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## **1. Introduction**

Related to the implementation of the Capital Requirements Directive (CRD), financial institutions have to fulfil several disclosure requirements. The aim is to make information available to the public relating to solvency aspects and risk profile of the institution. The requirements are part of the so-called Pillar III of the CRD, or Disclosures and Market Discipline and have been included in the Financial Supervision Act (Wet op het financieel toezicht/Wft). These requirements are effective as of 1 January 2008. This document contains Pillar III disclosures of GarantiBank International N.V. (hereinafter referred to as “GBI”) as at 31 December 2011.

## **2. Scope of Application**

The scope of application of the requirement of the Disclosures and Market Discipline Directive requirement is confined to GBI including its branches. The information disclosed in this document is not subject to an external audit whereas was verified and approved internally by GBI.

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### 3. Overview on the Risk Governance at GBI

The risk management culture at GBI supports value creation by providing insight into the levels of risk that can be absorbed, compared with the earnings power and the capital base. Integrated risk management has become a key ingredient in GBI's strategy.

Senior management holds the ultimate responsibility to ensure that GBI is operating with adequate level of capital in order to sustain the financial stability of the Bank. Risk Management at GBI is structured as an integrated effort under various levels within the organization. The Audit and Risk Management Committee of the Supervisory Board is the ultimate authority for the monitoring of all material risks, setting the risk appetite of the Bank and monitoring the adequacy of capital and liquidity at the board level.

The Risk Management Committee (RMC), which is chaired by the CEO, is responsible for the coordination and monitoring of risk management activities within the Bank and reports directly to the Audit and Risk Management Committee of the Supervisory Board. Other risk committees are established to manage more specifically the key banking risks; the Credit Committee for credit risk, Asset & Liability Committee (ALCO) for market, interest rate and liquidity risks, and the Legal and Compliance Committees for legal and compliance risks.

The Internal Audit Department (IAD) is responsible for the monitoring of the proper functioning of the governance framework around risks through regular audits and reports these to the Audit and Risk Management Committee of the Supervisory Board.

The Risk Management Department (RMD) is an independent risk control unit, which does not have any involvement in commercial activities. RMD is responsible for the quantification and monitoring of the material risks in terms of economic capital and regulatory capital in order to limit the impact of potential events on the financial performance of the Bank. Risks are continuously monitored through a well established Internal Capital Adequacy Assessment Process (ICAAP) and reported comprehensively to the related committees and limits are established as per the risk appetite of the Bank. RMD presents ICAAP report to the Supervisory Board Audit and Risk Management Committee and follows up the key financial risks on an ongoing basis as per the methodologies set within ICAAP.

RMD develops and implements risk policies, procedures, methodologies and risk management infrastructures that are consistent with the regulatory requirements, best market practices and the needs of business lines. RMD also coordinates all efforts for compliance of the Bank's risk management policies and practices with Basel principles and the Financial Supervision Act (FSA, Wet op het financial toezicht / Wft).

2011 saw a restructuring of these various control functions at GBI, with the resulting Risk Management, Control and Reporting (RMCR) Division serving as a centre for the Risk Management Department (RMD), Internal Control Unit (ICU), Financial Control (FC), and Management Reporting (MR) Departments. The Bank aims to streamline the risk and control functions in the most effective manner and to further promote risk management throughout the organization. The new structure also provides an integration of previously overlapping functions in different departments, and promotes efficient handling of all types of reporting requirements and financial control processes. Following the integration of ICU under RMD, the latter department is also involved in the monitoring and reporting of operational risks and establishing preventive control processes.

During 2011, all rating models have been validated by independent third party experts. The Internal Audit Department has reviewed the use of the models and the data quality. De Nederlandsche Bank N.V. (DNB) has reviewed the ICAAP within the scope of Supervisory Review Process.

## 4. Own Funds

GBI's capital base consists of two parts: Tier 1 (primary) and Tier 2 (supplementary) capital. Tier 1 capital of GBI consists of fully paid-in capital and retained earnings including current year profit. Deductions from Tier 1 capital includes 50% of the excess<sup>1</sup> of expected loss over provisions (IRB provision shortfall). No hybrid capital products are used at GBI. Therefore, the common equity Tier 1 is equal to the Total Tier 1 Capital. Tier 2 capital of GBI consists of revaluation reserves and subordinated debt. The remaining 50% of the IRB provision shortfall is deducted from Tier 2 capital.

The subordinated debt comprises subordinated retail deposits and subordinated loan received. These debt instruments are subordinated with respect to the other current and future liabilities of GBI. The original maturity of the retail deposits ranges from five to ten years.

The Bank has fully paid back the subordinated lower Tier 2 notes, with an amount of Eur 30 mio in 2011. A subordinated loan with an original maturity of ten years has been received with the same amount.

In line with article 64, paragraph 3 c) of the directive 2006/48/EG the amount of subordinated debt that is included in the own funds is gradually amortized if its remaining maturity falls below five years.

Please find below an overview of GBI's own funds composition as at 31.12.2011.

**Table 1**

(EUR 1,000)	31.12.2011	31.12.2010
<b>Tier 1</b>		
Paid-in and called-up capital	136,836	136,836
Eligible reserves	239,045	185,423
IRB provision shortfall	-4,684	-5,176
<b>TOTAL Tier 1</b>	<b>371,197</b>	<b>317,083</b>
<b>Tier 2</b>		
Revaluation reserves	-	2,084
IRB provision shortfall	-4,684	-5,176
Subordinated debt	41,631	42,870
<i>Subordinated retail deposits</i>	11,631	12,870
<i>Subordinated loan</i>	30,000	30,000
<b>TOTAL Tier 2</b>	<b>36,947</b>	<b>39,778</b>
<b>TOTAL Eligible Capital</b>	<b>408,144</b>	<b>356,861</b>

Total own funds of GBI increased by 14% mainly due to the addition of net profit of the current year amounting to EUR 53.6 mio to the reserves.

<sup>1</sup> If the total impairment provisions exceed the expected loss, it is added to Tier 2 capital up to the limit of 0.625% of credit risk weighted assets.

## 5. Regulatory Capital Requirements

Total of Tier 1 and Tier 2 capital should correspond to at least eight per cent of the banks' risk weighted assets, of which Tier 1 capital must constitute at least four per cent.

