

2009

REPORT ON THE THIRD PILLAR IN ACCORDANCE WITH BASEL II

**DISCLOSURE PURSUANT
TO §§ 26 AND 26A
AUSTRIAN BANKING ACT
(BWG)**



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QUALITATIVE DISCLOSURE

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List of Abbreviations

ABS	Asset backed securities
ALCO	Asset and liability management committee
AS	Application scoring
BPV	Basis point value
BS	Behavioural scoring
BWG	Bankwesengesetz (Austrian Banking Act)
CAC	Credit approval committee
CAD	Canadian dollar
CDO	Collateralised debt obligation
CEO	Chief Executive Officer
CHF	Swiss franc
CLS	Continuous linked settlement
CRM	Credit risk mitigation
CRO	Chief Risk Officer
ERM	Enterprise Risk Meeting
EUR	Euro
FX	Foreign exchange
GBP	British pound
IAS	International Accounting Standards
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
IRB	Internal rating based
JPY	Japanese yen
LGD	Loss given default
MR	Market Risk division
OeNB	Oesterreichische Nationalbank (Austrian National Bank)
OffV	Offenlegungsverordnung (Disclosure Regulation)
OTC	Over the counter
PD	Probability of default
PVBP	Present value basis point
RCSA	Risk control self assessment
S&P	Standard & Poor's
TM	Treasury markets division
UGB	Unternehmensgesetzbuch (Austrian Commercial Code)
USD	US dollar
VaR	Value-at-risk

1. GENERAL REQUIREMENTS

1.1. Scope of consolidation and consolidation methods

Article 3, lines 2, 4 OffV

Owing to diverging objectives in the international accounting standards and the Austrian Banking Act (also called BWG in the following), there are two different scopes of consolidation, one for accounting purposes and one for regulatory purposes.

1.1.1. Consolidation for accounting purposes

In accordance with IAS 27, 28 and 36 and IFRS 3, the scope of consolidation in the annual financial statements takes in BAWAG P.S.K. AG and all material subsidiaries owned directly and indirectly. Total assets and the subsidiary's share in total consolidated profit/loss are the criteria for materiality.

The consolidated financial statements as of 31 December 2009 contained 57 fully consolidated companies and two companies included at equity. The book value of associated interests not valued at equity amounted to EUR 72 million as of 31 December 2009. Controlled companies with a book value of EUR 58 million were not included in the consolidated accounts because of their negligible effect on the assets, financial situation and earnings.

The following fully consolidated subsidiary was sold in 2009:

- ▶ BAWAG P.S.K. Capital Advisors Ltd, London

Furthermore, one subsidiary was dropped from the scope of consolidation owing to immateriality and ten subsidiaries established in 2009 were included in the consolidated accounts.

1.1.2. Consolidation for regulatory purposes

Consolidation for regulatory purposes is carried out in accordance with Articles 24 and 30 Austrian Banking Act, whereby the financial statements of the individual companies and the consolidated financial statements are prepared in accordance with the principles of the Uniform Commercial Code (also called UGB in the following).

Undertakings involving an equity interest of more than 10 per cent

Undertakings	IFRS		Bank Group as per § 30 BWG			Not part of Bank Group
	fully consolidated	at equity	fully consolidated	proportionate	deducted from own funds	
Credit institutions						
BAWAG P.S.K. AG	x		x			
BAWAG Allianz Mitarbeiter Vorsorgekasse AG				x		
BAWAG Banka d.d.	x		x			
BAWAG Malta Bank Ltd	x		x			
BAWAG P.S.K. INVEST GmbH	x		x			
BAWAG P.S.K. Wohnbaubank AG	x		x			
easybank AG	x		x			
Aviso Zeta Bank AG					x	
Kapital Beteiligungs AG					x	
Österreichische Verkehrskreditbank AG	x		x			
PayLife Bank GmbH					x	
Real estate sub-group	7		9			5
Leasing sub-group	20		32	2	1	1
Other undertakings	23	2	21	1	4	56

Table 1

BAWAG P.S.K. Group availed itself of the option in Article 24 (3a) Austrian Banking Act with respect to eight small financial institutions and ancillary service providers, as the inclusion of the capital and the capital requirements of these companies is not material to the consolidated capital and consolidated capital requirement.

As of 31 December 2009, a total of 69 subsidiaries were fully consolidated in BAWAG P.S.K. Group in accordance with Article 30 Austrian Banking Act. Four subsidiaries were proportionally consolidated and eight subsidiaries were deducted from own funds. For regulatory purposes, 62 equity interests in which BAWAG P.S.K. Group held more than a 10 per cent stake and which are neither credit institutions nor financial institutions or that for other reasons do not fall under the definition of groups of credit institutions set forth in Article 30 Austrian Banking Act were neither consolidated nor deducted from own funds. As all subsidiaries subject to banking regulations are included in the consolidation or their book values were deducted from own funds, there is no case of a shortfall in own funds as described in Article 3, line 4 Disclosure Regulation (also called OffV in the following).

1.2. Impediments to the transfer of own funds

Article 3, line 3 OffV

There are currently no known restrictions or other significant impediments to the transfer of own funds within BAWAG P.S.K. Group.

2. RISK MANAGEMENT

2.1. Internal Capital Adequacy Assessment Process – ICAAP

Article 5, line 1 OffV

BAWAG P.S.K. Group assesses capital adequacy monthly by calculating its capacity to bear economic risks. The full Managing Board deals with this calculation at the Enterprise Risk Meeting (ERM).

The following risk categories are quantified and juxtaposed with the risk coverage capital available:

- ▶ **Credit risk:** The credit risks are reported quantified and consolidated for BAWAG P.S.K. Group in the risk-bearing capacity account in relation to credit institutions and SME and private customers based largely on the probabilities of default (PDs) and loss given defaults (LGDs) calculated using internal rating systems and otherwise analogous to the standardised approach. Beyond that, the credit risk is quantified in a concurrent calculation using a value-at-risk model. It is planned to also apply the results from this model calculation for the internal assessment of the necessary economic capital. Risks associated with subsidiaries and real estate are treated as separate risk categories and therefore not taken into account in the credit risk for the corresponding asset items
- ▶ **Risks arising from subsidiaries:** Risks associated with subsidiaries held directly by the Bank Group and not subject to consolidation are quantified using the PD/LGD approach. If no current internal rating is available in exceptional cases, the risk is quantified using the simple risk weight method in Pillar 1. Consolidated subsidiaries are examined in a look-through approach, whereby the individual transactions of these companies are quantified according to the risk categories involved, namely credit and market risks.
- ▶ **Market risks:** In the market risk category, risks associated with interest rate changes, foreign currencies and net asset value are measured with value-at-risk models. Risks associated with interest rate changes are quantified using the VaR variance/covariance approach.
- ▶ **Liquidity risks:** Structural liquidity risks are quantified based on liquidity gaps arising from a possible deterioration of spreads connected to an imputed worsening of the rating of BAWAG P.S.K. Group. Dispositive liquidity risks are controlled by Asset Liability Management.
- ▶ **Operational risks:** Operational risks are quantified for the analysis of risk-bearing capacity based on the statutory basic indicator approach.
- ▶ **Other risks:** For the other risks, the real estate risks are quantified in a simple value-at-risk approach based on the volatility of the Austrian real estate index. Sales risks are taken into account in the worst case scenario in the P&L control system.

The individual risks are added to total bank risk (enterprise risk) in the risk-bearing capacity calculation with a correlation factor of 1 and juxtaposed with the risk coverage capital at BAWAG P.S.K. Group.

The available risk coverage capital must adequately cover the enterprise risk at all times.

The **economic risk coverage capital** includes components of the core capital and of subordinate capital as well as net undisclosed reserves and undisclosed charges from securities, real estate and subsidiaries. One item is allocated as a precaution to cover the coverage gap arising from a 100 per cent impairment charge for outstanding collectibles. The calculation of economic coverage capital is based on IFRS and UGB provisions expanded by an economic perspective.

To ensure its risk-bearing capacity, the Group defines a **confidence level** of 99.9 per cent (based on the target rating) and sets aside buffer capital as a reserve for additional risks that materialise. According to both approaches (IFRS and UGB), the buffer capital must equal at least 10 per cent of the economic risk coverage capital. The target for buffer capital was set at 20 per cent. Limits were determined for all limit categories and defined control portfolios and are monitored monthly by Risk Reporting. Overdrafts are likewise escalated according to the prescribed procedures.

2.2. Capital allocation and limit setting at total bank level

Article 5, line OffV/Article 6, line 1 OffV

The processes for limit setting and capital allocation run parallel to planning and budgeting at least once a year or more often if required. First, the established premises such as confidence level and buffer capital (risk appetite) are updated. The individual front-office units of BAWAG P.S.K. AG and the major subsidiary banks serve as the control portfolio for the credit risk.

The definition of capital allocation and limit setting in Article 39a of the Austrian Banking Act assumes the following premises and information:

- ▶ Strategy the Managing Board has set for the next five years
- ▶ Premises set down by the Managing Board: confidence level, holding period, capital buffer, control units
- ▶ Planning and budgeting process and any changes in risk value/balance sheet items determined by virtue of this process
- ▶ Existing limit setting systems (e.g. in connection with market risks)
- ▶ Limit setting for the control units analogous to the quantification methods defined for the individual risk categories
- ▶ Other strategy stipulations

The Managing Board approves the allocation of capital and the Supervisory Board is informed of it.

2.3. Enterprise risk reporting

Article 2, line 2 OffV

The full Managing Board determines the business strategy for the Group and the individual business segments as part of its risk management responsibilities and defines target values for the key ratios (cost-income ratio, return on equity). The Managing Board then derives from this business strategy the risk strategy for the Bank and sets the risk tolerance limits for the current planning period. Finally, the Managing Board takes fundamental decisions with regard to the processes to be used to identify, measure, control and monitor risks. The Chief Risk Officer (CRO) is a member of the Managing Board and is accountable as risk manager for the entire Group. All risk management entities answer to the CRO. The CRO monitors the activities of the organisational units and regularly informs the full Managing Board about the risk situation at the Bank. As required by the supervisory authority, this organisational structure separates the front-office and back-office units, particularly risk management, at all levels of the Bank including the Managing Board level. Functions for the monitoring and communication of risks must always be separated organisationally from control functions.

The Enterprise Risk Meeting (ERM) is a monthly risk meeting of all members of the Managing Board and is chaired by the CEO. It performs the following tasks for BAWAG P.S.K. Group based on the Austrian Banking Act (Articles 39 and 39a – ICAAP), the specifications of the Supervisory Board and internal regulations:

- ▶ Grants authorisations to set limits for committees on credit and market risks
- ▶ Approves the risk strategy, defines risk acceptance and, if need be, gives recommendations to the Supervisory Board on changes and adjustments
- ▶ Approves the capital allocation in the framework of the Bank's ICAAP
- ▶ Approves new transactions and products recommended by committees of the Managing Board
- ▶ Allocates the necessary value adjustments for the quarter as recommended by the Credit Policy Committee
- ▶ Reviews material findings made in the supervisory audits and orders actions to be taken to remedy shortcomings
- ▶ Deals with actions taken by the Credit Policy Committee
- ▶ Deals with actions taken by the OpRisk Committee
- ▶ Deals with and approves goals for the risk-based determination of margins
- ▶ Deals with audit findings from internal auditing and loan auditing as well as compliance findings and the steps/plans for remedying shortcomings
- ▶ Deals with the monthly risk reports

Alongside ERM, the following further committees at Managing Board level deal with risk management:

Credit Approval Committee (CAC): Approves credit applications within a certain scope of authorisation

Credit Policy Committee (CPC): The main tasks of this committee are to examine the appropriateness of credit risk management, approve credit risk strategies, review concentration risks related to sectors, products, geographical regions and countries, and examine and approve guidelines and processes

Asset Liability Committee (ALCO): The Asset Liability Committee (ALCO) controls market and liquidity risks while the front-office units control credit risks. The front-office units bear responsibility in their conduct of business for earnings and risks and conduct operational risk control activities autonomously and locally, based on set rules. The ALCO reports to ERM and to the entire Managing Board.

To perform its tasks, the risk management organisation comprises the following organisationally independent units:

- ▶ Corporate & Institutional Risk
- ▶ Credit Risk Retail & SME
- ▶ Market Risk
- ▶ Operational Risk
- ▶ Risk Reporting
- ▶ Workout Group
- ▶ Special Projects

3. CREDIT RISK

3.1. Objectives and principles of credit risk management

Article 2, lines 1 through 4 OffV

3.1.1. Strategies and procedures

Commercial credit

Credit is processed and decided upon according to extensive work instructions and the decision-making powers set forth in the corporate powers chart.

The following points are considered for the extension of credit:

- ▶ All individual customers in a customer group/a corporate group are rated annually.
- ▶ The analysis of creditworthiness is based on current business documents. Planning calculations of the company and other information ensure a meaningful analysis for the rating and decision.
- ▶ The assessment of a customer's creditworthiness and credit capability are based on ratings that must systematically cover all information made available from the relationship manager. The credit decision is taken solely according to a set system of responsibilities and powers.
- ▶ The Bank must strive to collect suitable collateral to minimise the credit risk and must subject it to standardised valuation based on the Group collateral list. In the event of any uncollateralised portion, correspondingly higher collateral must be furnished if the rating shows any signs of worsening.
- ▶ Finance for complex business models (e.g. leveraged finance) or in new countries or regions is based on a thorough analysis and description of the associated (credit) risks. The (credit) risk units must be involved with appropriate expert opinions, as set forth in the product launch process. New lines of business must also be compatible with the general treatment of credit risk in terms of classification and basic rules in order to ensure consistency.
- ▶ Any decision that could change the risk position of BAWAG P.S.K. in a customer relationship requires approval from the competent authorised person as set forth in the chart of corporate powers. Each application requires a positive front-office recommendation from the customer advisor before being submitted to the back office.

- ▶ If key figures are defined in a credit relationship as auxiliary conditions (known as covenants), they must be spelled out in the credit application and approved. Compliance with the key figures relevant at the contractually fixed dates must be checked by the competent risk unit within the organisational structure.
- ▶ According to the risk strategy, the non-collateralised or overall exposure per customer and obligor group is not allowed to exceed the limit set for the risk class involved.

Retail and small business

Building on the existing risk assessment systems in Retail and Small Business, the Bank focused in 2009 on refining and improving the automatic rating assessment systems.

These efforts entailed adjusting and validating score cards as required and setting guidelines for the extension of credit.

The credit risk in retail business is measured monthly using the following methods:

- ▶ Portfolio trend in terms of risk class distribution
- ▶ Portfolio trends in terms of overdue/late payments
- ▶ Portfolio trends for defaulted credit facilities
- ▶ Portfolio trends in terms of losses
- ▶ Scorecard performance
 - Approval rate
 - Manual scoring of reversed decisions

The findings of the analysis are reported monthly to the Enterprise Risk Meeting.

