# Capital Management

## Capital management process

Group's capital management is based on the high-level document „Capital Management and Planning Framework", approved by the Bank's Management Board and Supervisory Board.

Group's capital management relates to two areas: capital adequacy management and capital allocation. For both areas, management goals were set.

The goal of capital adequacy management is: (a) ensuring the solvency of the Group in the normal and stressed conditions (economic capital adequacy) and (b) meeting the requirements specified in external regulations (regulatory capital adequacy).

Capital allocation purpose is to create value for shareholders by maximizing the return on risk in business activity, taking into account established risk appetite.

## Own Funds requirements

Group is obliged by law to meet minimum own funds requirements, set in art. 92 of Regulation of European Parliament and Council no 575/2013 on prudential requirements for credit institutions and investment firms (CRR) and Polish Banking Act. At the same time, maintaining regulatory capital adequacy on a higher level than required minimum is one of a goal of capital management. Calculating own funds requirements, local solutions and interpretations are used (issued by Polish Financial Supervisory Authority - PFSA).

Group is implementing a project of an implementation of internal ratings based method (IRB) for calculation of own funds requirements for credit risk and obtaining of approval decisions from Regulatory Authorities on that matter.

In the end of 2012, Banco de Portugal (consolidated Regulator) with cooperation of Polish Financial Supervision Authority (PFSA) granted an approval to the use of IRB approach as to following loan portfolios: (i) Retail exposures to individual persons secured by residential real estate collateral (RRE), (ii) Qualifying revolving retail exposures (QRRE). According to the mentioned approval, minimum own funds requirements calculated using the IRB approach must be temporarily maintained at no less than 80% (“Regulatory floor”) of the respective capital requirements calculated using the Standardized approach.

During 2014, the Group submitted to Regulatory Authorities an IRB approval pack regarding the remaining loan portfolios under the IRB roll-out plan – “other retail” and “corporate” portfolios.

In the end of 2014, the Group received another decision by Regulatory Authorities regarding the IRB process. According to its content, for the RRE and QRRE loan portfolios, the minimum own funds requirements calculated using the IRB approach had to be temporarily maintained at no less than 70% (“Regulatory floor”) of the respective capital requirements calculated using the Standardized approach until the Group fulfils further defined conditions. The IRB approval for the remaining portfolios under roll-out plan shall be possible after meeting a list of conditions defined by Regulatory Authorities.

Beside own funds requirement described in IRB decision (“Regulatory floor”), Group is not required by Regulatory Authorities to hold any additional own funds requirements.

Data on regulatory capital adequacy (own funds requirements and capital ratios) are shown in the below table.

| Bank Millennium Group – capital adequacy | 31.12.2014 | 31.12.2013 |
|---|---|---|
| (PLN mn) | IRB with regulatory floor[1)] | IRB with regulatory floor[2)] |

| | | |
|---|---|---|
| Risk-weighted assets (RWA) | 35.257,0 | 36.653,9 |
| Own funds requirements, including: | 2.820,5 | 2.932,3 |
| - Credit risk and counterparty credit risk | 2.514,4 | 2.665,1 |
| - Market risk | 24,8 | 18,4 |
| - Operational risk | 257,5 | 248,8 |
| - Credit Valuation Adjustement CVA | 23,8 | -/- |
| Own Funds including: | 5.368,9 | 5.327,8 |
| - Common Equity Tier 1 Capital | 5.123,1 | 4.927,9 |
| - Tier II Capital | 245,8 | 399,9 |
| Total Capital Ratio (TCR) | 15,2% | 14,5% |
| Common Equity Tier 1 Capital ratio (CET1 ratio)[3] | 14,5% | 13,4% |

*1) Risk-weighted assets and own funds requirements are calculated with 70% „Regulatory floor"*
*2) Risk-weighted assets and own funds requirements are calculated with 80% „Regulatory floor"*
*3) Common Equity Tier 1 Capital ratio is equal to Tier 1 Capital ratio*

Total risk-weighted assets went down by almost 4% and that decrease was influenced mainly by the end of the year IRB decision reducing the Regulatory floor from 80% to 70%. Own Funds raised by less than 1% in effect from retaining the part of net earnings from 2013 and consideration of 50% of 1st half 2014 net profit as well as the results of the above mentioned IRB decision.

## Internal capital

Group defines internal capital according to Polish Banking Act, as the estimated amount needed to cover all identified, material risks found in Group's activity and changes in economic environment, taking into account the anticipated level of risk in the future.

Internal capital is used in capital management in following processes: economic capital adequacy management and capital allocation.

Maintaining economic capital adequacy means a coverage (provision) of internal capital (that is an aggregated risk measure) by available financial resources (own funds). An obligation to banks to have in place that sort of risk coverage stems from Banking Act. It was mirrored in the Group's capital targets/limits: economic capital buffer and economic capital buffer in stressed conditions.

In 2014, both above capital targets were met with a significant surplus. A material surplus of own funds over internal capital supports a further increase of banking activity, in particular in areas with a higher risk-adjusted return.

At the same time internal capital is utilised in capital allocation process, to assign an internal capital to products/business lines, calculating risk-adjusted performance measures, setting risk limits and internal capital reallocation. In the future, Group plans to utilise internal capital for another purposes as well.