GBI applies Foundation Internal Ratings Based (F-IRB) Approach for credit risk of Corporate, Bank and Sovereign portfolios since 1 January 2008 based on the permission obtained from DNB. Exposures related with Retail and Private Banking, are subject to permanent exemption from F-IRB and are treated under Standardised Approach (SA). GBI uses Standardised Measurement Approach for market risk and Basic Indicator Approach for operational risk in the calculation of the minimum level of required capital. In the table below, an overview of capital requirement and net exposure at 31 December 2011 is presented.

**Table 2**

(EUR 1,000)	31.12.2011		31.12.2010	
	Gross Exposure	Capital Requirement	Gross Exposure	Capital Requirement
<b>Credit Risk</b>				
<b><i>F-IRB approach:</i></b>				
Central governments and central banks <sup>2</sup>	928,268	15,731	634,451	11,022
Institutions	1,866,780	57,648	1,976,624	76,853
Corporates	1,742,117	59,002	1,319,984	46,186
Corporates (Specialised Lending) <sup>3</sup>	384,899	19,037	358,525	19,045
<i>Total F-IRB approach</i>	4,922,064	151,418	4,289,584	153,106
<b><i>Standardised approach:</i></b>				
Central governments and central banks <sup>2</sup>	-	-	-	-
Institutions	-	-	2,012	81
Corporates	143,297	4,170	75,632	2,389
Retail	21,142	1,150	11,957	553
Equity	250	20	319	24
Other non credit-obligation assets	21,724	1,738	29,988	2,399
<i>Total Standardised approach</i>	186,412	7,078	119,908	5,447
<b>Total Credit Risk</b>	<b>5,108,476</b>	<b>158,496</b>	<b>4,409,492</b>	<b>158,553</b>
<b>Total Market Risk, standardised approach</b>		<b>504</b>		<b>7,923</b>
<b>Total Operational Risk, basic indicator approach</b>		<b>12,332</b>		<b>11,600</b>
<b>Total Capital Requirement</b>		<b>171,332</b>		<b>178,076</b>
<b>Total RWA</b>		<b>2,141,648</b>		<b>2,225,948</b>
<b>Tier 1 Ratio</b>		<b>17.33%</b>		<b>14.24%</b>
<b>Solvency Ratio</b>		<b>19.06%</b>		<b>16.03%</b>

<sup>2</sup> GBI applies IRB approach for the capital requirement calculation of exposures to central governments and central banks. However the capital requirement calculation for the exposures central governments and central banks that satisfy the conditions for 0% weighting is performed by using SA, as per DNB's national discretion. These exposures amount to EUR 750 mio (2010: EUR 467 mio) and are classified under IRB in this table.

<sup>3</sup> GBI applies Supervisory Slotting Criteria approach for the calculation of capital requirement of Specialised Lending exposures.

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The capital requirement under Pillar 1 is EUR 171.3 mio. The largest part (93%) of the capital requirement relates to credit risk. 96% of the credit risk weighted assets are treated under F-IRB approach. GBI operates at a comfortable solvency level of 19.06% with a strong Tier 1 ingredient of 17.33%. Solvency and Tier 1 ratios increased by 22% and 19%, respectively compared to 2010. This solvency level provides a strong base to the Bank for the implementation of Basel III. An overview of new regulations is provided in Chapter 7.

## 5.1. Credit Risk

Credit risk is one of the most severe risks that a financial institution might face. This type of risk is inevitably associated with the counterparties of a bank, with whom it has either directly or indirectly credit relations and is exposed to the risk of loss if counterparties fail to fulfil their agreed obligations and the pledged collateral does not cover GBI's claims.

At GBI, credit risk arises mainly from trade finance lending and treasury activities but also from various other sources. GBI is mainly involved in low default portfolios such as sovereigns, banks, large corporate companies and trade finance activities. The credit risk framework of GBI is built in a way that allows classifying counterparties, segregating them and subsequently applying specific processes to effectively cope with credit risks. All business flows implying credit risk are routed via the Credit Division that in turn is subdivided into separate teams responsible for assessing and managing credit risks pertinent to corporate counterparties, financial institutions and sovereigns. The aggregation of business flows in Credit Division allows adequate evaluation of the global balance of risks and exposures. Credit Division is not a front office and has no commercial or profit concerns.

The risk assessment approaches for different types of counterparties within above mentioned subdivisions are different and adjusted to the specific properties of each subdivision type (e.g. financial institutions, non-bank financial institutions, trading companies, industrial corporates) and to the variety of transactions typically handled (e.g. trade finance, shipping finance, treasury, private banking etc).

Being an F-IRB Bank for calculating the required regulatory capital, GBI has dedicated internal rating models for all asset classes for evaluating the creditworthiness of the counterparties. The rating models are integrated in the credit allocation and monitoring processes. Risk rating models serve as a basis for calculation of the regulatory capital and economic capital that GBI has to maintain to cover expected and unexpected losses from its lending activities. Ratings are also integral parts of pricing and risk based performance measurement processes.

The Credit Committee is responsible for the control of all credit risks arising from the banking book and the trading book, i.e. counterparty risks (for sovereigns, banks, corporates and specialized lending facilities) and concentration risks (single name, industry and country concentrations).

The effectiveness of risk monitoring is supported by internal systems ensuring proper compliance to segregation of duties and authorizations principle. Every transaction under approved credit limits requires a number of authorizations and controls prior to execution and cannot be finalized without those processes. Under this structure, every commercial initiative goes through multiple checks and is inputted in the system by authorized personnel who are functionally separated from the personnel with commercial targets. Regular monitoring of GBI's exposure and compliance with the established credit limits ensure timely management of credit risk. The exposures to various customers, business lines and geographical locations are monitored on a daily basis by assigned account and credit officers, while compliance with the established limits is controlled by an independent unit that provides independent judgement.

The credit follow-up process is divided into two main parts which are; follow-up of the customer and follow-up of the credit facility itself. The follow-up of the customer is associated with the credit risk, whereas follow-up of credit facility (i.e. documentation) is related to credit risk mitigation and operational risk. The credit facility follow-up is a dynamic process and distinguished in performing, watch list, default, provision and write-off stages. All shifts within those categories either in the direction of downgrading or upgrading, are done after approval of GBI's Credit Committee. A loan may be shifted to the watch list based on the events outlined in pre-defined warning signals. In case a loan is classified by the Credit Committee as 'in default' it is shifted to the impaired loan list.

The internal information system of GBI offers great flexibility in delivering information on regular and ad-hoc basis and allows producing a variety of daily reports that comprise all exposures and concentrations by geographical location, commodity type, supplier and many other criteria.