Independent of this process, risk-relevant data from standardised assessments between market managers (distribution directors) and risk management units (Risk Centres) are discussed and documented in monthly committee meetings. The recorded results are summarised and also discussed and analysed monthly in central committees. This process ensures the regular and standard flow of information while also enabling the Bank to respond directly to changes in risk parameters/situations.

In November 2009, new credit processes were established in the Small Business segment. To make the process simpler, leaner and faster whilst also ensuring standardised data input, the Bank now pursues these objectives:

- ▶ To increase the efficiency and relieve sales/distribution by bundling the recording of economic information in a central specialised department
- ▶ To improve data quality in relevant ways using central recording of economic documents in the specialised unit

- ▶ To ensure a common data base on the economic situation of Small Business customers in order to account for a statistically valid further refinement of the scorecard and a consistent transition for the further development of a customer to a different segment
- ▶ To reduce the manual effort of risk assessment in new applications and extensions using a key figure calculation that is automatic within the system
- ▶ To implement regulatory requirements correctly (Basel II)
- ▶ To implement a recommended decision in the scoring system so as to enable quicker local decisions in the front office and shorter throughput times for applications. This factor is crucial for increasing the level of customer satisfaction.
- ▶ To reduce effort in prolongation while also correctly estimating risk based on longer terms in prolongation agreements. This approach yields essential advantages for the Bank and for the customers, especially cost and expense reductions by requiring a smaller number of prolongation agreements.

3.1.2. Risk measurement systems

The measurement of credit risk for supervisory purposes is based on the Basel II standardised approach. Beyond that, country risk is also considered in the examination of credit risk. Country risk is the risk in the given country that a counterparty or the country itself will fail to meet its obligations on time or at all due to sovereign measures or economic/political problems. Country limits reflect the maximum risk that BAWAG P.S.K. is prepared to bear in a given country. These limits cover all transactions with customers/ counterparties from a given country less risk mitigants that result in an allocation to a different country.

Another aspect always kept in mind is that transactions or risks can only be entered into if they are deemed acceptable in accordance with the approval standards of the Bank. Internal auditing regularly checks compliance with the guidelines.

3.1.3. Reporting systems

The entire Managing Board of BAWAG P.S.K. is apprised monthly of all risks of BAWAG P.S.K. Group at the Enterprise Risk Meeting. The **Credit Risk Report** accounts for a large part of this reporting and covers trends in the portfolio, concentrations and the credit portfolio itself from the standpoint of size classes, regions and ratings.

Special attention is devoted to the part of the portfolio that is in excess of the facility extended or in default. To highlight individual customer concentrations, an “outlier list” is kept of all commercial customers or customer groups whose uncollateralised or total exposure exceeds the value defined for the relevant risk class.

The Credit Risk Report also covers special characteristics of industries or customer groups, new approvals exceeding EUR 20 million, exposures on which no report has been made to the Managing Board for more than a year, as well as arrears from prolongations and annual risk audits.

A special summary covers data on corporates, credit institutions and the public sector and provides information on exposure, non-collateralised portion, average rating, arrears from prolongation, rating data, number of defaults and reatings.

3.1.4. Risk hedging and mitigation

Collateral is recognised and valued in accordance with the credit collateral list that is valid throughout the Group (KSHK). The KSHK serves as the basis for cataloging collateral according to internal risk criteria at BAWAG P.S.K. The KSHK also determines the amount to be set for the fair value and lending value and whether the collateral may or may not be applied to reduce risk under the regulations of the current Austrian Banking Act. If new collateral not yet defined in the KSHK is taken in, Credit Risk Private and Corporate Customers must check whether this new collateral is eligible for recognition and select the valuation method for the fair value and the limits for the lending value.

The lending value is the value at which the collateral is internally estimated at BAWAG P.S.K. in terms of reducing exposure. The lending value incorporates values empirically obtained from saleability, duration of realisation or haircuts based on risks specific to the rating or country. In the case of real estate with prior liens, these liens are also considered in figuring the lending value. The lending value is set for daily credit business and is generally far below the current fair value.

The fair value is the value of the collateral usually attainable from selling the asset in a fair business transaction. The fair value is determined using a valuation process that takes into account future marketability and is geared to standardised valuation processes (e.g. for real estate: income approach, cost approach, sales comparison approach, etc.). Speculative aspects are not considered in the calculation of the fair value.

3.2. Counterparty risk of default arising from derivatives, repurchase transactions, securities and commodities lending transactions, margin lending transactions and long settlement transactions

3.2.1. Risk hedging and mitigation

Article 6, line 2 OffV

BAWAG P.S.K. can demand the provision of collateral or take other steps to mitigate risk based on bilateral agreements (repurchase agreements, lending transactions, ISDA netting agreements, credit support annexes, etc). From the standpoint of BAWAG P.S.K., credit risk only exists in cases in which the net fair value is positive (replacement risk). As this risk depends largely on fluctuations in market risk parameters (exchange rates, interest rate movements, stock prices, etc.), it must be regularly recalculated and the collateral must be adjusted accordingly. The types of collateral generally allowed include cash in several stipulated major currencies (usually EUR, USD, GBP) and securities from issuers with top ratings (government bonds of several European countries and the United States).

If securities are provided as collateral, a haircut is additionally applied based on the remaining term. The collateral amounts are adjusted to the current risk situation (market valuation of the counterparty's transactions), or the intrinsic value of the collateral is checked at contractually agreed times. This check takes into account exchange rate fluctuations for collateral denominated in foreign currency as well as the market value of securities. The customary intervals for valuation in the market are daily, weekly or monthly. For credit support annexes, BAWAG P.S.K. strives to conduct a valuation at least weekly.

The possibility of realising the deposited collateral in the event of the partner's bankruptcy and its further use (e.g. rehypothecation or passing along of the collateral as security for another contracting party) is ensured by the legal opinions drawn up on behalf of ISDA for the given jurisdiction of the individual contracting parties.

For derivative business, BAWAG P.S.K. only accepts financial collateral in the form of cash deposits. This type of security does not result in any reserves being formed. Nor is hedging required for the financial collateral taken in, as its value cannot be altered by price changes.

3.2.2. Correlation risks

Article 6, line 3 OffV

According to the Basel Committee, there are two types of correlation risk, general and specific. A general correlation risk exists if there is a high correlation between the counterparty's probability of default and risk factors in the general market risk. A specific correlation risk exists if there is a high correlation between the counterparty's probability of default and the replacement value of current transactions being conducted with him due to the nature of these transactions.

BAWAG P.S.K. takes account of the general correlation risk by conservatively assuming a correlation of 1 between credit and market risk when calculating the total bank risk in Pillar II/ICAAP. Assumptions on general and specific risk correlations also go into defining the total bank stress test and are thus indirectly quantified and reported. The stress tests are currently being revised at BAWAG P.S.K.

Possible correlation risks are also taken into account in connection with deliberations on the collateral portfolio at BAWAG P.S.K. Any specific correlation risks are countered by combining the granting of limits to a counterparty or obligor group of counterparties and the setting of internal limits (exposure determination). For derivative business, only financial collateral in the form of cash deposits is usually allowed. This practice is also intended to help avoid specific correlation risks. In determining the limit and limit structure during the rating check, the Bank considers a counterparty's rating and a possible worsening of this rating. These factors are not part of the determination of exposure.

In the case of counterparties with whom a comparatively large volume of derivative business is conducted, collateral agreements are also signed. They stipulate that positive fair values are regularly compensated solely in the form of cash deposits and thus allow a correspondingly greater volume of derivative business to be conducted at the same credit limit.

With respect to repos and securities finance, additional risks are largely eliminated in the corresponding agreements (repo annex, tri-party agreement) by setting restrictive criteria on acceptable types of securities, issuers, rating classes and haircuts. In repos trade, margin calls are periodically executed to compensate for the fair value.

Performance risk is a special case of counterparty risk. It always arises when a payment is to be rendered upon the finalisation of transactions but there is not yet a corresponding counter-performance for that payment. The amount owed determines the size of the risk. This risk is added to the settlement limits, which are also defined at counterparty level. Payment netting agreements are concluded to minimise this risk. Also, these transactions are increasingly handled through clearing houses (continuous linked settlement) and corresponding CLS agreements are concluded for them.

3.2.3. Rating downgrade and its impact on collateral

Article 6, line 4 OffV

Contractual clauses on dependencies between the security furnished and the rating of BAWAG P.S.K. exist only in a few isolated cases in connection with risk mitigation agreements from derivative transactions. In some of these agreements, this provision affects what are known as the “independent amount”, the “threshold amount” and the “minimum transfer amount”. Based on existing agreements and as matters stand today, a downgrade of the rating of BAWAG P.S.K. would not have any material ramifications on the additional amount to be furnished.

3.2.4. Measures for exposure value

Article 6, line 6, OffV

BAWAG P.S.K. enters into derivative transactions and repos in its trading activities and to control assets and liabilities. Derivative financial transactions are conducted in the form of interest rate and currency swaps, forward exchange dealing, interest rate and foreign exchange options, forward rate agreements, interest rate futures and credit derivatives. Credit derivatives are used for trading purposes and for hedging parts of the securities portfolio. Repo business is dominated by repos und reverse repos. BAWAG P.S.K. was not engaged in any securities or commodity lending, margin lending transactions and long settlement transactions on 31 December 2009.

The fair value is applied in the valuation of derivatives and repos. It is determined from publicly quoted prices. If there is no quoted price available, accepted valuation methods are used to determine the fair value. The fair value represents the potential replacement cost.

BAWAG P.S.K. has opted to use the market valuation method as defined in supervisory law. The counterparty risk thus consists of the potential replacement cost (positive fair value) plus the add-on as a risk haircut. This approach takes account of the possibility that the fair value of an instrument can change due to market price fluctuations over time from the start of a transaction. A positive fair value from the standpoint of the Bank is an economic exposure in relation to the counterparty, which would be lost in part or altogether in the event of default. The fair value thus also represents the additional cost that would be necessary to place a comparable transaction in the market at the time of default, which is why it is referred to as the replacement value. To take account of potential future market price fluctuations as well, an add-on is also determined. Its amount varies depending on the instrument and remaining term and is calculated from a fixed percentage factor added to the nominal value of the transaction. In calculating the internal exposure (limit add-on), BAWAG P.S.K. is guided by the procedure stipulated for determining capital adequacy.

3.2.5. Estimation of the scaling factor

Article 6, line 9 OffV

BAWAG P.S.K. does not have its own process for estimating the scaling factor.

3.3. Credit risk mitigation

3.3.1. Policies and processes for netting

Article 17, line 1 OffV

BAWAG P.S.K. has made use of off-balance-sheet netting since 31 December 2008. Netting pertains exclusively to derivative instruments with counterparties for whom corresponding netting agreements exist. The pertinent netting agreements are legally valid and legally enforceable in all relevant jurisdictions in the event that the counterparty becomes insolvent or goes bankrupt.

3.3.2. Types of collateral and collateral valuation and management

Article 17, lines 2, 3, OffV

The following guidelines must be followed for collateral valuation and management:

- ▶ The Bank reserves the right to accept or reject collateral or to assign collateral the value deemed necessary and reasonable in order to protect Bank interests.
- ▶ A collateral list defined for the entire Group shows the combinations of goods (characteristics of the economic good/asset) and collateral (to which the Bank has title) that are deemed basically acceptable, the value (market value, nominal value, etc.) that is applied, the downgrades from the calculated value that are applied, and the circumstances under which this collateral can be applied to reduce capital requirements. This document is revised as warranted but at least once a year.
- ▶ The accompanying documents stipulate the process steps required to evaluate, take-in, and effect the collateral and to manage and realise it. Transaction-related exceptions to haircuts set down in the collateral list must be approved by Credit Risk Private and Corporate Customers.
- ▶ All collateral must have a fair value that is easy to determine or an internally calculated value and the Bank must be in a position to represent its interests in the collateral.
- ▶ Collateral must meet the general legal requirements for eligibility, in particular the minimum recognition requirements and the policies as set down by the Credit Policy Committee (CPC).

The compliance of the collateral with the legal criteria and the policies is determined during the credit application process in the front office and checked by the risk departments.

Generally, the value of collateral is checked during annual prolongation or the annual risk check or as warranted (e.g. increase, default).

The table below provides a summary of the key types of collateral, their estimated values, and the frequency of valuation:

Types of collateral and collateral valuation and management

Type of collateral	Estimated values	Frequency of valuation
Financial collateral	Fair value (taking into account volatility adjustments)	Automatic daily valuation except for deposits at other banks
Residential real estate	Fair value	At least every three years
Commercial real estate	Fair value	Annually
Other physical collateral	Fair value (no estimate for regulatory purposes)	At least once a year
Pledging or assignment of life insurance policies	Repurchase value	Automatically on a quarterly basis
Guarantees	Guaranteed amount (nominal value) less possible currency risks (volatility adjustment)	Monthly
Co-obligations	Outstanding balance unless a restriction applies (no estimate for regulatory purposes)	Ongoing

Table 2

Real estate valuation is centralised to ensure a standard valuation approach throughout the Group. Residential real estate is estimated automatically using a valuation tool. The value of commercial real estate is assessed by an expert unconnected to the credit process at the current fair value, at most. The values of real estate serving as security must be monitored periodically. For commercial real estate, the necessary information must be obtained annually and if necessary the fair values must be updated. The values of residential real estate are monitored annually using statistical methods and adapted as required (e.g. in response to changes in the market).

3.3.3. Guarantors/counterparties for credit derivatives

Article 17, line 4 OffV

The main types of guarantor eligible for regulatory credit risk mitigation are domestic and foreign banks, the federal government, state governments, local governments and sovereigns. Credit derivatives are concluded exclusively with major international banks and brokers.

3.3.4. Risk concentrations in risk mitigation

Article 17, line 5 OffV

A concentration risk exists if a significant percentage of collateral items Group-wide (at portfolio level) are concentrated in a small number of collateral categories, instruments, special protection providers (e.g. collateral providers) or sectors.

Certain reporting and monitoring activities must be conducted at consolidated level for credit and market risks for all categories of physical collateral/guarantees and sureties.

3.4. Value adjustments and provisions

3.4.1. Definition of “past due” and “impaired”

Article 7, paragraph 1, line 1 OffV

Definition of “past due”

Exposures are classified as past due as soon as a customer fails to comply with the contractual agreements. This applies when he fails to make an installment payment or when the set limit is exceeded in accounts.

Definition of “impaired”

Positions are classified as impaired if the associated borrowers can be assumed unable to perform their outstanding payment obligations. BAWAG P.S.K. recognises appropriate provisions for this purpose.

