list-style-type: none"> <li>i) understanding of the methodology formalized and approved by the management body and comparison with that effectively used;</li> <li>ii) assessment of the changes to the models to determine parameters to reflect the expected loss;</li> <li>iii) analysis of the changes made during the 2018 financial year to the risk parameters (PD, LGD and EAD);</li> <li>iv) on a sample basis, comparison of the data used in determining the risk parameters with source information;</li> <li>v) enquiries of specialists of the Bank responsible for the models, of the previous auditors and inspection of the internal audit, regulatory and previous auditors’ reports;</li> <li>vi) inspection of the reports with the results of the operational assessment of the model (back-testing).</li> </ul> </li> <li>➤ We obtained the understanding and evaluated the design of the model for the calculation of expected loss, tested the calculation, compared the information used in the model, through reconciliations prepared by the Bank, with source information, evaluated the assumptions used to overcome data gaps, compared the parameters used with the results of the estimation models, compared the results with the amounts in the financial statements;</li> <li>➤ Analysis of the disclosures included in</li> </ul> |

| Description of the main risks of material misstatement | Summary of our response to the main risks of material misstatement  |
|--|---|
|  | the explanatory notes to the financial statements, based on the requirements of the international financial reporting standards and the accounting records. |

## Other Matters

We were appointed Statutory Auditors of BEST – Banco Electrónico de Serviço Total, S.A., on 28 May 2018. The financial statements related to the financial year ended on 31 December 2017 were examined by another Statutory Audit Firm, which Statutory and Audit Report, dated as of 24 April 2018, contained no qualifications or emphases. Given this is a first-year audit, we carried out a number of transition procedures with the previous auditor under the terms laid down in ISA 510 – Initial audit work – opening balances.

## Responsibilities of the management and the supervisory bodies for the financial statements

The management body is responsible for:

- the preparation of financial statements, which present fairly the financial position, the financial performance and the cash flows of the Bank in accordance with International Financial Reporting Standards, as adopted by the European Union;
- the preparation of the Management Report in accordance with the applicable laws and regulations;
- the creation and maintenance of an appropriate system of internal control to enable the preparation of financial statements that are free from material misstatement due to fraud or error;
- the adoption of appropriate accounting policies and criteria under the circumstances; and
- the evaluation of the Bank’s capacity to maintain its continuity, disclosing, when applicable, the matters that may raise significant doubts as to the continuity of its activities.

The supervisory body is responsible for overseeing the process of the preparation and disclosure of the Bank’s financial information.

## Auditor’s responsibilities for the audit of the financial statements

Our responsibility is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud or error, and to issue a report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISA will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of those financial statements.

As part of an audit in accordance with ISA, we exercise professional judgment and maintain professional scepticism throughout the audit and also:

- identify and assess the risks of material misstatement of the financial statements, due to fraud or error, design and perform audit procedures that respond to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- obtained an understanding of the internal control relevant to the audit in order to design audit procedures that are appropriate under the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control;
- evaluated the appropriateness of the accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management body;
- concluded on the appropriateness of the use, by the management body, of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern.

If we conclude that a material uncertainty exists, we are required to draw attention in our report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion.

Our conclusions are based on the audit evidence obtained up to the date of our report. However, future events or conditions may cause the Bank to cease to continue as a going concern;

- evaluated the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation;
- obtained sufficient and appropriate audit evidence related to the financial information of the entities or activities within the Bank to express an opinion on the financial statements. We are responsible for the orientation, supervision and performance of the audit of the Bank and are the ultimate responsible entity for our audit opinion;
- communicated with those charged with governance, including the supervisory body, regarding, among other matters, the planned scope and timing of the audit and the significant audit findings, including any significant weaknesses in internal control identified during our audit;
- regarding the matters we have communicated to those charged with governance, including the supervisory body, we determined which of these were the most important in the audit of the financial statements of the current year, these being the key audit matters. We describe these matters in our report, except when the law or regulation prohibits their public disclosure; and
- declared to the supervisory body that we comply with the relevant ethical requirements regarding independence and communicated all relationships and other matters that may be perceived as threats to our independence and, where applicable, the respective safeguards.

Our responsibility also includes verifying that the information included in the Management Report is consistent with the financial statements.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

### **On the Management Report**

In compliance with paragraph e) of No. 3 of Article 451 of the Portuguese Commercial Companies Code, we are of the opinion that the Management Report has been prepared in accordance with applicable requirements of the law and regulations in force, that the information included in the Management Report is consistent with the audited financial statements and, taking into account the knowledge and assessment of the Bank, no material misstatements were identified.



## **On the additional information required in Article 10 of the Regulation (EU) 537/2014**

In compliance with Article 10 of the Regulation (EU) 537/2014 of the European Parliament and of the Council, of 16 April 2014, and in addition to the key audit matters referred to above, we also report the following information:

- We were appointed auditors of BEST- Banco Electrónico de Serviço Total, S.A. for the first time at the Shareholders' General Meeting of 28 May 2014 for the term of office 2018-2020;
- The management body has confirmed to us it has no knowledge of the occurrence of any fraud or suspicion of fraud with material effect on the financial statements.

In the planning and execution of our audit in accordance with IAS we maintained professional scepticism and designed audit procedures to address the risk of material misstatement due to fraud in the financial statements. Based on the work performed, we have not identified any material misstatement in the financial statements due to fraud;

- We confirm that our audit opinion is consistent with the additional report that was prepared by us and issued to the Bank's supervisory body on 4 April 2019; and
- We declare that we did not provide any prohibited non-audit services referred to in No. 8 of Article no. 77 of the by-laws of the Institute of Statutory Auditors ("Estatutos da Ordem dos Revisores Oficiais de Contas") and that we remained independent of the Bank during the conduct of our audit.