### 5.1.1. Exposure Amounts before Credit Risk Mitigation

The total credit exposure after provisions and before credit risk mitigation is as follows:

**Table 3**

(EUR 1,000)	Average Exposure		Total Exposure		
	Q1-Q4 2011	Q4-2011	Q3-2011	Q2-2011	Q1-2011
Central gov. and central banks	588,822	928,268	531,742	363,993	531,285
Institutions	1,982,148	1,866,780	1,828,955	2,000,554	2,232,302
Corporate	2,119,412	2,270,312	2,339,714	2,024,338	1,843,285
Retail	15,762	21,142	17,003	13,190	11,715
Equity	284	250	250	317	319
Other non credit-obligation assets	24,012	21,724	24,529	24,833	24,962
<b>Total</b>	<b>4,730,440</b>	<b>5,108,476</b>	<b>4,742,192</b>	<b>4,427,224</b>	<b>4,643,869</b>

### 5.1.2. Geographical Breakdown of the Exposures

The following table gives an overview of the geographical breakdown of gross exposure by material exposure classes based on customer residence:

**Table 4**

(EUR 1,000)	The Netherlands	Other Europe	Turkey	CIS countries	Rest of the World	Total
<b>31.12.2011</b>						
Central gov. and central banks	561,544	277,425	69,847	19,451	-	928,267
Institutions	140,748	609,019	757,459	229,929	129,625	1,866,780
Corporates	176,587	611,254	926,561	36,715	519,196	2,270,313
Retail	2,916	973	17,253	-	-	21,142
Equity	250	-	-	-	-	250
Other non credit-obligation assets	21,502	222	-	-	-	21,724
<b>Total</b>	<b>903,547</b>	<b>1,498,892</b>	<b>1,771,120</b>	<b>286,095</b>	<b>648,821</b>	<b>5,108,476</b>
Percentage of total	17.7%	29.3%	34.7%	5.6%	12.7%	100.0%
<b>31.12.2010</b>						
Central gov. and central banks	256,505	283,870	86,572	7,504	-	634,451
Institutions	83,643	501,002	875,974	344,514	173,504	1,978,637
Corporates	120,734	550,890	697,951	57,190	327,376	1,754,141
Retail	3,008	958	7,991	-	-	11,957
Equity	318	-	-	-	-	318
Other non credit-obligation assets	24,866	5,122	-	-	-	29,988
<b>Total</b>	<b>489,074</b>	<b>1,341,842</b>	<b>1,668,488</b>	<b>409,209</b>	<b>500,880</b>	<b>4,409,492</b>
Percentage of total	11.1%	30.4%	37.8%	9.3%	11.4%	100.0%



### 5.1.3. Effective Maturity Breakdown

GBI mainly enters into transactions with short maturities. 81.4% of the total credit exposures have effective maturity of lower than one year. The effective maturity breakdown of gross exposure based on exposure classes is as follows:

**Table 5**

(EUR 1,000)	< 3 Months	< 6 Months	< 1 Year	< 2 Years	< 3 Years	< 5 Years	Total
<b>31.12.2011</b>							
Central gov. and central banks	749,688	-	-	5,432	31,250	141,897	928,267
Institutions	883,383	239,751	329,388	68,516	141,573	204,169	1,866,780
Corporates	1,349,431	271,589	295,092	122,830	91,740	139,631	2,270,313
Retail	12,467	1,522	1,767	255	1,771	3,360	21,142
Equity	250	-	-	-	-	-	250
Other non credit-obligation assets	-	-	-	-	-	21,724	21,724
<b>Total</b>	<b>2,995,219</b>	<b>512,862</b>	<b>626,247</b>	<b>197,033</b>	<b>266,334</b>	<b>510,780</b>	<b>5,108,476</b>
Percentage of total	58.6%	10.0%	12.3%	3.9%	5.2%	10.0%	100.0%
<b>31.12.2010</b>							
Central gov. and central banks	425,726	-	39,800	55,255	6,258	107,412	634,451
Institutions	702,921	315,929	466,527	135,995	107,397	249,868	1,978,637
Corporates	956,995	185,975	179,580	216,152	93,846	121,593	1,754,141
Retail	4,501	137	1,192	971	222	4,934	11,957
Equity	318	-	-	-	-	-	318
Other non credit-obligation assets	-	-	-	-	-	29,988	29,988
<b>Total</b>	<b>2,090,461</b>	<b>502,041</b>	<b>687,099</b>	<b>408,373</b>	<b>207,723</b>	<b>513,795</b>	<b>4,409,492</b>
Percentage of total	47.4%	11.4%	15.6%	9.3%	4.7%	11.7%	100.0%

### 5.1.4. Breakdown of the Exposures by Industry

The breakdown of gross exposure by industry and exposure class is as follows:

**Table 6**

(EUR 1,000)	31.12.2011		31.12.2010	
	Total	% of Total	Total	% of Total
<b>Central governments and central banks</b>	<b>928,267</b>	<b>18.2%</b>	<b>634,451</b>	<b>14.4%</b>
<b>Institutions</b>	<b>1,866,780</b>	<b>36.5%</b>	<b>1,978,637</b>	<b>44.9%</b>
<b>Corporates</b>				
Basic materials	633,726	12.4%	476,027	10.8%
Financial services	397,188	7.8%	295,303	6.7%
Transport & logistics	233,110	4.6%	172,335	3.9%
Chemicals	162,640	3.2%	151,990	3.4%
Oil & Gas	153,464	3.0%	115,001	2.6%
Construction	119,749	2.3%	49,170	1.1%
Consumer products	118,042	2.3%	71,999	1.6%
Agriculture	97,731	1.9%	70,227	1.6%
Telecom	60,607	1.2%	86,147	2.0%
Media	40,569	0.8%	8,671	0.2%
Utilities	31,290	0.6%	31,471	0.7%
Food, beverages and Tobacco	27,934	0.5%	77,540	1.8%
Insurance and pension funds	16,717	0.3%	17,172	0.4%
Wholesale	10,587	0.2%	678	0.0%
Leisure and Tourism	10,014	0.2%	1,406	0.0%
Services	4,863	0.1%	6,109	0.1%
Automotive	-	0.0%	35,793	0.8%
Other	152,082	3.0%	87,102	2.0%
<b>Retail</b>	<b>21,142</b>	<b>0.4%</b>	<b>11,957</b>	<b>0.3%</b>
<b>Equity</b>	<b>250</b>	<b>0.0%</b>	<b>318</b>	<b>0.0%</b>
<b>Other non credit-obligation assets</b>	<b>21,724</b>	<b>0.4%</b>	<b>29,988</b>	<b>0.7%</b>
<b>Total</b>	<b>5,108,476</b>	<b>100.0%</b>	<b>4,409,492</b>	<b>100.0%</b>