3.4.2. Approaches and methods for determining value adjustments and provisions

Article 7, paragraph 1, line 2 OffV

Main components of value adjustments are

- ▶ Value adjustments determined at individual account level based on an assessment by the Credit Risk unit, with the Workout unit bearing responsibility, and
- ▶ Value adjustments recognised automatically by the Bank risk engine in the event of unpaid installment payments, current account overdrafts of more than 90 days and accounts handed over to the Workout unit for active collection.
- ▶ Portfolio value adjustments according to IAS 39 AG 89 for losses in the Group credit portfolio incurred but not detected on the reporting date. For this portfolio-based value adjustment (IFRS portfolio provision), it is assumed that losses have been incurred but not yet detected for a certain percentage of customers not deemed defaulted on the reporting date. To calculate this value adjustment, the exposures are grouped into homogeneous portfolios with comparable risk characteristics, exposure class and number of days past due. The quantification is based on the expected loss taking into account the period from incurrence to detection of the default (the loss identification period). This period is determined for each customer segment based on the average period until the next due payment and is checked periodically. Structured credits, off-balance-sheet transactions, and items already in default are not considered in the determination of the portfolio value adjustment.

Information regarding the level of value adjustments and any changes in them can be found in the quantitative section of this publication.

4. MARKET RISK

4.1. Objectives and principles of the management of market risk

Article 2, lines 1, 3, 4 OffV

4.1.1. Strategies and procedures

Activities in the trading book concentrate primarily on own trading, i.e. buying and selling in defined markets and in defined product classes. The objective is primarily to carry out proprietary trading activities in highly liquid monetary and capital market instruments in the money market, fixed-income and FX segment. All spot products and associated derivatives are traded within their risk class (interest rate, FX).

Investments in securitisation instruments (structured credits) are based on a buy-and-hold strategy. Each individual investment is approved within the scope of a global investment strategy by the responsible front-office and back-office unit based on a sound analysis, including a stress test. Only actions that mitigate risk, i.e. reduce/diversify credit risks, are taken in this asset class based on current market trends.

All transactions for which an active market exists and the market price is available are valued at the market price. Valuation models were applied to determine the fair value for several classes of structured credit transactions, as a fully active market does not exist for these transactions. These transactions involve securitised corporate exposures (index-sensitive corporate CDOs), CDOs with exposure in US mortgage loans (ABS CDOs with subprime exposure) and CLOs as well as US RMBSs. The valuation models were calibrated at the market prices of comparable transactions (liquid indices such as ABX, iTraxx, CDX, CLO Trading Runs).

The risks are monitored in the scope of a limit system. The Market Risk Division (MR) measures availment of market risk limits and also orders counter-measures if the market risk limit is exceeded (VaR, vega, gamma, worst case, BPV, volume limits).

The objectives of the limit unit were defined as follows:

- ▶ To create a risk-oriented limit system that consistently and methodically covers all positions in the trading and banking book sensitive to market risk and all risk factors using standard risk ratios.
- ▶ To improve the controllability of market risk using clear-cut, non ambiguous risk ratios and to set limits for these ratios in a limit system.
- ▶ To integrate risk measurement, limit setting and the monitoring of limit availment systematically for all positions in the trading and banking book sensitive to market risk at individual and aggregate level in order to improve the basis for making decisions on risk policy and risk diversification.
- ▶ To integrate the market risk limits into budget planning and to take account of calculated risk-bearing capacity and, thereafter, of risk appetite in the scope of the overall Bank control system.

Additional risk restrictions can be temporarily put in place in response to the market situation for the immediate controlling of risks in current business in the trading and banking book.

Trading book limits

Overnight limits apply to trading positions at the end of the trading day, whereas intraday limits are restricted to the maximum outstanding risk position during the day and are 1.5 times as large as the overnight limits.

A further distinction is made in

- ▶ Sensitivity and volume ratios
- ▶ Worst case limit (maximum loss with executed crisis tests)
- ▶ VaR limits (limit check in relation to management overnight)
- ▶ Gamma limit (for options in interest rate segment and FX)
- ▶ Vega limit (for options in FX segment)
- ▶ Annual loss limit (dynamic limit)

Enterprise limits

There are basis-point value limits at enterprise level in the interest rate segment that are divided by maturity range and total, as well as by enterprise total and enterprise fair value. There is a limit for each of the maturity ranges 0–1Y, 1–2Y, 2–3Y, 3–4Y, 4–5Y, 5–7Y, 7–10Y and >10Y. The total of all basis-point values is also limited for the individual maturity ranges. Additional limits are set within the described maturity ranges and overall also for the subportfolios calculated at fair value.

All limits are monitored and reported in the MR unit.

4.1.2. Reporting systems

Trading book reports

The VaR, its limit avilment, the BPV and the gamma are reported daily to the Managing Board and the competent trading units. If a VaR limit is exceeded, trading management can take over the overdraft in the scope of their VaR limit, provided they keep within certain bounds. If this is not possible or not desired by trading management, the MR sends a written message to the CRO and the risk position is ordered to be closed out immediately. The MR must inform trading management and the competent group head in writing whenever any of the other market risk limits are exceeded.

Along with the daily reports, interest rate and FX shifts are done weekly and reported to the corresponding trading unit. An ALCO Report containing all material market risk factors is produced monthly and submitted to the ALCO. In addition, monthly shifts (interest rate, FX, volatility) are done for the respective trading units and reports are sent to the supervisory authority.

Further, stress and crisis tests are conducted quarterly and reported to the Austrian National Bank and the Financial Market Authority. Statistics for fixed interest rates are also produced for risk-oriented reporting (ROM). If an outlier occurs in the daily VaR calculation, it is reported to the Austrian National Bank and Financial Market Authority within five business days along with the reasons for it.

Banking book reports

Limit compliance is checked daily in Treasury for the FX risk, option risk (gamma value) and BPV and reported to the Managing Board. Compliance with the BPV limits (enterprise and maturity range limits as well as limit relevant to P/L) is monitored monthly at credit institution and Group level. Stress tests and scenario analyses have also been conducted since the end of September 2009. Future measures will be included in all reports as required. A net-interest-income simulation (NII simulation) is also done monthly for BAWAG P.S.K., with stress tests also being carried out.

The basis-point value calculation and the NII simulation are both reported to ALCO or Strategic ALCO. The VaR is calculated monthly for the entire Bank (enterprise) and for all subsidiary banks. The minimal equity exposure risk at BAWAG P.S.K. is calculated monthly. This figure is included in the risk-bearing capacity account and reported quarterly to the Austrian National Bank. Liquidity gaps are calculated monthly for BAWAG P.S.K. and its subsidiary banks and incorporated in the risk-bearing capacity account. Further, interest rate risk statistics at individual credit institution and Group level are produced and reported to the Austrian National Bank each quarter.

Exceedance of the limit in the trading book

If the VaR limits defined in the Risk Management Manual for individual trading groups are exceeded, trading management can take over the overdraft in the scope of its VaR limit (trading management in its function as limit buffer). If this buffer is utilised to an extent exceeding 20 per cent of the total limit set for trading management, MR informs the Managing Board member responsible for market risk in writing.

If this is no longer possible or not desired by trading management, MR sends a written message to the Managing Board member responsible for MR. If that member is absent, the message is sent to the Managing Board member responsible for TM. The corresponding risk position is closed out immediately in collaboration with trading management. If no Managing Board member is present, MR is authorised to have trading management close out the position that caused the limit to be exceeded.

In the event of an exceedance of all other market risk limits (delta/gamma/vega/volume/intraday/worst-case limit), trading management and the competent group head must be informed by MR immediately in writing (by e-mail) and the corresponding counter-measures taken by the affected group and monitored by MR.

If the worst-case limit is exceeded, a risk-mitigating limit order must also be placed in the market in order to reduce the potential loss and the risk position in the event the worst case actually materialises. If 30 per cent of the defined annual loss limit is reached (warning level), MR sends a written message to the Managing Board members responsible for MR and TM.

Exceedance of limit for entire bank (enterprise)/banking book

If the market risk limit set by ALCO or the full Managing Board is exceeded, MR sends a written message immediately to the Managing Board members responsible for the given area and to the Managing Board member responsible for MR. In the event of exceedance in the banking book, a message is also sent to the division management and the competent group heads within the division. Counter-measures are initiated. If the market risk limit is exceeded by more than 25 per cent MR must also notify the CEO thereof in writing.

4.1.3. Risk hedging and mitigation

If a market risk limit is exceeded, the position responsible must be closed out immediately. Alternatively, an adequate counter-position providing adequate risk mitigation can be entered into under certain circumstances (hedge).

4.2. Internal models for market risk limitation

Article 11, line 1, lit a, b, c OffV

4.2.1. Characteristics and mode of operation

BAWAG P.S.K. Group has used an internal market risk model since 1998 for calculating its minimum capital requirements in the trading book. A variance-covariance approach is applied for making daily forecasts of the expected loss for the next day (value-at-risk) for all equity, interest rate and FX positions in the trading book within the defined confidence level. The following parameters apply:

- ▶ Variance-covariance approach
- ▶ Historical time series of 250 days, equally weighted
- ▶ 99% confidence level
- ▶ Holding period of one day for internal risk control and ten days for the calculation of minimum capital requirement
- ▶ Use of correlations within and between the risk categories (equities, interest rate, FX)

The non-linear market risk is evaluated in two steps; the gamma risk is incorporated in the VaR calculation as a Taylor series (derivation of the market risk factors incorporated to second order). The vega risk is calculated using an analytical approach in the internal vega model (99 per cent confidence level, one-day or ten-day holding period).

In addition, a Monte Carlo simulation is conducted especially to compare the non-linear results (options). Daily back-testing is carried out to measure the quality of the forecast loss figures (VaR).

In VaR analyses, the limits for the underlying methods must also be kept in mind. Factors limiting the VaR method include:

- ▶ When historical data are used as a basis for estimating future market trends, all potential events may not be covered, in particular extreme movements in the market.
- ▶ The assumption that changes in the risk factors are normally distributed could prove to be untrue, which would lead to an underestimation of the risk.
- ▶ The use of a one-day or ten-day holding period assumes that all positions can be closed out or hedged in the corresponding period. This assumption does not fully capture the market risk during illiquid periods when trading positions cannot be closed out or hedged.

- ▶ When a confidence level of 99 per cent is used, losses that could occur above this level are neither taken into account nor duly recognised.
- ▶ The value-at-risk calculations are based on the end-of-the-day positions in the trading book.

Given the limits of the value-at-risk method, Market Risk additionally applies sensitivity limits and stress tests (worst case limits).

4.2.2. Crisis tests

The VaR approach provides a quantitative measure for market risks in the trading book under normal market conditions. An estimate is made of the possible future loss that will not be exceeded over a defined period and with a defined confidence level under normal market conditions. Losses in connection with unexpected extreme market developments are assessed by additionally carrying out crisis and stress tests. In the course of these stress tests, the trading book is subjected to stresses from scenarios simulating extreme market conditions not covered by the confidence interval.

A distinction is made between time-based and event-based stress tests. Statistical methods (different correlations, higher confidence level, etc.) and extreme movements by market risk factors (equity prices and index prices, interest rates, exchange rates, volatilities) and illiquidity in the markets are assumed in the process and applied to the valuation. Stress test findings are performed limited by number and by the fact that not all scenarios can be foreseen and simulated. Stress tests are therefore constantly checked and improved to ensure the material risks are captured and possible extreme market changes are depicted.

4.2.3. Back-testing

The quality of the forecast loss figures (VaR) is measured in daily back-testing. To this end, the exposures in the trading book from day x are subject to valuation at market prices from day x and day $(x+1)$ and the actual trading result is calculated from the difference. In the process, the VaR is compared to the loss or profit that actually occurred on the next day. If a negative back-test result exceeds the VaR, it is referred to as an “outlier”. As the number of outliers increases, so too does the multiplier determined by the Federal Ministry of Finance for calculating minimum capital requirements. Basically, back-testing must take into account not only the change in market value in the narrower sense, but also the change in volatility.

The change in volatility is implicitly taken into account for products traded on exchanges using stock market prices. For OTC products where the volatility feed occurs daily, the change in volatilities must be incorporated into the calculation of market value. No exception (outlier) occurred in the year under review at BAWAG P.S.K. This confirms the quality of the model and means that the best possible multiplier of 3 set by the Ministry of Finance can be retained for calculating capital adequacy.

4.2.4. Scope of application of the models used

Article 11, line 2 OffV

By virtue of the decision made by the Ministry of Finance on 27 December 1999, BAWAG P.S.K. was granted permission to use a model in accordance with Article 21e Austrian Banking Act for the calculation of the minimal capital requirements for

- ▶ the general position risk in debt instruments,
- ▶ the general position risk in value stocks and
- ▶ foreign exchange positions in the trading book.

4.2.5. Minimum capital requirement based on the internal model

Article 11, line 3 OffV

Marking to market:

The positions in the trading book are marked to market based on market prices provided by Reuters. For instruments with an official close-out price, this price is used; otherwise, the arithmetic mean is calculated from the ask and bid price. Trading book positions undergo valuation as part of the calculation of daily results by the trading groups using Kondor+ and OPUS within Treasury. These results are adjusted for consistency in a reconciliation procedure using the valuation and position data in PMS. The trading results reported by the front office are reconciled with the back-office figures at least monthly.

Marking to model:

Positions in the trading book for which there are no listed market prices are marked to model, whereby only recognised models customary in the banking industry are used. No self-developed models are applied. The market parameters utilised for valuation are provided by Reuters.

For linear derivatives such as IRS, CRS, FX forwards, and FRA, the present value is determined by discounting the replicating cash flows. Plain vanilla OTC options in the trading book undergo valuation using recognised option price models (Black Scholes method or Garman-Kohlhagen); interest rate derivatives that are more complex are calculated using Hull White models. A key prerequisite for mark-to-model valuation is to ensure a liquid and automated feed of market parameters by a recognised data provider subject to constant monitoring by Market Risk.

Independent price verification:

The correct valuation of the trading positions is verified annually by an audit conducted by internal auditing and by the expert opinion issued by the Austrian National Bank when the model is approved. All trading book positions also undergo valuation daily by a system independent of the front office with a separate market data feed as part of the daily VaR calculation. The results (market values and sensitivities) are compared with those from the front-office systems. This constitutes independent price verification.

Valuation adjustments or reserves:

In its trading book, BAWAG P.S.K. only conducts trade in liquid positions that allow state-of-the-art mark-to-market valuation. Further, OTC positions undergo valuation with models customary in the market, whereby model risks for models developed in house are avoided and prices in line with the market are applied in the valuation. Moreover, BAWAG P.S.K. does not have a market maker function with its total trading book position due to its size. The structure of trading book positions is evaluated annually to determine whether existing valuation processes and methods are suitable for correctly presenting the trading book in the internal model.

4.3. Interest rate risk from positions not held in the trading book

4.3.1. Measurement of interest rate risk

Article 14, line 1 OffV

The method currently used for the banking book controls all interest-bearing instruments through sensitivity analysis using basis point value and value-at-risk, all currency instruments using volume limits for open positions, and the non-linear option components in several books using gamma values.