Lisbon, 4 April 2019

Ernst & Young Audit & Associados – SROC, S.A.  
- Sociedade de Revisores Oficiais de Contas  
represented by:

António Filipe Dias da Fonseca Brás – Statutory Auditor no. 1661  
Registered with the CMVM under no. 20161271

**REPORT AND OPINION**  
**OF THE SUPERVISORY BOARD**

**BEST - Banco Electrónico de Serviço Total, S.A.**

**Financial period 2018**

To the Shareholders of  
BEST - Banco Electrónico de Serviço Total, S.A.

1. In accordance with the legal and statutory provisions, we are bound to present for your appraisal our report on the supervisory activity carried out by the Supervisory Board, as well as to issue an opinion on the management report and proposed appropriation of results that the Board of Directors of BEST - Banco Electrónico de Serviço Total, S.A. (Bank) presented in respect of the financial year ended on 31 December 2018 and, also, our appraisal of the respective statutory audit report issued by the statutory audit firm.
2. The Supervisory Board carried out with regularity the functions attributed to it, namely having performed the verifications it considered convenient, attended periodic meetings and appraised the accounting elements that were regularly made available to it, as well as the supplementary explanations that were given to same by the Board of Directors. To the effect, we met regularly with the Executive Commission and the Board of Directors of the Bank, as well as with the persons responsible for the relevant areas, namely risk management, compliance, accounting and corporative internal audit.
3. The order of the accounting records was verified as was the process for the monitoring and accompanying of the Bank's activity, with those responsible for the operational areas having met with the Supervisory Board, presented the main trends and evolutions occurring at the level of the activity developed and the results obtained. We verified the compliance with the law and with the articles of association.
4. In order to guarantee an adequate supervision of the effectiveness of the risk management system, of the internal control system and of the internal audit system, the Supervisory Board met with: (i) those responsible for the Internal Audit Department of the Group, given that this consists of a corporative function; (ii) those responsible for the area identifying and

monitoring the risk system and compliance; and (iii) the external auditors, having taken note of the different phases of the work carried out. No situations were communicated to us of abnormal risks or significant weaknesses in the internal control system that may have a material impact on the financial statements.

5. The Supervisory Board reviewed the accounting policies and valuation criteria adopted by the Bank which aim to ensure the presentation of a true and fair view of the financial position and of the results of its operations. In addition, the Supervisory Board accompanied the process of the preparation and disclosure of the financial information, with same being adequate.

During the course of the present financial year, the Bank implemented a set of actions aimed at compliance with the regulatory framework resulting from MiFID II.

6. We met with the Bank's Statutory Auditor, having taken note of the results of the work carried out in the different phases of the audit work, namely the risks identified in the planning phase and the response to same conceived by the audit team, the audit tests planned, the work carried out and the respective conclusions. The Statutory Auditor accompanied the process of the preparation and presentation of the financial statements of the Bank, having made the Supervisory Board aware of its conclusions on and agreement with the documents prepared by the Board of Directors.

We took note of the Statutory Audit Report on the financial statements for financial year 2018 issued by the statutory audit firm, without any qualifications or emphases, and with which we concur.

It is the understanding of the Statutory Auditor that the key matter of the audit was the impairment losses of loans and advances to customers. In this area, the audit procedures and tests considered relevant under the circumstances were carried out.

The Statutory Auditor, through the Additional Report addressed to the Supervisory Board, communicated the relevant aspects of the work carried out and respective conclusions.

We verified the independence of the Statutory Auditor for the exercising of the functions, with same meeting the necessary independence requirements.

7. We appraised the management report and the financial statements of the Bank that were presented to us by the Board of Directors. The management report complies with the legal and statutory provisions, referring the more relevant aspects of the activity during the financial year. The financial statements were prepared in accordance with the accounting referential in force, with the main accounting principles and valuation criteria adopted being adequate and allowing for same to present a true and fair view of the financial position and of the results of the Bank.

As referred in the Management Report, the Bank maintained its leadership strategy in the innovation of the financial products and services offer, in its various aspects. Simultaneously, the Bank reinforced its investment in its technological base at the level of the Hardware, having also started its program to update and upgrade its core system (Siebel/Oracle).

Likewise, the Bank has been strengthening its internal control system with digital-based initiatives.

8. Given the activity developed by the Bank, namely in the area of customer portfolios' management, an efficient monitoring of its internal control and the continuous evaluation of its operational effectiveness comprises an essential factor for the mitigation of risk, namely the risk of fraud, with the Bank having strengthened its controls in these areas.

#### Opinion

9. As a result of the supervisory actions realized and the appraisal of the documents referred to in the previous numbers, the Supervisory Board is of the opinion that the Shareholders' General Meeting approve:
  - a) The Management Report and financial statements and other accountability documents for the financial year ended on 31 December 2018, as presented by the Board of Directors;
  - b) The proposed appropriation of results presented by the Board of Directors.
10. Finally, the Supervisory Board wishes to thank the members of the Board of Directors, the Statutory Auditor and the Employees of the Bank for all the collaboration received during the exercise of its functions.

Lisbon, 5 April 2019

The Supervisory Board

Chair - António Joaquim Andrade Gonçalves

Member - Isabel Maria Beja Gonçalves Novo

Member - Fernando Jorge Henriques Bernardo