## 5.1.5. Past Due and Impaired Exposures, Provisions and Value Adjustments

A loan is recognized as impaired if there is an objective evidence of impairment. This evidence could be given by, but is not limited to, the events listed below:

- It is probable that the borrower will enter bankruptcy or other financial reorganization
- The debtor has payment defaults against the third parties, the customers, banks, employees, etc
- The debtor has been in arrears for at least 90 days with regard to repayment of principal and/or interest
- Observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets
- A breach of contract, such as a default or delinquency in interest or principal payments
- Significant financial difficulty of the issuer or obligor
- The disappearance of an active market for that financial asset because of financial difficulties

For problematic loans on the impairment list, GBI attempts to ensure recovery by restructuring, obtaining additional security and/or proceeding with legal actions. Provisions are proposed by Credits Department and approved and established by the Credit Committee, for the outstanding amount of the defaulted credit facility after deduction of expected recoveries and/or liquidation value of the collaterals. The provisioned credit facility is further proposed by Credits Department to the Credit Committee for write-off after all possible means of recovery have been exhausted. Below table provides information on the impaired loans and provisions by exposure class:

**Table 7**

(EUR 1,000)	31.12.2011		31.12.2010	
	Impairment <sup>4</sup>	Provisions	Impairment <sup>4</sup>	Provisions
Corporates	49,020	24,551	45,085	24,858
Retail	993	993	1,032	1,032
<b>Total</b>	<b>50,013</b>	<b>25,544</b>	<b>46,117</b>	<b>25,891</b>
<b>Loan Loss Reserve Ratio</b>	<b>51.1%</b>		<b>56.1%</b>	

Loan loss provisions are at 51.1% level and reflect the robust recoveries expected due to the collateralised nature of the credit portfolio. Below table gives an overview of the impaired and past due exposures and the provisions set aside by the residence of the counterparty:

**Table 8**

(EUR 1,000)	Impaired Exposures	90 Days Past Due <sup>5</sup>	Provisions for Impairment
<b>31.12.2011</b>			
The Netherlands	2,612	176	1,454
Other Europe	29,788	-	12,468
CIS countries	5,152	-	2,576
Rest of the world	9,155	-	5,833
Turkey	3,305	-	3,213
<b>Total</b>	<b>50,013</b>	<b>176</b>	<b>25,544</b>
<b>31.12.2010</b>			
The Netherlands	811	-	811
Other Europe	38,535	-	18,309
CIS countries	-	-	-
Rest of the world	3,970	-	3,970
Turkey	2,801	-	2,801
<b>Total</b>	<b>46,117</b>	<b>-</b>	<b>25,891</b>

<sup>4</sup> Impaired exposures after deduction of financial collaterals

<sup>5</sup> This amount refers to 90 days past due, but not provisioned exposures.

Exposure is past due if a debtor has failed to make a payment of principal and/or interest when contractually due. The 90 days past due amount which is not provisioned is EUR 176 thousands in 31.12.2011.

The actual value adjustments in the preceding periods for each exposure class are as follows:

**Table 9**

(EUR 1,000)	31.12.2011	31.12.2010
Position as of 1 January	25,891	31,925
Additions	6,203	11,535
Write-offs	(39)	(15,231)
Releases	(6,776)	(3,008)
Exchange rate differences	265	670
<b>Position as of 31 December</b>	<b>25,544</b>	<b>25,891</b>

The new provision set aside has decreased substantially compared to the last year. Due to the fact that the collection amount is higher than the addition in 2011, the provision set aside for impaired loans decreased by 1.3% compared to 31.12.2010.

### 5.1.6. Counterparty Credit Risk

Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flow. The exposure value of the counterparty credit risk is calculated according to chapter 5 of the Dutch Central Bank's Supervisory Regulation on Solvency Requirements for Credit Risk. Establishment of a credit limit for counterparty credit risk includes, but is not limited to, for the products below:

- Spot and forward foreign exchange (FX) transactions
- Currency transactions including currency swaps
- Options
- Forward rate agreement (FRA)
- Interest rate swaps
- Credit default swaps (CDS), etc
- Securities lending or borrowing transactions

Credit risk from derivatives mitigated by netting agreements where assets and liabilities of the same counterparty with the same maturity and same underlying is netted. Collateral is obtained against derivative transactions based on the riskiness of the counterparties. In order to mitigate the credit risk of the counterparties, GBI obtains ISDA master agreements with Credit Support Annex (CSA), which serve to exchange collateral for obligations resulting from derivatives.

Please find below an overview of the derivative exposures and repurchase transactions:

**Table 10**

(EUR 1,000)	Gross Exposure <sup>6</sup>	Gross positive fair value	Collateral held	Positive fair value after collateral
<b>31.12.2011</b>				
Repurchase transactions	499,064	499,064	418,861	80,203
Interest rate swaps	5,238	-	-	-
FX swaps	82,167	60,110	10,436	49,674
FX spot and forwards	7,526	1,929	139	1,790
Currency options	25,848	29,876	9,817	20,059
Other options	496	2,193	160	2,033
<b>Total</b>	<b>620,338</b>	<b>593,172</b>	<b>439,414</b>	<b>153,758</b>
<b>31.12.2010</b>				
Repurchase transactions	460,886	460,886	359,272	101,614
Interest rate swaps	8,588	-	-	-
FX swaps	64,125	35,669	2,617	33,052
FX spot and forwards	2,648	384	140	244
Currency options	11,485	9,843	7,565	2,278
Other options	827	960	7	953
<b>Total</b>	<b>548,558</b>	<b>507,742</b>	<b>369,601</b>	<b>138,141</b>

### 5.1.7. Credit Risk Mitigation

GBI applies diversified collateral requirements and systematic approaches to collaterals submitted by customers, which depend on the transaction type and purpose, including but not limited to cash margins, physical commodities, receivables, cash flows, guarantees, accounts, financial instruments and physical commodities. The value of collateral is usually monitored on a daily basis to ensure timely corrections or measures are taken, if necessary.

Credit risk mitigants are financial collaterals and guarantees which directly decrease the credit exposure or transfer the credit risk from obligor to guarantor. The range of collateral that is eligible for the use of credit risk mitigation is based on the regulatory capital calculation method that is used. GBI uses Comprehensive – IRB method in the calculation of credit risk mitigation factors.