In order to limit the interest rate risk, a maximum available basis point value (BPV) is defined relevant to the interest rate risk for individual credit institutions which are in the scope of consolidation in accordance with the Austrian Banking Act. The BPV is also sub-divided into maturity ranges and limited once again at this level. Positions affecting the profit and loss account are also subjected to separate limits. Volume limits per currency are applied to reduce the currency risk; the foreign currency risk in the Treasury banking book is limited by a low overall limit. In general, however, BAWAG P.S.K. follows the strategy of avoiding foreign currency risk in the banking book.

The interest rate risk in the banking book is measured at least monthly. A static analysis of interest rate risk is currently conducted for BAWAG P.S.K. AG subsidiary banks and other financial institutions relevant to interest rate risk.

Types of interest rate risk examined:

- ▶ Present value perspective: Account is taken of risks resulting from changes in the market value of transactions accompanied by a parallel shift in interest rate curves (currencies: EUR, USD, JPY, CHF, GBP and CAD). Changed interest rate curves are also simulated for the main currencies in the monthly stress tests.
- ▶ Income perspective: Risks that may cause an unexpected decline in the interest margin (interest margin risk; impact of possible interest rate scenarios). Major further quality improvements were made in 2009 such as the introduction of additional market and balance sheet structure scenarios.

4.3.2. Assumptions regarding fixed interest rates

Article 14, line 2 OffV

For positions without a defined fixed interest rate, the Bank makes replication assumptions based on empirical studies and expert opinions.

4.3.3. Scenario analysis

Article 14, line 3 OffV

A static and a dynamic analysis is currently carried out for BAWAG P.S.K. AG (internal risk report).

Interest rate gaps, PVBP (also per maturity range), market values, duration and average interest rate (also per maturity range) are calculated for each defined portfolio as part of the static analysis. The following different scenarios and risk parameters are analysed to determine their impact on the economic value of the exposure:

- ▶ PVBP
- ▶ Parallel shifts in the interest rate curves (+/-25 bp, +/-50 bp, +/-110 bp, +/-145 bp, +/-200 bp)
- ▶ Interest rate forecast from the Economic Department

In the dynamic simulation of interest income, the different scenarios below are investigated along with their impact on net interest income:

- ▶ Forward rates
- ▶ Interest rate forecast from the Economic Department
- ▶ Parallel shift in main currencies (at stable rates): +/-110 bp
- ▶ Non-parallel shift for EUR: 1 month +/-140 bp to 5 years +/-40 bp
- ▶ Gradual strong inflation scenario

5. OPERATIONAL RISK

Article 2, lines 1, 3, 4; Article 12, lines 1, 3 OffV

5.1. Strategy and procedures

BAWAG P.S.K. defines operational risk as *“the risk of losses due to inadequate or failed internal processes, people and systems or external events”*. This definition of operational risks includes legal risks but not strategic risks and reputation risks. The latter two risks are directly assessed and controlled by the Managing Board.

The strategic policies on the management of operational risks seek to minimise these risks by taking suitable action. This action includes:

- ▶ Determining comprehensive principles by which BAWAG P.S.K. Group can control its operational risks
- ▶ Assigning responsibility and authority for the development of standards and processes to identify, assess, measure, monitor and check operational risks and to produce reports on operational risks
- ▶ Abiding by a strategic orientation for the Group that complies with regulatory requirements and measures the danger from operational risks
- ▶ Support from Management in efficiently controlling the operational risks in the Bank and promoting a corporate culture that encourages understanding and recognition of operational risks and that gives priority to risk management
- ▶ Periodically determining material operational risks and initiating process improvements
- ▶ Minimising losses from operational risks and thereby maximising profits

The treatment of operational risks is governed in the Operational Risk Policy, in the Operational Risk Framework and in work instructions. The Managing Board of BAWAG P.S.K. establishes Group-wide principles for the management of operational risks as part of the Operational Risk Policy. These activities are coordinated by Operational Risk, a central unit, in order to ensure a common approach throughout the Group. The detailed management of operational risks is done locally in the individual business segments in the respective Group units by the area heads and their operational risk agents.

5.2. Risk measurement systems

BAWAG P.S.K. has used the basic indicator approach outlined in Articles 182ff Austrian Solvency Regulation (SolvaV) since 1 January 2008 to calculate minimum capital requirements for operational risks at Group and individual institution level.

Loss database

Events, losses, profit, payments and near-losses resulting from operational risks in the business segments/ areas are collected continuously as part of an institutionalised loss reporting system to provide a data base for the internal management of operational risk (decentralised loss database).

The subsequent central analysis then allows high incidences of loss to be determined in good time so further losses can be avoided.

Definitions:

- ▶ Operational risk events
An operational risk event is an incident occurring during a business process that has an effect other than the one expected owing to inadequate or failed internal processes, people or systems or owing to external events or circumstances. An operational risk event can, but does not have to, lead to an economic or financial effect for the company.
- ▶ Losses from operational risks
Losses from operational risks result from operational risk events with a negative financial impact on the company. The analysis of these losses provides important evidence that can be used to identify the operational risks and to take steps to avoid future losses. Regardless of the nature of the events and the time at which they occur, the events may reflect the existing or historical environment of the checks.
- ▶ Profit from operational risks
Profit from operational risks results from operational risk events with a positive financial impact on the company. Even if profit results from an operational risk event, the event itself is an indication of a process weakness that could result in a loss the next time it occurs. These events therefore give valuable indications to Risk Management.
- ▶ Payments
Payments refer to the reduction of a loss (e.g. by means of insurance). Operational risk payments are divided into insurance payments and other payments.

Insurance

Insurance policies are an important way of reducing loss. Even if taking out an insurance policy cannot prevent a possible operational risk event, it can at least reduce the financial effect of that event.

Other payments

Other payments refer to payments by third parts that reduce the loss for the company.

Examples:

- Damage claim payments
- Penalty payments
- Recourse payments
- Refunds
- etc.

▶ Near-losses

Near-losses are risk events that ultimately do not result in an actual loss. Near-losses refer to mistakes, system failures or process accidents that could have a negative financial effect for the company but that do not occur thanks to favorable circumstances. Identifying near-losses can open up ways to improve the structure of a system, to improve processes and thereby to reduce the extent of loss. A near-loss is an event signalling that a system or process weakness can result in losses in the future if not remedied. Recognising near-losses is therefore a way to improve and rework the stability and structure of the system, to develop better processes or training programmes and to reduce the extent of loss.

Risk control self-assessments

Additional information is obtained in risk control self-assessments (RCSA). Within a standard framework, all business areas and subsidiaries annually identify and assess their main operational risks and the effectiveness of their control activities. These efforts include evaluating individual control activities and estimating the probability and extent of losses from the various individual risks.

Monitoring the actions from the RCSAs to avoid operational risks

In the course of risk control self-assessments, actions are agreed for further reducing the operational risks. Implementation of the agreed actions is tracked using a monitoring list provided by Operational Risk. Findings on the progress being made in implementing the actions are reported quarterly to the competent Managing Board members and the CRO.

5.3. Reporting systems

Every month, the Enterprise Risk Meeting receives a summary of recorded losses and the results of the risk control self-assessments as part of the Risk Report.

5.4. Risk hedging and mitigation

BAWAG P.S.K. has laid the foundation for operational risk mitigation with its segmented organisational structure, clear rules on competencies and responsibilities, and work instructions. Consistent guidelines on powers and an internal control system adequate for risk handling, including computerised plausibility checks, help to keep the risk situation under control.

6. PARTICIPATIONS NOT INCLUDED IN THE TRADING BOOK

6.1. Objectives and principles for the management of participations

Article 2, lines 1, 3, 4 OffV

6.1.1. Strategies and procedures

The participation risk includes potential losses from own funds provided, from risks caused by the assumption of liability (e.g. comfort letters) or from profit and loss transfer agreements (assumptions of loss).

Under the **participation strategy** approved by the Managing Board, BAWAG P.S.K. and its Group undertakings carry participations in the following categories:

- ▶ **Majority interests in the financial services sector** that are considered part of the core business of BAWAG P.S.K. Group and that therefore address additional groups of customers or enlarge the product range and that must satisfy minimal return requirements in the medium term.
- ▶ **Minority interests in the financial services sector** of strategic significance for enlarging the product range within the financial services sector. These equity exposures are measured based on direct return.
- ▶ **Auxiliary undertakings of BAWAG P.S.K. Group** perform services for BAWAG P.S.K. Group in outsourced legal entities. Auxiliary undertakings are generally active in the IT sector or in payments. The participation portfolio carries auxiliary undertakings both as majority interests and as minority interests (usually collaborations with other credit institutions).
- ▶ **Participations for generating own funds.** These participations are held mainly due to own funds generation associated with them and are also measured on that basis. A return can only be depicted in individual cases.
- ▶ **Other participations**

BAWAG P.S.K. generally pursues the goal of achieving appropriate and lasting profitability taking any risk mitigation into account. Any major change in the participation portfolio therefore requires the approval of the Managing Board of BAWAG P.S.K. following a request from the front-office unit responsible for participations and an expert opinion from the risk unit designated as Commercial and Institutional Risk.

6.1.2. Risk measurement systems

Requests from the front-office unit responsible for participations to change a participation are forwarded to the management for a decision after a separate **expert opinion** on the associated risk is drawn up by **Commercial and Institutional Risk**. For significant operational participations, the front-office unit responsible for participations does a **standardised target/actual analysis of the company figures** during the year, with monthly reports to Controlling and the full Managing Board.

All participations are rated once a year based on the BAWAG P.S.K. rating standards. The confirmed rating is issued by Commercial and Institutional Risk. Credit-financed participations are handled in the restructuring phase by Workout. An **impairment test for participations** must be conducted annually and checked by Commercial and Institutional Risk. The purpose of the impairment test is to determine whether the estimates for the participations have maintained their value and to recognise the undisclosed reserves in the participation portfolio. Any value corrections are taken into account immediately in accounting.

6.1.3. Reporting systems

Risk controlling for participations is done quarterly in the form of reports to the Managing Board. The risk assessment covers the risk types credit risk, market risk, operational risk, tax risk, country risk and participation risk for each participation directly held and for indirectly held participations using a minimum exposure.

6.1.4. Risk hedging and mitigation

The treatment of risks arising from participations is governed in the Participation Risk Strategy, the Participation Risk Manual and the work manual "Risk Controlling for Participations".

The **Participation Risk Strategy**, a sub risk strategy of BAWAG P.S.K Group, determines the medium-term projects related to essential risky participations.

The **Participation Risk Manual** describes the organisation, processes for the current management of participation risk and methods for risk measurement and risk mitigation for participations.

A risk controlling report on participations must be submitted quarterly to the Managing Board.

The **Work Manual for Risk Controlling** presents the processes, responsibilities and methods stipulated for risk controlling.

In addition, the Participation Controlling Department, located in the front-office unit responsible for participations, monitors the financial results of all significant operational participations on an ongoing basis and monitors the performance of all other participations in the overall portfolio annually.

6.2. Accounting and valuation methods

Article 13, line 2 OffV

Austrian Uniform Commercial Code

Participations are valued at acquisition cost unless persistent losses or a lack of earning power necessitate a write-down.

IFRS

Non-consolidated participations are assigned to the category “Financial assets available for sale”.

The valuation is based on the fair value. If this cannot be reliably determined, the valuation is based on acquisition cost. Extraordinary writedowns are not written up again according to IAS 39.

7. SECURITISATIONS

7.1. Securitisation activities and functions in the securitisation process

Article 15, lines 1, 2, 7, 8, 10, 11 OffV

BAWAG P.S.K. itself has not yet conducted any securitisations and currently acts solely as an investor of structured securitisation for the purpose of attaining interest income. The extent and structure of the portfolio is described in the quantitative section of this publication and in the Annual Report. Beyond that, BAWAG P.S.K. plays no role in any securitisation transactions.

7.2. Approaches to the calculation of risk-weighted exposure amounts

Article 15, line 4, OffV

Securitisations are to be carried out in the standardised approach according to the provisions of Article 161 Austrian Solvency Regulation. The ratings from Moody's, Standard & Poor's and Fitch are incorporated into the calculation of risk-weighted exposures.

7.3. Accounting policies for securitisations

Article 15, line 5, lit a through d OffV

This requirement applies only to the originator of an ABS arrangement and is not currently relevant for BAWAG P.S.K.

7.4. Eligible external rating agencies used for securitisations

Article 15, line 6 OffV

In its investment deliberations, BAWAG P.S.K. utilises the ratings of Moody's, Standard & Poor's and Fitch in all asset classes for securitised transactions. BAWAG P.S.K. does not act as a customer of rating agencies as regards the rating of securitised transactions.

8. RATING SYSTEMS AND RATING PROCESSES

8.1. External ratings

Article 8, lines 1, 2, 3, 4 OffV

The weighted exposure figures are calculated for the entire credit portfolio of BAWAG P.S.K. Group using the standard credit-risk approach set forth in Article 22a Austrian Banking Act. For calculating risk-weighted exposure amounts, BAWAG P.S.K. Group generally only uses ratings from Moody's and in the case of securitisations, also ratings from Standard & Poor's and Fitch.

8.2. Internal rating systems

Article 16, paragraph 1, line 2, lit a OffV

8.2.1. Customer segmentation and overview of the internal rating systems

The Bank employs an internal rating and scoring system for risk management purposes and in preparation for the use of the IRB approach. Customers are assigned an exposure category and the stipulated rating procedure based on a process called segmentation. The first step in segmentation occurs automatically in advance of actual calculations based on the following parameters:

- ▶ ÖNACE Code (the Austrian adaptation of NACE (the Statistical Classification of Economic Activities in the European Community; in French: Nomenclature statistique des activités économiques dans la Communauté européenne)
- ▶ Country containing the principle place of business
- ▶ Type of accounting (takes into account the operating revenues of the customer or company group)
- ▶ Amount of the exposure of the customer's corporate group with BAWAG P.S.K. Group
- ▶ Special finance code Y/N

The relevant rating and scoring process is determined based on these criteria and, in retail business, also on the selected product.

Individual provisions of the Austrian Solvency Regulation are taken into account in the calculation of required capital in the risk engine, at which time the exposure class or its sub-category is finally set.

The table below summarises the significant rating and scoring models for the customer segment Banks and Commercial and Retail Customers.