The total exposure value that is covered by financial and other collaterals that are recognized as eligible credit risk mitigation by the capital requirements directive is as follows:

**Table 11**

(EUR 1,000)	Financial Collateral	Guarantees	Other Collateral	Total
<b>31.12.2011</b>				
Central governments and central banks	165,000	-	-	<b>165,000</b>
Institutions	335,848	-	-	<b>335,848</b>
Corporates	198,295	116,321	63,987	<b>378,602</b>
Retail	6,677	-	-	<b>6,677</b>
<b>Total</b>	<b>705,820</b>	<b>116,321</b>	<b>63,987</b>	<b>886,127</b>
<b>31.12.2010</b>				
Central governments and central banks	160,000	-	-	<b>160,000</b>
Institutions	223,487	16,500	-	<b>239,987</b>
Corporates	137,128	59,778	34,802	<b>231,709</b>
Retail	4,959	-	-	<b>4,959</b>
<b>Total</b>	<b>525,574</b>	<b>76,278</b>	<b>34,802</b>	<b>636,654</b>

<sup>6</sup> Credit exposures for derivative transactions are calculated as per the original exposure method.

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## 5.2. Scope of Acceptance for F-IRB Approach

GBI applies F-IRB approach for the following exposure classes:

- Central Governments,
- Institutions and
- Corporates (including sub classes such as; Corporates, Non-Bank Financial Institutions, Specialized Lending exposure classes of Commodity Finance and Shipping Finance).

Retail exposures (including sub classes Retail and Private Banking) are subject to permanent exemption from F-IRB and are treated under SA.

### 5.2.1. General Description of Models

GBI has dedicated rating models for all the sub-exposure classes as mentioned above. The rating models within the scope of F-IRB application can be grouped in two:

- Probability of Default (PD) Models: These models provide obligor grades based on the masterscale defined by GBI. The masterscale has 22 rating grades and provide sufficient granularity for risk assessment. The rating grades are converted to PD via masterscale. Masterscale is reviewed on an annual basis and updated where necessary based on the internal and external changes in observed default rates.
- Supervisory Slotting Criteria (SSC) Models: GBI has developed rating models for Specialized Lending exposure classes of Commodities Finance and Shipping Finance based on the SSC as per the conditions stated in CRD. SSC Models provide 5 grades, which are mapped to risk weights set by the regulation.

All rating models used within GBI have similar and consistent methodologies, which are based on two steps. The first step contains financial and non-financial models that produce a combined score. The models use financial information along with qualitative information that is collected through standard questionnaires. This score is further adjusted for a number of warning signals. The result is an individual rating, which is subject to an override framework in the second step. Override framework has three layers, which are; country layer, parental support and manual override.

The internal models are subject to regular cycle of validation and review performed by external and internal parties.

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## 5.2.2. Governance Framework around F-IRB Models and Processes

Credit rating models at GBI are based on a model-life cycle framework and consist of the following steps;

- Model development
- Model approval
- Model implementation
- Use and monitoring of model performance
- Model validation

Model development starts with the identification of the model requirement. This may arise from regulatory needs, improving risk management practices, changes in the risk management structure, changes in business structure that might lead to a new business line or a new asset class, a drastic change in macroeconomic or business environment that might affect risk factors, change in market practices and validation results that would necessitate model re-development.

Model approval starts after the completion of model development and model documentation. All the relevant material regarding the model development is submitted to the RMC for approval. The models are approved based on the criteria, i.e. the model should reflect risk perception of GBI, it should meet regulatory requirements and have a consistent methodology with the other models used by GBI, and it should perform adequately for that specific asset class.

Model implementation starts once the model is approved by RMC. IT related issues, data management, business line re-design and training of the user of the models are included in the generic roll-out plan of model implementation.

The models are used within the various levels of the organization. Related business lines initiate the rating process together with the credit proposals. The Credit Department reviews the rating which is then approved by the Credit Committee. The assigned rating is used for all relevant transactions of the counterparty throughout the whole credit decision making process, including credit allocation, utilization, pricing and performance monitoring.

The correct use of models is audited by IAD within the scope of the regular audit activities. RMD is responsible for ongoing monitoring of performance of the models. Model accuracy, stability, granularity, use of overrides and the data quality are key performance indicators for model performance.

Model validation framework is managed by a validation team that is composed of independent members from the model development team. In order to avoid the "Conflict of Interest" adequately, third parties are hired to ensure independence. RMC has the ultimate decision making authority in the formation of the validation team and the selection of the third party. The findings of the validation team are presented in the validation reports. These reports are immediately shared with DNB following the completion of the validation process and the developments are discussed annually within the scope of regular Supervisory Review Process. Model validation is conducted once a year and may be conducted more frequently based on the model performance.

Model maintenance is an ongoing process which follows several steps within the lifecycle of the model. GBI has established procedures in order to support the change management. These procedures explain the roles and responsibilities of the related stakeholders during the implementation of a change in the models, including detailed procedures related with the IT infrastructure of the models. These activities are audited by IAD on a regular basis in addition to the independent checks and controls carried out within the scope of the validation process.

### 5.2.3. Calculation of Risk Weighted Assets for F-IRB Exposure Classes

Risk Weighted Asset (RWA) calculation for credit risk is performed based on a regulatory formula under the F-IRB approach where the Probability of Default (PD), Maturity (M), Exposure at Default (EAD) and Loss given Default (LGD) are the factors. Under F-IRB approach, PDs are estimated by the institution while M, LGD and EAD are supervisory estimates.

Below is an overview of the portfolios within the scope of F-IRB methodology as of 31 December 2011:

**Table 12**

(EUR 1,000)	Gross Exposure	RWA	Average PD
<b>31.12.2011</b>			
Central governments and Central Banks <sup>7</sup>	928,268	196,635	0.89%
Institutions	1,866,780	720,601	0.54%
Corporates	1,742,117	737,523	0.69%
<b>Total</b>	<b>4,537,165</b>	<b>1,654,759</b>	<b>0.53%</b>
<b>31.12.2010</b>			
Central governments and Central Banks <sup>7</sup>	634,451	137,770	0.57%
Institutions	1,976,624	923,617	0.90%
Corporates	1,319,984	577,324	0.70%
<b>Total</b>	<b>3,931,059</b>	<b>1,675,756</b>	<b>0.74%</b>

### 5.2.4. Specialized Lending

Credit institutions have to distinguish specialized lending exposures within the corporate exposure class. Specialized lending exposures possess the following characteristics:

- (a) The exposure is to an entity which was created specifically to finance and/or operate physical assets;
- (b) The contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate; and
- (c) The primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.

The following table discloses the gross specialized lending exposures after provision, assigned to the different risk categories as at 31 December 2011:

**Table 13**

(EUR 1,000)		31.12.2011		31.12.2010	
Risk Weight Category	Risk Weight	Gross Exposure	RWA	Gross Exposure	RWA
Strong	50% - 70%	113,061	48,200	93,234	35,710
Good	70% - 90%	207,861	123,603	149,470	89,995
Satisfactory	115%	57,864	64,084	111,416	111,795
Weak	250%	1,205	2,077	659	568
Default <sup>8</sup>	0%	4,907	-	3,745	-
<b>Total</b>		<b>384,899</b>	<b>237,963</b>	<b>358,525</b>	<b>238,068</b>

<sup>7</sup> The capital requirement calculations for the exposures to central governments and central banks that satisfy the conditions for 0% risk weighting are calculated by using SA, as per DNB's national discretion. These exposures amount to EUR 750 mio (2010: EUR 467 mio) and are classified under IRB in this table.

<sup>8</sup> Exposures categorised as 'default' do not attract a risk weighting but are instead treated as expected loss deductions at a rate of 50% of the exposure value.

### 5.3. Market Risk

Market risk is defined as the current or prospective threat to GBI's earnings and capital as a result of movements in market factors, i.e. prices of securities, commodities, interest rates and foreign exchange rates.

GBI assumes limited market risk in trading activities by taking positions in debt, foreign exchange, other securities and commodities as well as in equivalent derivatives. The Bank has historically been conservative while running the trading book. Hence the main strategy is to keep the end of day trading positions at low levels.

GBI uses Standardised Measurement Approach in order to calculate capital requirement arising from market risk (trading book) under Pillar I. Value-at-Risk (VaR) analyses is used in order to assess the adequacy of the capital allocated under Pillar I and in daily limit monitoring process.

Below table gives the breakdown of the capital requirement as at 31.12.2011:

(EUR 1,000)	31.12.2011	31.12.2010
Foreign Exchange Risk	504	7,085
Equity Risk	-	838
<b>Total Capital Requirement</b>	<b>504</b>	<b>7,923</b>

ALCO bears the overall responsibility for the market risk and sets the limits on product and desk level. Treasury Department actively manages the market risk within the limits provided by ALCO. Middle Office (MO) and Internal Control Unit (ICU), which are both established as independent control bodies, monitor and follow-up all trading transactions and positions on an ongoing basis. Trading activities are followed-up as per the position, stop-loss and VaR limits set by ALCO. Single transaction and price tolerance limits have been established in order to minimize the operational risks involved in the trading processes. RMD is responsible for the maintenance of internal models, follow-up of risk based limits and performing stress tests and presenting the results to the related committees.

### 5.4. Operational Risk

GBI uses the Basic Indicator Approach in order to determine the capital requirement which arises from operational risk under Pillar 1. Capital requirement is equal to 15% of the relevant indicator in this methodology. The relevant indicator is the average over three years of the sum of annual net interest and net non-interest income. The three-year average is calculated on the basis of the last three financial year observations.

(EUR 1,000)	31.12.2011	31.12.2010
Operational Risk Exposure	100,419	75,779
<b>Total Capital Requirement</b>	<b>12,332</b>	<b>11,571</b>

The average of net interest income and net non-interest income over the past three years amounts to EUR 82.2 mio in 2011, which resulted in a capital requirement of EUR 12.3 mio.



## 6. ICAAP Framework

GBI has designed a comprehensive ICAAP framework by making use of qualitative and quantitative assessment methodologies where applicable. The methodologies used are believed to be the most appropriate ones in line with the risk profile of GBI and they reflect the underlying risks in a prudent manner.

ICAAP starts with the assessment of the capital allocated for Pillar I risks. The capital calculations under Pillar I are referred as Regulatory Capital (RCAP). GBI has dedicated assessment methodologies for credit, market and operational risks, which are used to come up with an Economic Capital (ECAP) figure. RCAP and ECAP are compared for each risk type under Pillar I and the maximum of RCAP and ECAP is taken as the outcome of the comparison. The total of the outcomes for each risk type is the final result of ICAAP for Pillar I risks.

The second step is to take into account the additional capital requirements arising from the risks, which are not taken into account in Pillar I. GBI has a dedicated assessment methodology for each material Pillar II risk. The capital requirement for the concentration risk and interest rate risk in the Banking Book (IRRBB) are calculated through quantitative techniques, whereas the strategic risk is assessed within the scope of capital plan.

The Bank categorizes the materiality of risks as per the groups shown in below. The categorization is made based on an appropriate qualitative or quantitative assessment of the particular risk type.

**Table 16**

Materiality	Definition	Likely Action
<b>1. Material</b>	The probability of a risk event leading to a significant or high impact is material.	Established controls and risk assessments are performed on a regular basis. Mitigating actions shall be taken. Adequate level of capital shall be allocated for the risk type where necessary
<b>2. Immaterial</b>	The probability of a risk event leading to a significant impact is low.	Established controls and risk assessments are performed on a regular basis. Mitigating actions are taken, where necessary. No capital is allocated for the risk type.
<b>3. Not Applicable</b>	Risk is not applicable at all.	No action taken.

GBI is subject to the risk types presented below as a result of the activities pursued by the Bank.

**Table 17**

<b>Risk Type</b>	<b>Covered in</b>
<b>Credit Risk</b>	Pillar I and Pillar II
<b>Concentration Risk</b>	Pillar II
<b>Market Risk</b>	Pillar I and Pillar II
<b>Operational Risk</b>	Pillar I and Pillar II
<b>Interest Rate Risk on the Banking Book</b>	Pillar II
<b>Liquidity Risk</b>	Pillar II
<b>Strategic Risk</b>	Pillar II

## **6.1. Credit Risk**

GBI has a dedicated ECAP model for credit risk, which is used as a benchmark to assess the adequacy of regulatory capital allocated for credit risk under Pillar I. A 99.9% confidence level is used in the ECAP calculations.

## **6.2. Concentration Risk**

GBI constantly follows the credit risk positions of all obligors via a comprehensive management information system. Exposures to countries and industries are followed up frequently by the Credit Division and monitored and discussed regularly at the Credit Committee.

Follow-up of large exposures is also an integral part of this process. GBI monitors the large credit exposures to group of customers and proactively manages single name concentration. Large exposures are also reviewed by Credit Committee and Supervisory Board on a regular basis. RMD monitors the concentration risk, quantifies its impact on the regulatory and economic capital, and reports to RMC.