Overview of rating and scoring systems

	Rating system	Stat. model / Expert model	BAWAG P.S.K.	easybank	Others *)
Corporates	Standard commercial	Stat. model	x	x	x
	Holding companies	Expert model	x	x	x
	Private real estate	Expert model	x	x	x
	Construction of not-for-profit housing	Expert model	x		x
	Project financing	Expert model	x		x
	Income-generated real estate financing	Expert model	x		x
	Project financing	Expert model	x		x
	Financing based on commodity trading	Expert model	x		x
Banks	Banks	Stat. model	x	x	x
Retail	AS – overdrafts	Stat. model	x	x	x
	AS – consumer loans	Stat. model	x	x	x
	AS – mortgage loans	Stat. model	x	x	x
	AS – credit cards	Expert model	x	x	x
	AS – SME retail	Stat. model	x	x	x
	BS – private and SME loans	Stat. model	x	x	x
	BS – current accounts (private)	Stat. model	x	x	x
	BS – current accounts (others)	Stat. model	x	x	x
	BS – credit cards	Expert model	x	x	x
	BS – SME accounts	Expert model	x	x	x

*) Applied only in isolated cases

Table 3

8.2.2. Relationship between internal and external ratings

BAWAG P.S.K. ratings from Moody's are employed to calculate the minimum capital requirements for regulatory purposes. For securitisations, the ratings from Moody's, Standard & Poor's and Fitch are incorporated in the calculation of risk-weighted exposures.

The results of the internal rating procedures are depicted using a master scale. The table below shows the relationship between the internal rating notches and the ratings used by external rating agencies.

Rating notches and classes

Rating notch	Rating class	Corporates			Banks			Sovereigns		
		Moody's	S&P's	Fitch	Moody's	S&P's	Fitch	Moody's	S&P's	Fitch
1.1	Excellent							Aaa	AAA	AAA
1.2					Aaa	AAA	AAA	Aa1, Aa2	AA+, AA	AA+, AA
1.3		Aaa	AAA	AAA	Aa1, Aa2	AA+, AA	AA+, AA	Aa3	AA-	AA-
2.1	Very good	Aa1	AA+	AA+	Aa3	AA-	AA-	A1, A2	A+, A	A+, A
2.2		Aa2	AA	AA	A1, A2	A+, A	A+, A	A3	A-	A-
2.3		Aa3	AA-	AA-	A3	A-	A-	Baa1	BBB+	BBB+
3.1	Good	A1	A+	A+	Baa1	BBB+	BBB+	Baa2	BBB	BBB
3.2		A2	A	A	Baa2	BBB	BBB	Baa3	BBB-	BBB-
3.3		A3	A-	A-	Baa3	BBB-	BBB-	Ba1	BB+	BB+
4.1	Average	Baa1	BBB+	BBB+	Ba1	BB+	BB+	Ba2	BB	BB
4.2		Baa2	BBB	BBB	Ba2	BB	BB	Ba3	BB-	BB-
4.3		Baa3	BBB-	BBB-	Ba3	BB-	BB-	B1	B+	B+
5.1	Acceptable	Ba1	BB+	BB+	B1	B+	B+	B2	B	B
5.2		Ba2	BB	BB	B2	B	B	B3	B-	B-
5.3		Ba3	BB-	BB-	B3	B-	B-	Caa 1-3	CCC+, CCC, CCC-	CCC+, CCC, CCC-
6.1	Poor	B1	B+	B+	Caa 1-3	CCC+, CCC, CCC-	CCC+, CCC, CCC-	Ca	CC	CC
6.2		B2	B	B	Ca	CC	CC		C	C
		B3	B-	B-		C	C			
7	Poorest	Caa 1-3	CCC+, CCC, CCC-	CCC+, CCC, CCC-						
		Ca	CC	CC						
			C	C						
8.1– 8.8	Default	C	R, SD, D	DDD – D	C	R, SD, D	DDD – D	C	R, SD, D	DDD – D

Table 4

The internal rating processes for the exposure classes also take into account external ratings under certain conditions (e.g. more current or more comprehensive information).

8.3. Rating systems and processes in the retail segment

Article 16, paragraph 1, line 3, lit. d OffV

8.3.1. Private customers

Private customers are defined as natural persons whose income does not primarily derive from self-employment. The main exposure categories in the private customer segment are overdrafts of salary accounts, private loans and credit card sales.

Any time a product with a credit facility is opened, private customers are subject to a

- ▶ Scoring of their application

to determine a rating. After using the product for six months, they are subject to an automatic

- ▶ monthly process to determine a score for behaviour.

Scoring of the application

The application is scored based on the product involved and on the different scorecards for the product categories:

- ▶ Loans for which real estate was furnished as security,
- ▶ Current accounts and standard loans,
- ▶ Qualified revolving retail exposures.

The scorecards take into account customer characteristics (e.g. age, occupation), application and product characteristics (e.g. amount of credit extended) and external data on any incidences of payment problems.

Loans can be approved only for customers in risk classes up to 6.2. Beyond the determination of risk class, scoring gives a recommendation on what decision to make (accept/green; reject for now/yellow; reject/red) based on the regulations specifying the essential criteria of the credit extension guidelines (total credit exposure, affordability, security, etc.).

These recommendations are binding for the authorised employees in Sales. Only authorised staff in the Risk Centres are allowed to overrule the categories “reject for now” and “reject”. Another application scoring procedure can be carried out during the term of any product where warranted, particularly if essential new information has come up that indicates a (positive or negative) change in the customer’s current risk class.

Application scoring for mortgage loans

Alongside the customer's personal data (e.g. economic environment, employment status, revenue and expenditure account) and credit application information (e.g. amount of loan), the automatic rating procedure also incorporates collateral characteristics. Decision-making rules are used to check compliance with the credit extension guidelines as regards security, affordability, etc. The final personal decision takes into account minimum collateral rates and accumulated non-securitised credit amounts in the applicant's total exposure.

Application scoring for a credit card

For credit cards for current account holders at the Bank, the risk class of the current account is the decisive factor. Some credit cards are issued jointly with organisations or companies outside the financial sector and served within BAWAG P.S.K. Group by easybank. In the case of these cobranded credit cards, a decision recommendation and risk class are issued using a generic scorecard and a decision tree.

Application scoring for consumer loans and overdrafts

For standard loans and overdrafts, the Bank determines a risk class based on the customer's personal data (e.g. economic environment, employment status) and the credit application data (e.g. amount, term, purpose); decision-making rules are used to check the specifications in the credit extension guidelines as regards total exposure and affordability and taking into account security reserves, etc. For current accounts, the customer's personal data (e.g. age, education and external information) is used to form a risk class.

Behavioural scoring

A distinction is made in behavioural scoring by product group, salary and other current accounts, loans and overdrafts. Behaviours geared to each category are incorporated in the scoring. Loans and overdrafts are all assessed with a behavioral scorecard. After six months, each product is checked at the end of the month using the appropriate behavioural scorecard and a behavioural score is determined. This score is based mostly on internal account movements: e.g. account behaviour (accounts and loans/overdrafts), duration of the customer relationship, payment behaviour, number of loans/overdrafts taken out, but also external information such as entries in warning lists.

Forming the customer risk class

Every month, the Bank conducts an aggregation to create a customer risk class from the different application scoring and behavioural scoring procedures for the individual products. This is done at least once at the end of the month or is calculated when a transaction is first commenced. The aggregation to the customer risk class is based on an internal weighting of the poorest risk classes for the products.

8.3.2. Small and medium-sized enterprises

The retail segment covers enterprises for which the exposure of the entire customer group in relation to BAWAG P.S.K. Group does not exceed EUR 1 million and whose operating revenues do not exceed EUR 50 million. If these enterprises cannot be assigned a special rating based on business purpose (see 8.4. Rating systems and processes at companies and institutions), the scoring procedure for small and medium-sized enterprises is applied.

In the Retail/Small Business segment, further sub-segments geared to the type of accounting (cash-based, lump-sum and balance sheet accounting) and the operating revenues are formed to take into account the different information bases and the procedural requirements. The exposures consist mainly of overdrafts in payment accounts as well as working capital finance and medium- and longer-term investment loans. As with private customers, both application and behavioural scoring processes are used here.

Scoring of the application

An application scoring risk class is determined based on quantitative information (customer's financial data) and qualitative characteristics (soft facts, account behaviour) as well as additional items of external and internal information (e.g. warning list, Kreditschutzverband von 1870 [KSV]). The Bank internally developed the key figures models for enterprises with cash-based accounting, lump-sum accounting and small balance sheet accounting. The statistically validated model RiskCalc Austria™ from Moody's KMV is used for the financial rating for businesses that draw up a balance sheet and that have more than EUR 0.5 million in operating revenue. Information from the commercial customer portfolio at BAWAG P.S.K. was significant in the development of this model. The Retail/Small Business rating systems for application scoring have been used in their initial versions since 2006. In 2007, the RiskCalc Austria™ financial rating model was replaced by a revised version (3.1.). In the autumn of 2009, adaptations were carried out in the small business application scoring rating systems for enterprises with cash-based accounting, lump-sum accounting and small balance sheet accounting with operating revenues less than EUR 0.5 million.

Application scoring must be done for each new application or as warranted (when a change occurs in essential information relevant to the rating) and regularly repeated in connection with accounting, operating revenues, exposure and the behavioural score of the customer. The application scoring results in a customer rating based on risk class and descriptive reasons associated with that risk class. In addition, a recommendation is given on what decision to make (accept/green; reject for now/yellow; reject/red) for special customer groups to enable differentiated treatment of the customers.

Behavioural scoring

Behavioural scoring essentially involves an evaluation of the customer's account behaviour. Consideration is also given to other variables such as the duration of the customer relationship and external information.

8.4. Rating systems and processes at companies and institutions

Article 16, paragraph 1, line 3, lit. b, c and e OffV

The rating systems must be used at companies and institutions who avail themselves of an exposure at BAWAG P.S.K. Group. This exposure is mainly attributable to claims from overdrafts in payment accounts, working capital finance, and medium- and longer-term investment loans or to corporate securities in the Bank's own portfolio and Treasury products. The rating process for companies basically calls for the customer advisor to solicit information relevant to the rating and conduct a qualitative evaluation of the customer (rating based on soft facts) in the central corporate data system. The customers' financial data are also centrally recorded and evaluated (hard-fact rating) in this database (separated from the lending process). Based on these qualitative and quantitative input factors, a risk class is calculated automatically for the customer and checked by risk analysts (back office; dual-control principle). It is altered if need be and then confirmed in the system. The risk class must likewise be approved by the employee responsible for it. The customer's rating must be updated at least once a year or as needed (new application, deterioration of creditworthiness, etc.), also during the year. It is subsequently used for calculating the regulatory minimum capital requirements, for reporting and for determining terms and conditions and risk control.

8.4.1. Standard commercial

This area of application extends to companies with balance sheet accounting to which a special rating procedure based on business purpose cannot be assigned (e.g. holding and real estate companies) and whose group exposure under Basel II is equal to or greater than EUR 1 million or whose consolidated operating revenues are equal to or greater than EUR 50 million.

The customer's risk class is calculated from a combination of financial rating from the statistically validated RiskCalc Austria™ model and an evaluation of qualitative characteristics (e.g. management, organisation, market/sector, general factors, and account management). The risk analyst can alter a confirmed customer rating if need be by issuing an overruling¹ or override². The major reasons for this step are downgrading based on an outdated balance sheet, external ratings or warning signals (e.g. outstanding tax, warning list entries) and consideration of a group influence, ratings of a rating sponsor (e.g. dominant shareholder, personal partner with unlimited liability) or under certain circumstances, consideration of external ratings.

1 An overruling is defined as a deviation in the confirmed rating from the automatically calculated rating in predefined cases with a defined effect, i.e. according to defined rules (e.g. outdated financial statements from the customer, various warning signals, group influence).

2 An override, on the other hand, is a variable deviation from the automatic rating results based on a subjective assessment involving an examination by the risk manager and with a corresponding decision by the person having authority in the matter.

The RiskCalc Austria™ financial rating model used since 2004 and developed with Moody's KMV was replaced in the summer of 2007 by a revised version (3.1.) that takes sector affiliation into greater account. Discriminatory power was noticeably improved by incorporating a credit cycle adjustment factor that is updated monthly. It is based on sectoral economic data and stock exchange price trends and adds a dynamic component for determining the probability of default.

8.4.2. Holding companies

This area of application extends to companies that hold permanent stakes in legally autonomous companies. As with standard commercial customers, the structure of the rating system for holding companies is divided into a hard-fact and a soft-fact rating. Risk analysts can combine them with an overruling/override and change them if need be. The hard-fact rating is segment-specific and derived from the rating of the holding company's balance sheet and the consolidated financial statements, with different weighting applied to the participation portfolio based on qualitative risk dispersion characteristics. The rating method was developed as an expert system.

8.4.3. Real estate companies

This area of application covers companies with balance sheet accounting that can be designated as real estate agents/investors based on their business activities. The rating system is basically structured like the standard commercial process. The financial rating is based on a business-specific key figures model developed by experts. The soft-fact list includes company-specific and property-specific characteristics.

8.4.4. Construction of non-profit housing

This area of application extends to non-profit building associations as defined in Article 1 Austrian Non-profit Housing Act (WGG). The risk class for this customer segment is based on a financial rating with key figures developed specifically by experts. The rating can be adjusted using upgrades and downgrades (defined qualitative parameters such as vacancies, property condition, owners, account management, etc.) and, if need be, by means of an overruling/override.

8.4.5. Special financing

According to the Austrian Banking Act, special financing refers to exposures created in relation to companies specially set up to finance or operate real properties that comply with the criteria set down in Article 22b para. 3 lit. a to c. As a first step, internal ratings are set for these companies based on the criteria laid down in Article 74 para. 4 Austrian Solvency Regulation. The ratings are then mapped to the five categories named in the Austrian Solvency Regulation.

- ▶ Category 1: Internal rating is equivalent to an external rating of Baa3 or better
- ▶ Category 2: Internal rating is equivalent to an external rating of Ba1 or Ba2
- ▶ Category 3: Internal rating is equivalent to an external rating of Ba3 or B1
- ▶ Category 4: Internal rating is equivalent to an external rating of B2 to C
- ▶ Category 5: Default

Any collateral that is involved is already contained in the rating, so the risk engine does not take it into account for special financing.

8.4.6. Banks

All banks (except special lending institutions) are rated in the portfolio of BAWAG P.S.K. Group using the bank rating system. Exposure to banks arises mainly from payment transactions and other handling transactions, from money market financing, the takeover of securities and in Treasury. A bank has to be assigned a risk class before accounts can be opened or limits granted.

The rating is based on the balance sheets and income statements from recent years plus further key figures. Data from the external database BankScope are applied for this purpose. The financial rating is determined first from the key figures. Comparisons with peer groups (bank type), registered office (division into country groups) and size of bank (grouping) are part of this process. Special attention is paid to the quality of the assets, capitalisation, profitability, efficiency and components of the net profit/loss.

In a second step, any external ratings are considered with a weighting factor. As part of an overruling procedure (rating upgrades/downgrades in a defined and limited scope), the risk analysts consider essential trends since the last balance sheet reference date (especially interim results as well as the take-up/dropping of lines of business, group structuring, etc.) and qualitative factors (e.g. ownership structure, risk management, competitiveness, external information policy). The rating that is calculated in this way is limited in that it may be no higher than the rating of the country in which the bank has its registered office. The final confirmed rating is then assigned a certain probability of default based on a master scale.