GBI has developed an integrated quantitative methodology for the assessment of concentration risk. Concentration risk model is another economic capital methodology, which takes into account the main concentration elements in the portfolio, namely single name concentration, country concentration and industry concentration, in a more conservative manner. The outcomes of the concentration risk model are supplemented by various stress tests.

The Bank complies with the requirements of the “Policy rule on the treatment of concentration risk in emerging countries”, which is a specific regulation on concentration risk that entered into force in the Netherlands as of July 2010.

## **6.3. Market Risk**

GBI uses Value-at-Risk (VaR) methodology as a risk measure for the market risk on the trading book, in order to assess the adequacy of the capital allocated under Pillar I. VaR quantifies the maximum loss that could occur due to changes in risk factors (e.g. interest rates, foreign exchange rates, equity prices, etc) for a time interval of one day, with a confidence level of 99.9%. Limits are defined and monitored periodically. VaR is supplemented by stress tests in order to determine the effects of potential extreme market developments on the value of market risk sensitive exposures. Stress tests

have the advantage of out-of-model analyses of the trading book. Hypothetical or historical scenarios are chosen and applied to the Bank's position regularly. These scenarios are reviewed periodically and updated when necessary.

#### 6.4. Interest Rate Risk on the Banking Book (IRRBB)

Interest rate risk is defined as the risk of loss in interest earnings or in the economic value of banking book items as a consequence of fluctuation in interest rates. The asset and liability structure of the Bank creates certain exposure to IRRBB. Business units are not allowed to run structural interest mismatch positions. As a result of this policy, day-to-day interest rate risk management is carried out by the Treasury Department in line with the policies and limits set by ALCO, with the help of a well defined internal transfer pricing process.

IRRBB is measured and monitored by using Duration, Repricing Gap and Sensitivity analyses. Sensitivity analyses are based on both economic value and earnings perspectives. Interest sensitivity is measured by applying standard parallel yield curve shifts, historical simulation and user defined yield curve twist scenarios. Full pricing methodology is used for the quantification. All analyses are based on the interest rate repricing maturities. Behavioural analyses are used for the products that do not have contractual maturities, i.e. saving deposits. The repricing frequency of these products are measured based on historical observations.

The Bank has a low duration structure. Therefore sensitivity to interest rate shocks is limited. The standard parallel shock in yield curve leads to a potential decrease in economic value of EUR 2.2 mio (0.54% of the total own funds), which is well below the regulatory threshold of 20%.

**Table 18**

<b>Economic Value Sensitivity Analysis<sup>9</sup></b> (EUR 1,000)	<b>EUR</b>	<b>USD</b>	<b>TRY</b>	<b>OTHER</b>	<b>TOTAL</b>
<b>31.12.2011</b>					
Shift Up Net <sup>10</sup>	1,325	-4,801	1,642	-370	-2,204
Shift Down Net <sup>10</sup>	437	6,879	-1,707	417	6,026
Change in Economic Value					2,204
<b>Change in Economic Value / Own Funds</b>					<b>0.54%</b>
<b>31.12.2010</b>					
Shift Up Net	-15,486	-8,486	416	-418	-23,975
Shift Down Net	17,924	13,873	-410	193	31,580
Change in Economic Value					23,975
<b>Change in Economic Value / Own Funds</b>					<b>6.72%</b>

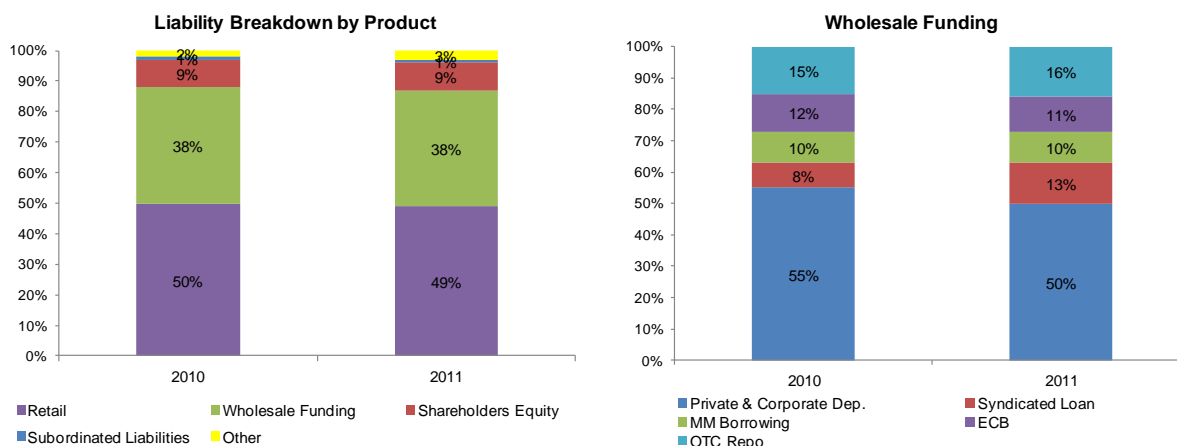
Interest rate sensitivity analysis is also used for evaluating hedging strategies, internal limit setting and limits monitoring purposes, which enables GBI to manage the interest rate risk in a proactive manner. Calculations are carried out on a weekly basis, discussed at ALCO level and used effectively in decision making processes for hedging and pricing.

<sup>9</sup> Static balance sheet, based on instant liquidation

<sup>10</sup> 200 Bps shock for G10 and 300 Bps shock for non-G10

## 6.5. Liquidity Risk

The main objective of GBI's liquidity risk policy is to maintain sufficient liquidity in order to ensure safe and sound operations. ALCO bears overall responsibility for the liquidity risk strategy. ALCO has delegated day-to-day liquidity management to the Treasury Department, which is responsible for managing the overall liquidity risk position of GBI within the limits established by ALCO.



GBI aims for a well-diversified funding mix in terms of instrument types, fund providers, geographic markets and currencies. The Bank monitors liquidity risk through gap analysis, which is supplemented by multiple stress tests designed based on different scenarios. These analyses apply shocks with different magnitudes on the liquidity position. In addition, the cash capital concept, which shows the excess of long term funds over illiquid assets, is used as a measure for long-term funding mismatch.

Scenarios are set based on bank-specific and market specific liquidity squeezes. In market specific stress scenario the assumptions are set according to market practices, regulatory guidelines and surveys. Bank specific stress scenario includes behavioural analyses in order to reflect possible liquidity structure of non-maturity assets and liabilities. Secured funding capacity is also included in the scenario which takes into account conservative haircuts.

Guidelines set by Basel Committee on Banking Supervision on the management of liquidity risk have already been incorporated within the scope of liquidity stress testing framework, which enables the Bank to manage the liquidity risk in a prudent manner based on the prospective regulatory requirements as well.

GBI complies with the regulatory requirements on liquidity risk of DNB. The regulatory limits are also closely monitored. The Bank is highly comfortable in meeting the regulatory minimum liquidity requirements, which takes into account weekly and monthly liquidity gap under regulatory stress scenario. GBI also has a detailed contingency funding plan in place for management of a liquidity crisis situation.

All liquidity analyses are reported to ALCO on a regular basis by RMD. ALCO reviews and plans the necessary actions to manage the liquidity gaps

The Bank has not endured liquidity shortages owing to the prudent liquidity policy, which is based on balancing short-term and long-term liquidity gaps simultaneously, and maintaining a high quality liquidity buffer. The Bank sustains a high quality liquidity buffer as short term placements to central banks or governments in Europe and to a very limited number of selected creditworthy counterparties as well as investments in high quality debt securities.

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GBI has a diversified mix of wholesale and retail funding sources. Retail funding, in general, is the primary funding source, which enables the Bank to have a positive liquidity gap even in the case where the wholesale funding market dries up. The non-financial counterparties, with which the Bank has established long lasting relationships through offering various financial services, constitute the major part of the wholesale funding. Although the Bank makes use of secured funding sources from time to time in order to increase the diversity of resources, the main liquidity strategy is built on unsecured funding and building a stock of high quality assets that could be used under distressed conditions.

## **6.6. Operational Risk**

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk includes potential losses caused by a breakdown in information or transaction processing and settlement systems and procedures, human errors, non-compliance with internal policies or procedures, including the possibility of unauthorized transactions by employees.

Such risks are managed through bank-wide or through business-line specific policies and procedures, controls, and monitoring tools. GBI's policy to control operational risk is communicated with and implemented in all business lines. Key elements in this policy are Know Your Customer principles, delegating tasks and responsibilities, issuing clear policies, procedures and directives, segregation of duties, four-eyes principles, carrying out supervision, taking corrective action, maintaining highly responsive accounting systems, systematic internal controls and performing periodic internal audits.

ICU has been recognized as part of the RMD in 2011. While the business lines and operation departments are jointly responsible for the day-to-day operational risk management as the first line of defence, ICU, ensures the compliance of activities of the Bank with regards to the internal policies, coordinates internal control process of the Bank by the help of centralized controlling tools and monitors the corrective actions on a consolidated basis.

IT risks are considered within the scope of operational risks. The Bank performs independent IT risk assessments by identifying the risks in relevant IT processes and validating the adequacy of the controls established around them. The assessments are performed based on the international (COBIT, Control Objectives for Information and related Technology) and national (FIRM, Financial Institutions Risk Analysis Method) standards. The control environment around the IT processes is considered as sufficient as a result of this analysis.

GBI uses a qualitative assessment methodology for the operational risk under Pillar 2. Financial Institutions Risk Analysis Method (FIRM) methodology is applied which is introduced by DNB. The standard FIRM questionnaires are filled out by IAD together with the related business lines and operations departments. The questionnaires are reviewed by IAD and taken into account proactively for several purposes, i.e. used in the preparation of the audit plan, included in the audit findings for the related department or used to design regular checks by ICU. The outcomes are also reviewed by the related departments and mitigating actions are taken where appropriate.

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## **6.7. Other Risks**

GBI has immaterial or no exposure to business risk, residual risk, pension risk, underwriting risk and securitization risk. Legal risk and settlement risk risks are monitored in regular audit activities and by way of applying FIRM assessments, together with operational risk. Strategic risk is taken into account in the capital planning process in order to account for the possible increase in the capital requirement based on the strategies or the business models that are chosen by GBI. The impact of reputation risk is included within the scope of liquidity risk management and contingency funding plan.

## **6.8. Capital Planning**

GBI's capital planning structure has been developed based on two scenarios, one of which is in line with the Bank's current expectations and financial budget. The second scenario applies more conservative assumptions in order to assess the future capital adequacy of GBI under stressed economic and financial conditions. Stress test outcomes are used to assess the adequacy of the own funds for potential future capital requirements for the next three years.

Capital plan aims to cover as many aspects as possible, including expected profit, liquidity sources, portfolio mix, capital structure and asset quality, in order to reflect the impact of several risk factors on the profitability and the capital adequacy of GBI at the same time.

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## 7. New Regulatory Standards

### 7.1. CRD II & CRD III

The changes in the treatment of large exposures and the new liquidity risk monitoring framework have been the most important regulatory changes for GBI within the CRD II and CRD III packages. The Bank has successfully finalized the implementation of these new regimes, together with the other aspects of CRD II and CRD III. GBI has taken the necessary measures to sustain the sound financial position and strong business franchise under changing regulatory rules.

Increased capital requirements for the trading book and securitizations do not have a major impact on GBI as the Bank is not involved in securitisations at all and does not run a significant trading book.

### 7.2. Basel III

With the introduction of the Basel III, the new minimum capital requirements will be in place. The Common Equity Tier 1 (CET1) requirement of 2% will be increased to 6% (4.5% plus 2.5% of capital conservation buffer), by the year 2019. In addition to that, the minimum total capital ratio requirement of 8% will be increased to 10.5% (8% plus 2.5% of capital conservation buffer). A countercyclical buffer between 0% and 2.5% will be introduced on top of these required minimums in order to achieve the broader macro-prudential goal of protecting the banking sector from periods of excess aggregate credit growth. Finally the definition of eligible instruments for capital treatment is changed to increase the loss absorbance quality.

In addition to the changes in the minimum required solvency, a non-risk based measure, namely Leverage ratio, is established in order to limit the excessive leverages created in the financial industry. Moreover short term (Liquidity Coverage Ratio, LCR) and long term (Net Stable Funding Ratio, NSFR) liquidity standards are developed to protect the financial industry from potential liquidity shocks.

GBI has actively taken part in BCBS/CEBS Comprehensive Quantitative Impact Study (C-QIS) for the implementation of Basel III. It has been observed as a result of 2011 C-QIS that the impact of the upcoming regulations is at a very limited level since the Bank has: a high CET1 ratio, no Tier 1 hybrid capital products, a high liquidity buffer, a strong retail funding base, a limited trading portfolio, no exotic products and a strong risk governance structure. The initial analysis has revealed that GBI is already equipped and well positioned for the smooth transition to the new regulatory environment.