8.4.7. Participation items

For participations of BAWAG P.S.K. Group, the same rating procedures are used as for external borrowers, namely the processes for corporates and banks. Equity requirements are determined by the simple risk weight method in accordance with Article 77 paragraph 3 Austrian Solvency Regulation.

8.5. Use of internal estimates

Article 16, paragraph 1, line 2, lit. b

The risk parameters in the rating systems are integral parts of the Bank control system within the scope of price calculation that adequately captures risk, the determination of standard risk costs and credit portfolio modeling.

8.6. Control mechanism for rating systems

Article 16 paragraph 1, line 2 lit. d OffV

The annual validation reports from the rating and scoring systems deserve mention first. They are conducted by a central risk management office for all rating models used throughout the Bank and comprise the following activities:

Description of the validation methods

Validation method	Description
Method 1.1	Verification of the documentation for the rating and scoring systems
Method 1.2	Verification of the assumptions underlying the systems in collaboration with experts
Method 2	Verification of the quality of the data being used for validation
Method 3	Verification of the correct use of the rating and scoring systems as part of a use test
Method 4.1	Distribution analysis to identify clusters of customers in individual risk classes
Method 4.2	Comparison of internal ratings with external ratings (benchmarking)
Method 4.3	Identification of clustering of high exposures in individual risk classes
Method 4.4	Verification by the risk manager of the frequency of overrulings/overrides in the automatically generated rating classes
Method 4.5	Verification of clusters of defaults in individual rating or scoring systems Observations are conducted over extended periods and economic cycles. Not yet possible at this time because a suitable time series is not yet available.
Method 5.1	Testing of rating and scoring systems for calibration using Brier score
Method 5.2	Testing of individual risk classes to determine correlation between the forecast PD and the observed PD using standard normal tests and binomial distribution tests
Method 6	Testing of the discriminatory power of the rating and scoring systems using ROC and Gini coefficient
Method 7.1	Stability analyses of discriminatory power over time
Method 7.2	Migration matrices for the observation of changes in the risk structure
Method 8	Any analyses on why one of the above methods posed problems, based on a traffic-light system for each method

Table 5

Credit Risk Private and Corporate Customers is the organisational unit responsible for validating the rating systems used in the Bank Group and is directly answerable to the CRO.

Above and beyond that, monthly changes in the following categories are compiled as part of standardised monitoring reports:

- ▶ Distribution of the customers and exposures across the Basel II segments, an internal subdivision of the exposure classes
- ▶ Distribution of the risk classes across the Basel II segments and their degree of up-datedness
- ▶ Risk classes based on overrulings

If defined limits are exceeded or fallen short of, the causes are analysed more closely and counter-measures are initiated as needed.

8.7. Estimation and validation of the risk parameters

Article 16, para. 1, line 8; Article 16, para. 2, line 2 OffV

8.7.1. Probability of default

The probability of default (PD) is the estimated probability that a borrower will default within the next twelve months. The occurrence of one of the events listed below is deemed a default event throughout the Group. The definition of default corresponds to the regulatory reference definition (“90 days past due” and “imminent default of payment”) as set forth in Article 22b para. 5 line 2 Austrian Banking Act in connection with Article 46 para. 1 and para. 2 Austrian Solvency Regulation:

Description of the reference definitions for default

Reference definition for default	Description
90 days past due	A material liability of the borrower is more than 90 days past due.
Imminent default of payment	In response to the rating, the parties agreed to a reorganisation interest rate/ exemption from interest, restructuring of the obligation (e.g. change in term, change in schedule for repayment of principal) or the like.
	In response to the rating, the Bank removed claims against the borrower from the Bank balance sheet.
	Legal case without allocation of a specific provision (e.g. due to full securitisation).
	The borrower filed a bankruptcy petition.
	A specific provision is allocated due to the rating (automatically or manually).

Table 6

At present, BAWAG P.S.K. Group primarily makes use of generic PD estimation models.

In the segments Small Business (Retail) and Standard Commercial, BAWAG P.S.K. uses a hard-fact rating based on selected key balance sheet figures. Moody's RiskCalc Austria™ model V3.1 is the version currently in use and has been employed since August 2007. This model is based on a classic probit regression, in which key balance sheet ratios and industry indicators are condensed into a score using a statistical model. The probit regression is a special case of the general linear model and closely associated with logistic regression in methodological terms. Parameters are estimated using the maximum likelihood principle. The score calculated using the model is assigned the customer-specific probability of default (PD) calibrated for the Bank portfolio. In addition, the PD is adapted based on current economic indicators (economic and stock exchange information) using what is referred to as the credit cycle adjustment (CCA) factor. To develop RiskCalc, balance sheets were taken from the period 1991 through 2003 and defaults from the period 1993 through 2005 (e.g. insolvencies, value adjustments, late payment).

The bank rating approach is based on a regression model in which a statistical model is used to condense key balance sheet figures, peer group information (peer group comparisons) and country weights into a customer PD. Data from 1995 through 2009 were used for model development.

Experts developed the generic rating systems for commercial customers and added available data to support them as development proceeded. The PD estimation is validated annually using qualitative and quantitative methods. The qualitative methods focus on data quality and use and on the quality of the documentation for the estimation process. Discriminatory power is measured in the quantitative area. Furthermore, a binomial test is used for calibration and to check the discrepancy between the forecast PD and the PD actually observed. The stability of the estimation models is also observed over extended periods of time.

8.7.2. Loss given default

Loss given default (LGD) is defined as economic loss as a percentage of the outstanding exposure at default (EAD). The economic loss comprises the outstanding exposure at default EAD less monies flowing back from the realisation of collateral and other non-collateral proceeds. Internal Bank estimates are carried out only for the retail portfolio (Private and Small Business). The LGD estimate is based on a two-step process. First, the collateral return rate (SEQ) is determined per collateral pool. Then the outstanding exposure less collateral return (EAD*) is determined. For the non-collateralised portion of the exposure, a non-collateralised LGD is estimated using a CHAID-class decision-tree process applying criteria with a high degree of discriminatory power. In a final step, the two components SEQ and non-collateralised LGD are then merged to arrive at the final estimated LGD. The generated values of the individual pools are calibrated at a conservative level using a systematic error determined by boot strapping. Data from the period extending back to August 2007 were used to develop the model.

The annual validation of the estimated LGD comprises analyses of the deviation between observed values and estimated values, plausibility checks, verification of model assumptions by experts, and descriptive statistics and tests for the individual LGD pools.

8.7.3. Credit conversion factor

The credit conversion factor (CCF) is the expected utilisation in per cent of a line of credit existing but not yet drawn at the time of estimation until such time as a default event occurs. In other words, the CCF is used for estimating exposure at default (EAD). Internal Bank estimates are carried out only for the retail portfolio (Private and Small Business). The CCF estimate is based on a CHAID-class decision-tree process using criteria with a high degree of discriminatory power. The generated values of the individual pools are calibrated at a conservative level using a systematic error determined by boot strapping. Data from the period extending back to August 2006 were used to develop the model.

The annual validation of the estimated CCF comprises analyses of the deviation between observed values and estimated values, plausibility checks, verification of model assumptions by experts, and descriptive statistics and tests for the individual CCF pools.

QUANTITATIVE DISCLOSURE

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List of Abbreviations

ABS	Asset-backed securities
AFS	Available for sale
BS	Balance sheet
BWG	Bankwesengesetz (Austrian Banking Act)
CDO	Collateralised debt obligation
CDS	Credit default swap
CHF	Swiss franc
CLO	Collateralised loan obligation
CMBS	Commercial mortgage-backed security
CPDO	Constant proportion debt obligation
CRM	Credit risk mitigation
EUR	Euro
IFRS	International Financial Reporting Standards
IRB	Internal ratings based
JPY	Japanese yen
LSS	Leveraged super-senior
OffV	Offenlegungsverordnung (Disclosure Regulation)
OTC	Over the counter
PVBP	Present value basis point
RMBS	Residential mortgage-backed security
RWA	Risk weighted asset
Repo	Repurchase agreement
USD	US dollar

1. SCOPE OF CONSOLIDATION AND ACCOUNTING STANDARDS

Section 1.1 of the qualitative part of the disclosure report describes the respective accounting standards and the scope of consolidation on which the annual financial statements of BAWAG P.S.K. Group are based and on which the regulatory standards in section V. of the Austrian Banking Act (referred to below as BWG) are based. These differences arise from differing objectives of the regulations in question and result in different values for some items.

The quantitative part of this disclosure report follows this differentiation. For example, the information on own funds and the own funds requirements as well as the detailed breakdown of the receivables in accordance with Article 7 of the Disclosure Regulation (referred to below as OffV) were prepared according to the regulatory principles and the BWG, while the notes on the values in the annual financial statements are based on IFRS. In cases of doubt, the regulations that were applied are stated with the respective table.

2. OWN FUNDS

Article 4 OffV

Own funds and their components

in millions of Euros	31.12.2009
Total	2,896
Tier 1	2,100
Eligible capital	800
Paid up capital (business and share capital, capital stock, allocated capital and capital assets) without preferred shares with dividend payment obligations	800
Other eligible reserves	1,394
Of which liability reserve	614
Eligible reserves	927
Minority interest	848
Of which: non-innovative instruments subject to limit	444
Of which: innovative instruments subject to limit	404
(-) Material losses of the current financial year	-271
Valuation differences eligible as original own funds	-110
+/- Difference arising from the combination of equity capital and shares	-110
Fund for general banking risks	28
(-) Other deductions from original own funds	-122
(-) Intangible assets	-122
Additional own funds	831
Core additional own funds	237
Revaluation reserves	10
Other additional own funds/supplementary capital	152
Country-specific core additional own funds	75
Hidden reserves	75
Supplementary additional own funds	594

in millions of Euros	31.12.2009
Subordinated loan capital	594
(-) Deductions from original and additional own funds	-101
Of which: (-) from original own funds	-51
Of which: (-) from additional own funds	-51
(-) Holdings in other credit and financial institutions amounting to more than 10% of their capital	-27
(-) Participations held in insurance undertakings, reinsurance undertakings and insurance holding companies	-54
(-) Subordinated claims and other items in insurance undertakings, reinsurance undertakings and insurance holding companies	-20
Total original own funds for general solvency purposes	2,049
Total additional own funds for general solvency purposes	780
Total original and additional own funds for general solvency purposes	2,829
Total additional own funds specific to covering market risks	67
Excess on limits for additional own funds transferred to additional own funds specific to covering market risks	230
(-) Unused but eligible Tier III capital	-164
Memorandum items:	
Gross amount of subordinated loan capital	951

Table 1

The core capital on 31 December 2009 amounted to EUR 2,100 million. Of this total, EUR 800 million are paid-in capital while EUR 1,394 million are reserves. The EUR 848 million in minority interests contain EUR 404 million in hybrid equity instruments pursuant to Article 24 paragraph 2 line 5 BWG, whose key features are presented in the table below.

Key features of equity items

Issuer	Title of issue	Issue date	ISIN	Interest
BAWAG Capital Finance (Jersey)	Perpetual Non-cumulative Non-voting Fixed/Floating Rate Preference Shares	31.10.2000	XS0119643897	8.765% p.a. up to 31.10.2010; thereafter 3 M EURIBOR + 4.7% p.a.
BAWAG Capital Finance (Jersey) II	Perpetual Non-cumulative Non-voting Fixed Rate Preference Shares	27.06.2002	DE0008600966	7.125% p.a.
BAWAG Capital Finance (Jersey) III	28 Yen Series C Fixed Rate Perpetual Reset Non-cumulative Non-voting Preference Shares	05.04.2004	GB00B00GQ100	3.085% up to 5.4.2034, thereafter 5 Y yen swap + 0.8%

Table 2

The subtraction of deduction items reported in Table 1 results in core capital totalling EUR 2,049 million. Long-term subordinated capital totals EUR 594 million and accounts for the overwhelming share of eligible supplemental capital, which totals EUR 780 million.

3. CAPITAL REQUIREMENTS

3.1. Capital requirements for each exposure class

Article 5, paragraph 2, 3 OffV

All risk-weighted exposure amounts are calculated using the standardised approach to credit risk.

Capital requirements by exposure class

in millions of Euros	31.12.2009
Standardised approach – total	1,579
Standardised approach – exposure classes	1,503
Exposures to central governments or central banks	3
Exposures to regional governments	1
Exposures to public-sector entities, administrative bodies and non-commercial undertakings	10
Exposures to institutions	121
Exposures to corporates	712
Retail exposures	198
Exposures secured by real estate	183
Past due exposures	56
High-risk items	139
Exposures in the form of covered bonds	2
Exposures in the form of shares in investment funds	5
Other items	73
Standardised approach – securitisation positions	76

Table 3

Capital requirements by exposure class

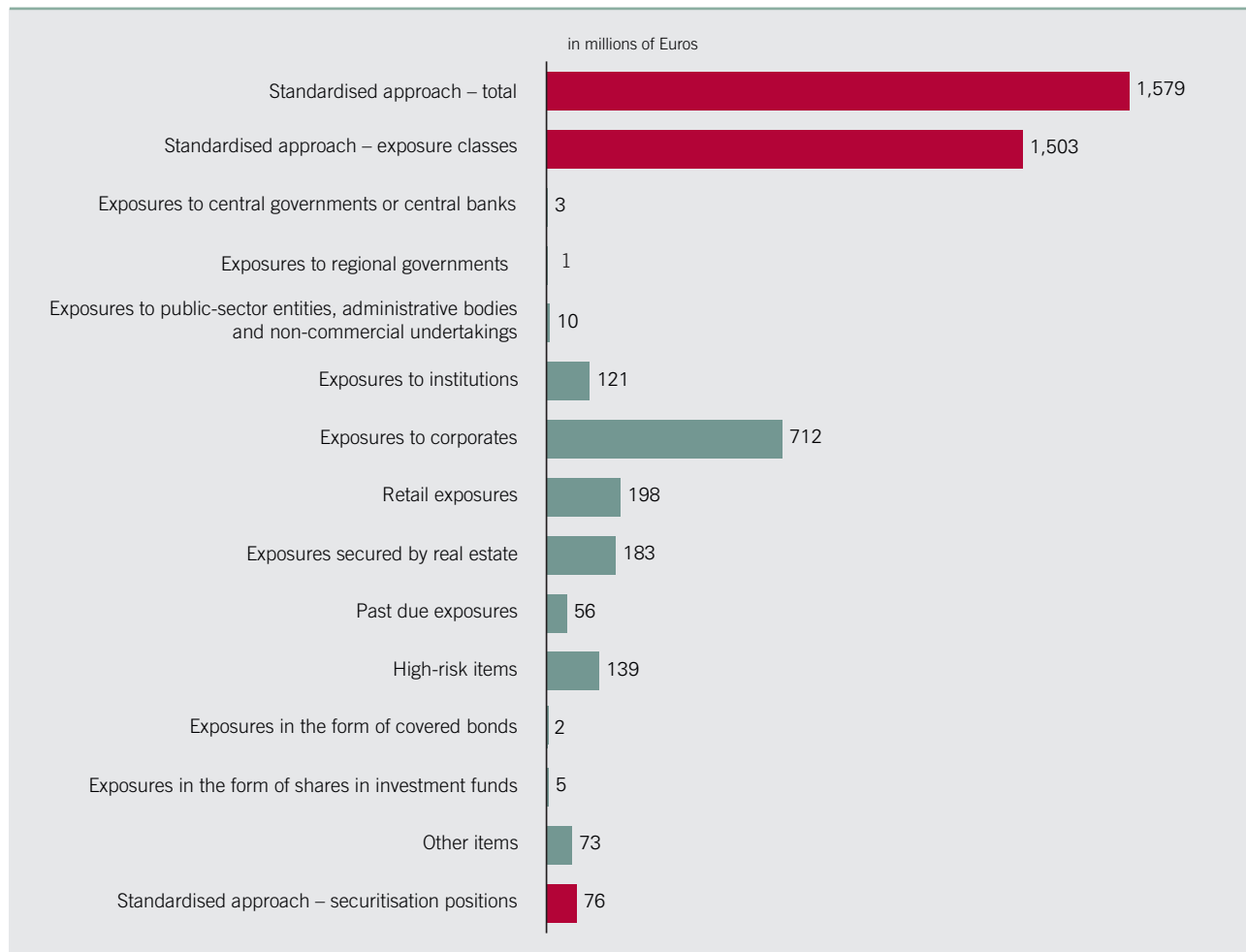


Figure 1

3.2. Capital requirements for commodities risk, foreign exchange risk and risk types in the trading book

Article 5, line 4 OffV, Article 10 OffV

Capital requirements for risk types in the trading book, commodities risk and foreign exchange risk

in millions of Euros	31.12.2009
Position, foreign exchange and commodity risks (standardised approach)	51
Of which debt instruments in trading book	51
Of which equities in trading book	–
Of which foreign exchange risk	–
Of which commodities risk	–
Position, foreign exchange and commodity risks (internal model)	16
Settlement risk	–

Table 4

3.3. Capital requirement to cover the operational risk

Article 5, line 5 OffV

The minimum capital requirement according to the basic indicator approach totals EUR 150 million.

4. COUNTERPARTY DEFAULT RISK FROM DERIVATIVES, REPURCHASE TRANSACTIONS, SECURITIES OR COMMODITIES LENDING OR BORROWING TRANSACTIONS, MARGIN LENDING TRANSACTIONS, AND LONG SETTLEMENT TRANSACTIONS

Article 6, lines 5, 7, 8 OffV

BAWAG P.S.K. has no commodity-borrowing transactions, margin lending transactions or transactions involving long-term settlement. Netting is utilised at BAWAG P.S.K. in the banking book. The positive fair values are offset against the negative fair values for each counterparty. Further, any cash collateral held at BAWAG P.S.K. is credited to reduce the applicable current values.

As contracts with a central counterparty are not subject to any counterparty risk, the information in the following table is confined to OTC derivatives and repos. The positive reacquisition values for derivative counterparty default risk positions and for repos totalled EUR 1,626 million on 31 December 2009.

Fair values for all derivatives and repos

in millions of Euros	31.12.2009
Total of applicable fair values for all derivatives and repos	
Derivatives	1,526
Repos	100
Positive added value for all derivatives and repos	1,626
Credit exposures from the transactions above prior to netting – depiction of the full credit exposure (positive value added + add on)	
Positive value added for all derivatives and repos	1,626
Add on	215
Total of credit exposures (off balance sheet)	1,841
Details on exposure amount, off balance sheet	
Interest derivatives	1,274
Foreign exchange derivatives	174
Credit derivatives	61
Other items	17
Repos	100
The amount of collateral held for transactions pursuant to § 6 OffV	
Financial collateral in the form of cash deposits	368

in millions of Euros	31.12.2009
Credit exposures from derivatives after netting	
BAWAG P.S.K. employs netting in the banking book. For each counterparty, the applicable negative fair value is subtracted from the positive fair value and any cash collateral is credited.	
Total credit exposures (off balance sheet)	1,841
Reduction due to netting	-878
Credited cash collateral	-362
Total credit exposure from derivatives after netting	601

Table 5

CDSs are largely used at BAWAG P.S.K. to hedge the securities held. A small part of the CDSs are used as security for loans. The iTraxx CDS and the Micro Hedges serve as hedges for part of the Bank's ABS portfolio.

Nominal values of the CDSs for hedging the securities held and for loans

in millions of Euros	31.12.2009
Nominal values of the CDSs for hedging the securities held	555
Nominal values of the CDSs for hedging loans	39

Table 6

The credit derivatives are used primarily as hedging for the securities portfolio totalling EUR 2,263 million. A small part of the CDSs are used as security for loans.

Nominal values of securities hedged and loans hedged

in millions of Euros	31.12.2009
Nominal values of securities hedged	2,263
Nominal values of loans hedged	39

Table 7

Information on credit derivatives

in millions of Euros	31.12.2009
Credit derivatives break down into	
Hedging for own credit portfolio	
Purchased credit derivatives (protection buy) – total nominal value	594
Sold credit derivatives (protection sell) – total nominal value	–
Credit derivatives for which the Bank acts as intermediary and the provision of CDSs	
Purchased credit derivatives (protection buy) – total nominal value	625
Sold credit derivatives (protection sell) – total nominal value	350

Table 8

5. CREDIT RISK AND DILUTION RISK

5.1. Total amount of exposures after accounting offsets and average amount of the exposures broken down by exposure class

Article 7, paragraph 1, line 3 OffV

Exposure values by exposure class (according to UGB/BWG)

in millions of Euros	31.12.2009 Exposure value	Average 2009
Exposures to central governments or central banks	5,713	5,407
Exposures to regional governments	2,757	2,687
Exposures to public-sector entities, administrative bodies and non-commercial undertakings	1,088	1,055
Exposures to institutions	7,143	8,057
Exposures to corporates	9,913	9,885
Retail exposures	3,330	3,321
Exposures secured by real estate	4,931	5,062
Past due exposures	1,365	1,355
High-risk items	1,157	808
Exposures in the form of covered bonds	216	203
Exposures in the form of shares in investment funds	72	70
Other items	1,585	1,515
Securitisation positions	1,045	1,372
Total	40,315	40,797

Table 9

5.2. Geographical distribution of the exposures

Article 7, paragraph 1, line 4 OffV

Exposure values by country group (according to UGB/BWG)

in millions of Euros	31.12.2009 Exposure value	Share in %
Austria	27,019	67.0%
Western Europe	9,018	22.4%
Central and Eastern Europe	1,743	4.3%
North America	1,060	2.6%
Asia/Pacific	237	0.6%
Others	1,238	3.1%
Total	40,315	100.0%

Table 10

Exposure values by country group

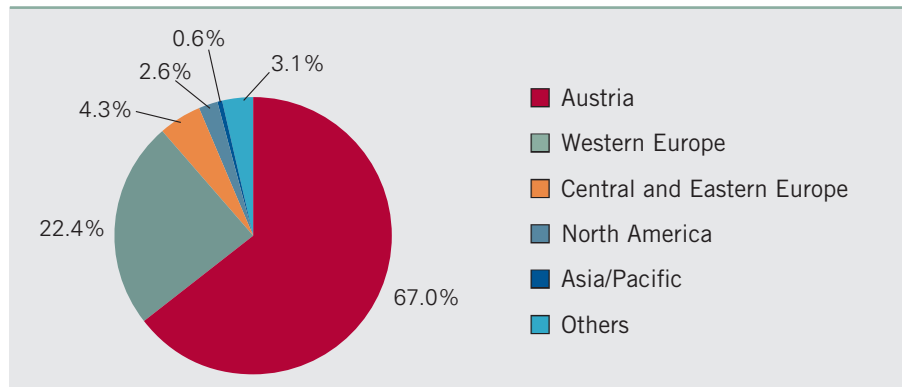


Figure 2

5.3. Distribution of exposures by industry

Article 7, paragraph 1, line 5 OffV

Exposure values by industry (according to UGB/BWG)

in millions of Euros	31.12.2009 Exposure value	Share in %
Agriculture and forestry	107	0.3%
Aviation	20	0.0%
Banks	10,312	25.6%
Chemicals, ceramics, glass and other products	285	0.7%
Communication	152	0.4%
Construction	452	1.1%
Food and beverage	390	1.0%
Healthcare	289	0.7%
Households	5,887	14.6%
Insurance and other financial institutions	5,786	14.4%
Machines/equipment/appliances	481	1.2%
Media and print	155	0.4%
Mining	126	0.3%
Oil/plastic products	193	0.5%
Public administration	8,251	20.5%
Pulp and paper	33	0.1%
Real estate	2,207	5.5%
Retail trade	971	2.4%
Services	1,388	3.4%
Steel/metal	184	0.5%
Subsidised housing	1,249	3.1%
Textiles and apparel/shoes	50	0.1%
Tourism	294	0.7%
Transport	305	0.8%
Utilities	176	0.4%
Wholesale trade	484	1.2%
Wood products and furniture	67	0.2%
Others	21	0.1%
Total	40,315	100.0%

Table 11

Exposure values by industry

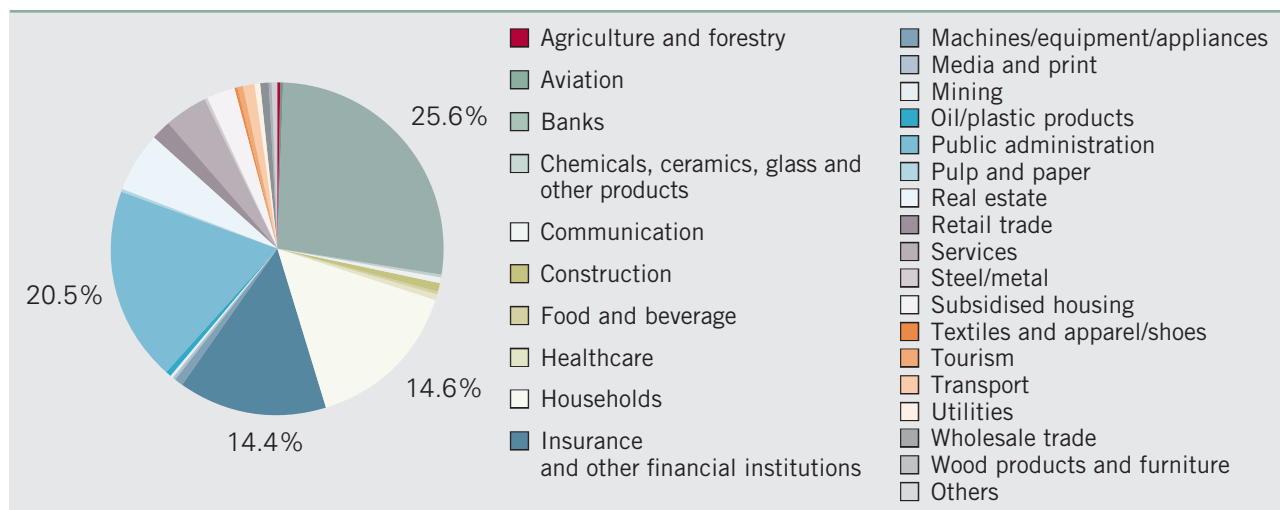


Figure 3

5.4. Breakdown of exposures by residual maturity

Article 7, paragraph 1, line 6 OffV

Exposure values by residual maturity (according to UGB/BWG)

in millions of Euros	31.12.2009 Exposure value	Share in %
Up to 3 months	8,945	22.2%
3 months to 1 year	2,712	6.7%
1 to 5 years	11,835	29.4%
Over 5 years	16,824	41.7%
Total	40,315	100.0%

Table 12

Exposure values by residual maturity

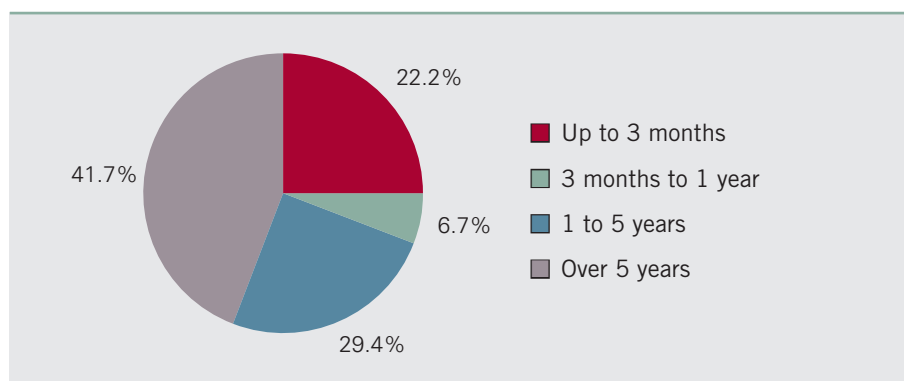


Figure 4

5.5. Exposure values and impairment provisions per industry for impaired exposures

Article 7, paragraph 1, line 7, lit a, b, c OffV

Exposure values by risk category and industry (according to UGB/BWG)

in millions of Euros	Risk category	31.12.2009 Exposure value	Share in %
Agriculture and forestry	impaired	5	0.2%
	past due	2	0.1%
Aviation	impaired	1	–
	past due	1	–
Banks	impaired	32	1.5%
	past due	90	4.3%
Chemicals, ceramics, glass and other products	impaired	12	0.6%
	past due	6	0.3%
Communication	impaired	–	–
	past due	7	0.3%
Construction	impaired	28	1.3%
	past due	12	0.6%
Food and beverage	impaired	9	0.4%
	past due	10	0.5%
Healthcare	impaired	5	0.3%
	past due	4	0.2%
Households	impaired	574	27.2%
	past due	230	10.9%
Insurance and other financial institutions	impaired	126	6.0%
	past due	104	4.9%
Machines/equipment/appliances	impaired	16	0.8%
	past due	42	2.0%
Media and print	impaired	11	0.5%
	past due	51	2.4%
Mining	impaired	–	–
	past due	39	1.8%
Oil/plastic products	impaired	1	0.0%
	past due	6	0.3%
Public administration	impaired	–	0.0%
	past due	32	1.5%
Pulp and paper	impaired	1	–
	past due	–	–

in millions of Euros	Risk category	31.12.2009 Exposure value	Share in %
Real estate	impaired	36	1.7%
	past due	75	3.6%
Retail trade	impaired	56	2.7%
	past due	25	1.2%
Services	impaired	96	4.6%
	past due	134	6.4%
Steel/metal	impaired	1	0.1%
	past due	6	0.3%
Subsidised housing	impaired	–	0.0%
	past due	35	1.7%
Textiles and apparel/shoes	impaired	4	0.2%
	past due	3	0.1%
Tourism	impaired	38	1.8%
	past due	17	0.8%
Transport	impaired	12	0.5%
	past due	12	0.5%
Utilities	impaired	–	–
	past due	22	1.0%
Wholesale trade	impaired	29	1.4%
	past due	31	1.5%
Wood products and furniture	impaired	14	0.7%
	past due	7	0.3%
Total		2,109	100.0%

Table 13

Impairment provisions by risk category and industry

in millions of Euros	Risk category	31.12.2009 Impairment provision	Share in %
Agriculture and forestry	impaired	1	0.1%
	past due	–	–
Aviation	impaired	1	0.1%
	past due	–	–
Banks	impaired	33	4.4%
	past due	–	–
Chemicals, ceramics, glass and other products	impaired	10	1.3%
	past due	–	–
Communication	impaired	–	–
	past due	–	–
Construction	impaired	18	2.4%
	past due	–	–
Food and beverage	impaired	8	1.1%
	past due	–	–
Healthcare	impaired	4	0.5%
	past due	–	–
Households	impaired	393	52.3%
	past due	–	–
Insurance and other financial institutions	impaired	73	9.7%
	past due	–	–
Machines/equipment/appliances	impaired	11	1.4%
	past due	–	–
Media and print	impaired	10	1.3%
	past due	–	–
Mining	impaired	2	0.3%
	past due	–	–
Oil/plastic products	impaired	–	–
	past due	–	–
Public administration	impaired	–	–
	past due	–	–
Pulp and paper	impaired	–	–
	past due	–	–
Real estate	impaired	17	2.3%
	past due	–	–
Retail trade	impaired	44	5.9%
	past due	–	–

in millions of Euros	Risk category	31.12.2009 Impairment provision	Share in %
Services	impaired past due	60 –	8.0% –
Steel/metal	impaired past due	– –	– –
Subsidised housing	impaired past due	– –	– –
Textiles and apparel/shoes	impaired past due	3 –	0.4% –
Tourism	impaired past due	24 –	3.2% –
Transport	impaired past due	8 –	1.1% –
Utilities	impaired past due	5 –	0.7% –
Wholesale trade	impaired past due	19 –	2.5% –
Wood products and furniture	impaired past due	7 –	0.9% –
Total		751	100.0%
Portfolio impairment provision for retail according to IFRS		23	
Portfolio impairment provision for leasing according to IFRS		43	
Total according to IFRS		817	

Table 14

5.6. Net charges for value adjustments for impaired exposures for significant economic sectors

Article 7, paragraph 1, line 7, lit c OffV

Net charges for value adjustments for impaired exposures for significant economic sectors (according to IFRS)¹⁾

in millions of Euros	31.12.2009
Exposures to central governments	–
Exposures to credit institutions	–
Exposures to corporates	65
Exposures to retail customers	109
Exposures to other customers	–
Total	174

¹⁾ Including expenses for losses incurred but not detected in accordance with IAS 39 AG 89.

Table 15

5.7. Exposure values and impairment provisions per country group for impaired exposures

Article 7, paragraph 1, line 8 OffV

Exposure values by risk category and country group (according to UGB/BWG)

in millions of Euros	Risk category	31.12.2009 Exposure value	Share in %
Austria	impaired	899	42.6%
	past due	788	37.4%
Western Europe	impaired	89	4.2%
	past due	134	6.4%
Central and Eastern Europe	impaired	101	4.8%
	past due	46	2.2%
North America	impaired	1	0.0%
	past due	12	0.6%
Asia/Pacific	impaired	–	–
	past due	22	1.0%
Others	impaired	16	0.8%
	past due	–	–
Total		2,109	100.0%

Table 16

Impairment provisions by risk category and country group

in millions of Euros	Risk category	31.12.2009 Exposure value	Share in %
Austria	impaired	631	84.1%
	past due	–	0.0%
Western Europe	impaired	81	10.8%
	past due	–	–
Central and Eastern Europe	impaired	34	4.5%
	past due	–	–
North America	impaired	1	0.1%
	past due	–	–
Asia/Pacific	impaired	–	–
	past due	–	–
Others	impaired	4	0.5%
	past due	–	–
Total according to UGB/BWG		751	100.0%
Impairment provisions for retail according to IFRS		23	
Impairment provision for leasing according to IFRS		43	
Total according to IFRS		817	

Table 17

5.8. Value adjustments and provisions for impaired exposures

Article 7, paragraph 1, line 9, lit a, b, c, d, e OffV

Value adjustments and provisions for impaired exposures as of 31.12.2009 (according to IFRS)

in millions of Euros	Individual and collective impairment	Impairment provisions for incurred but not reported losses	Total
Balance as of 1.1.2009	678	29	707
Additions			
Provisions created through profit or loss	238	6	244
Disposals			
Used as intended	-29	-	-29
Provisions released through profit or loss	-70	-	-70
Balance as of 31.12.2009	817	35	852

Table 18

5.9. Value adjustments and recoveries recorded directly to income statement

Article 7, paragraph 3 OffV

Value adjustments and recoveries recorded directly to income statement (according to IFRS)

in millions of Euros	31.12.2009
Direct write-downs	-13
Recoveries on loans previously written off	1
Total	-12

Table 19

6. STANDARDISED APPROACH TO CREDIT RISK

Article 8, line 5, lit a, b OffV

Exposure values¹⁾ before and after credit risk mitigation per rating notch and exposure values deducted from equity

in millions of Euros	31.12.2009									Total
	0%	10%	20%	35%	50%	75%	100%	150%	Other risk weights	
Exposures to central governments or central banks										
Gross exposure	7,045		98		10		73			7,226
Exposure according to CRM	7,334		98		25		4			7,461
Exposures to regional governments										
Gross exposure	3,037		44							3,081
Exposure according to CRM	4,410		44							4,454
Exposures to public-sector entities, administrative bodies and non-commercial undertakings										
Gross exposure			2,445							2,445
Exposure according to CRM			659							659
Exposures to institutions										
Gross exposure	45		10,208		116		174			10,543
Exposure according to CRM	45		6,682		56		153			6,936
Exposures to corporates										
Gross exposure	6		721		781		11,874	48		13,430
Exposure according to CRM	6		299		980		8,304	33		9,622
Retail exposures										
Gross exposure						7,095				7,095
Exposure according to CRM						3,305				3,305
Exposures secured by real estate										
Gross exposure				3,456	583	615	427			5,081
Exposure according to CRM				3,433	561	567	380			4,941
Past due exposures										
Gross exposure					24		1,121	288		1,433
Exposure according to CRM					24		352	221		597
High-risk items										

in millions of Euros	31.12.2009									
	0%	10%	20%	35%	50%	75%	100%	150%	Other risk weights	Total
Gross exposure								1,157		1,157
Exposure according to CRM								1,157		1,157
Exposures in the form of covered bonds										
Gross exposure		216								216
Exposure according to CRM		216								216
Exposures in the form of shares in investment funds										
Gross exposure							60		12	72
Exposure according to CRM							60		12	72
Other Items										
Gross exposure	675						910			1,585
Exposure according to CRM	675						910			1,585
<i>Of which other items deducted from equity:</i>										
Gross exposure	223									223
Exposure according to CRM	223									223

¹⁾ Exposure values contain balance sheet and off-balance-sheet elements, as credit risk mitigation techniques are also applied to gross exposures.

Table 20

7. PARTICIPATIONS NOT HELD IN THE TRADING BOOK

7.1. Participations based on their objectives

Article 13, line 1 OffV

A differentiation is made according to the following criteria:

Participations belonging to the **core business** of BAWAG P.S.K.: These are major and minority interests intended to be held long term within the financial services sector.

Participations performing **auxiliary tasks** for BAWAG P.S.K. Group: e.g. in payments or IT.

Other participations: These primarily cover participations in private equity financing, credit guarantees and real estate as well as legally mandatory participation in deposit insurance.

Differentiation between participations based on their objectives

in millions of Euros	Book value 31.12.2009
Participations belonging to core business	132
Participations performing auxiliary tasks for BAWAG P.S.K. Group	2
Other participations	175
Total non-consolidated participations	309

Table 21

7.2. Participations categorised by company shares

Article 13, lines 3, 4 OffV

Participations categorised by company shares

in millions of Euros	Book value ¹⁾ 31.12.2009
Shares categorised as "Available-for-sale assets"	279
Shares in credit institutions	177
Subsidiaries	–
Associates	36
Other shares	141
Shares in other companies	102
Subsidiaries	58
Associates	36
Other shares	8
Shares accounted for using the equity method	30
Associates	30
Total shares in non-consolidated companies	309

¹⁾ The book value was used at the fair value because a market value cannot be determined reliably for the most part.

Table 22

Breakdown of securities

in millions of Euros	Not listed	Listed			BAWAG P.S.K. Group total 2009
		Total	Held to maturity	Other valuation	
Bonds and other fixed-income securities	1,265	10,034	5,487	4,547	11,299
Shares and variable-income securities	127	49	–	49	176
Shares in associates and other shares	221	–	–	–	221
Shares in non-consolidated subsidiaries	58	–	–	–	58
Total securities	1,671	10,083	5,487	4,596	11,754

Table 23

7.3. Cumulative profit or loss from the sale of participations

Article 13, lines 5, 6 OffV

Accumulated profits and losses from sale of participations

No material profit or loss was generated in 2009 from the sale of participations.

Revaluation reserve

Additional own funds contain a revaluation reserve of EUR 10 million.

8. INTEREST RISK FROM NON TRADING BOOK POSITIONS

Article 14, line 3 Offv

PVBP of BAWAG P.S.K. Group as of 31.12.2009 per currency

in thousands of Euros	< 1 Y	1 Y-3 Y	3 Y-5 Y	5 Y-7 Y	7 Y-10 Y	> 10 Y	Total
EURO	-60	-135	73	41	154	-34	40
USD	10	2	-6	1	-17	-26	-35
CHF	-16	-2	-5	-12	-19	-62	-116
JPY	3	-	-1	-	-	9	11
Other currencies	1	6	-1	1	-	-	6
Total	-62	-130	61	31	118	-112	-94

Table 24

9. SECURITISATIONS

Article 15 OffV

BAWAG P.S.K. has not yet securitised any exposures. It acts solely as an investor. Exposure from securitisation items on the reporting date 31 December 2009 amounted to EUR 1,045 million.

Securitisation items by type of exposure

in millions of Euros	31.12.2009
CDO of ABS	21
CDO of ABS w/ subprime	1
CLO	42
CMBS	33
Corporate CDO	78
Corporate CDO squared	243
European RMBS	9
Others	618
Total	1,045

Table 25

Securitisation items by type of exposure

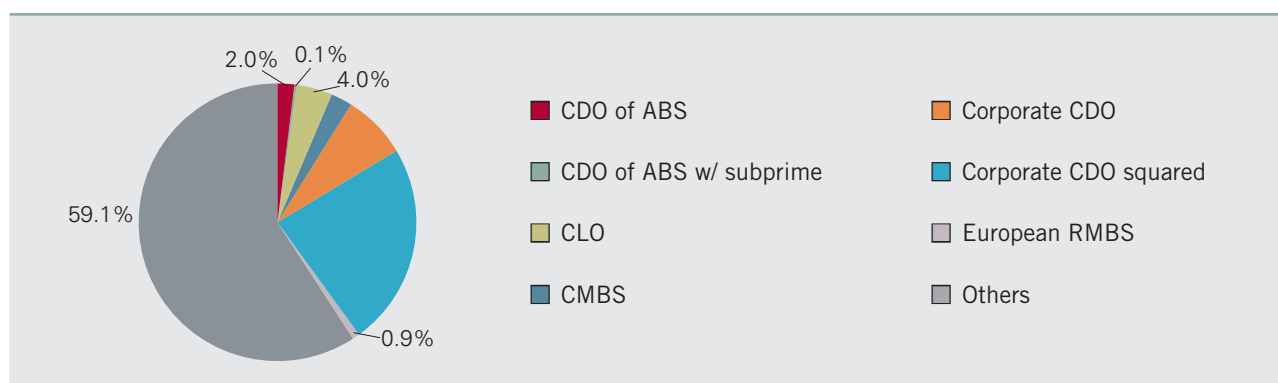


Figure 5

Securitisation items by risk weighting

in millions of Euros	31.12.2009
Weighting 20%:	834
Weighting 50%:	32
Weighting 240%:	142
Weighting 350%:	3
Weighting 1250%:	34
Total	1,045

Table 26

Securitisation items by risk weighting

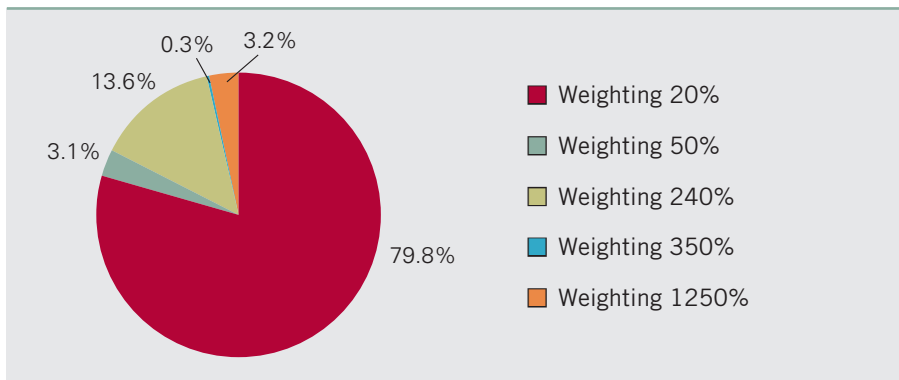


Figure 6

10. CREDIT RISK MITIGATION BY EXPOSURE CLASS

Article 17, lines 6, 7 OffV

Exposure values covered by eligible financial collateral and other real collateral

in millions of Euros	31.12.2009 Financial collateral	31.12.2009 Other real collateral
Exposures to institutions	762	
Exposures to corporates	312	
Retail exposures	64	
Exposures secured by real estate	33	4,148
Past due exposures	20	
Total	1,191	4,148

Table 27

Exposure values covered by personal collateral

in millions of Euros	Guarantees	Other forms of credit risk mitigation	Total
Exposures to central governments or central banks	69	–	69
Exposures to public-sector entities, administrative bodies and non-commercial undertakings	598	–	598
Exposures to institutions	1,142	–	1,142
Exposures to corporates	1,525	–	1,525
Retail exposures	8	18	26
Exposures secured by real estate	2	21	23
Past due exposures	14	2	16
Total	3,358	41	3,399

Table 28

Owner and publisher

BAWAG P.S.K.

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