# Pillar III SNS Bank 2008

## Capital adequacy and riskmanagement

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# Contents

# 1 Introduction

This is SNS Bank's first report on capital adequacy and risk management in accordance with the legal disclosure requirements in EU's Capital Requirements Directive (CRD). The report presents the capital position and how the size and composition of the capital base is related to the risks as measured in risk weighted amounts (RWA).

CRD is based on the Basel II framework. With Basel II, the Basel Committee has abandoned the 1988 Capital Accord's "one-size-fits-all" method of calculating minimum regulatory capital requirements and introduced a three-pillar concept that seeks to align regulatory requirements with the economic principles of risk management. Basel II aims at improving the stability and soundness of the financial system by more closely linking capital requirements to risks and by promoting a more forward-looking approach to capital management.

The Basel II framework is based on three pillars:
- Pillar 1 defines the regulatory minimum capital requirements by providing rules and regulations for measurement of credit risk, market risk and operational risk. This capital demand has to be covered by regulatory own funds.
- Pillar 2 addresses the bank's internal processes for assessing overall capital adequacy in relation to risks (ICAAP). Pillar 2 also introduces the Supervisory Review and Evaluation Process (SREP), which assesses the internal capital adequacy of credit institutions.
- Pillar 3 focuses on minimum disclosure requirements, covering the key pieces of information required to assess the capital adequacy of a credit institution.

The third pillar of Basel II aims to promote greater market discipline by enhancing transparency in information disclosure. It means that more information concerning risks, risk management practices and capital adequacy will be published to the external world.

The recommendations of the Basel Committee on Banking Supervision (BCBS) were implemented in European legislation by the so-called CRD: the Capital Requirement Directive. This is embodied in two texts:
- Directive 2006/48/EC of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions;
- Directive 2006/49/EC of 14 June 2006 on the capital adequacy of investment firms and credit institutions;

These two directives are legally enforced under Dutch law.

This report constitutes the comprehensive disclosure on risks and capital as well as risk management and capital management. In a summarised form, the main disclosure on exposures as well as on risk, liquidity and capital management are also presented in SNS REAAL's annual report . In the capital adequacy and risk management report for 2008, SNS Bank increases the transparency on relevant risk factors inherent in the operations, how these are managed and mitigated and the effect on the capital adequacy for SNS Bank. The report has been developed with the ambition to meet the pillar 3 requirements as well as to meet the increased need of transparency in the financial market . The enhanced disclosure is developed to be aligned with the recommendations issued in 2008 by the Financial Stability Forum, Committee of European Bank Supervisors (CEBS) and European Banking Federation (EBF).

The pillar 3 report follows the structure below:
- Risk management SNS Bank
- Scope of application
- Regulatory capital requirements
- Credit risk
- Market risk
- Operational Risk
- Disclosure of off-balance
- Information about securitisation
- Internal capital adequacy assessment process
- Liquidity risk
- Capital adequacy

The full pillar 3 disclosure for SNS Bank is made annually. Periodic information is published bi-annually, included in the half year press release of SNS REAAL. The key data on capital adequacy is also presented in the annual report of SNS REAAL. The Pillar 3 report for the SNS Bank is presented on www.snsreaal.com.

# 2 Risk management SNS Bank

## 2.1 General

In 2008, the financial markets showed a negative development and a volatility that is rare in historic perspective. The effects were more extreme than anticipated. A number of risk management measures taken by SNS Bank had a mitigating effect.
The credit crunch, which started in 2007, continued and intensified significantly in the second half of 2008. With this, volatility in global capital markets increased. The turmoil and volatility on the stock, bond and derivative markets caused balance sheets and income statements of many financial institutions to be severely impacted. At the same time, the global macro economic climate deteriorated sharply into a pronounced slowdown in many countries and an outright recession in some.

## 2.2 Maintaining a moderate risk profile

SNS Bank's business activities have inherently a moderate risk profile as SNS Bank sells straightforward banking and insurance products and services with little exposure to higher risk activities (for example, proprietary trading), complex products or foreign exchange. The predominantly Dutch customer base is well diversified within the retail and SME market segments. Furthermore, the asset portfolios in the group have very little exposure to so-called 'toxic' asset classes, including no exposure to US sub-prime mortgages.

The unprecedented market conditions have severely tested risk management within all financial services companies. In response, many financial companies, including SNS Bank, are re-evaluating their strategic, tactical and operational risk management. The major adjustments are:

- De-risking of balance sheet exposures and at the same time issuing more capital.
- Re-evaluating the possible impact of correlated shocks on diversified business portfolios.
- More collaboration between risk management and the businesses.
- More elaborate evaluation of model assumptions and stress test scenarios.
- Reviewing compensation arrangements for senior management and employees.

SNS Bank's commitment to maintaining a moderate risk profile is even more important in these times of extremely volatile financial markets. This is why SNS Bank wants to further de-risk the balance sheet, while maintaining higher capital levels. In 2009 SNS Bank will take the appropriate steps, principally relating to the international project finance loan book of SNS Property Finance.
In addition, in 2008 the following improvements in operational risk management systems have been implemented within SNS Bank:

- Tighter monitoring of counterparty risks and the bank's liquidity position and solvency.
- Increased frequency of the meetings of the risk committees.
- Greater focus on Earnings-at-Risk (EaR) and Solvency-at-Risk.

## 2.3 Risk management organisation

SNS REAAL, has defined a number of risk principles for its risk management process in order to ensure a consistent approach to risk management. These principles, which are fully adopted by SNS Bank, ensure an integral risk management, geared to maintaining a moderate risk profile.
The risk principles are:

- One group-wide risk type classification.
- A preset risk tolerance per risk type.
- Scenario analyses for stress situations and contingency planning with regard to the key risks.
- Testing and validating models that are used for risk management.
- Risk owners have been appointed for all defined risks.
- Monitoring and assessment of risks independently of commercial activities.

The responsibilities within the risk management structure have been clearly defined, whereby the ultimate responsibility for risk management lies with the Executive Board. SNS REAAL's Chief Financial Officer is also the Chief Risk Officer. Risk owners have been appointed within the Executive Board and the Management Board of SNS Retail Bank and SNS Property Finance.
These risk owners are responsible for the formulation and execution of the risk policy for the appointed areas of attention.

SNS Bank, distinguishes three risk management responsibility levels:
- the line organisation, which is responsible for the risk and the management of the risk, and generally delegates risk management to risk committees;
- the risk management departments, which advise the line management and monitor positions;
- the internal auditor (the Group Audit Department of SNS REAAL), which reviews the process and performance of the risk organisation.

## 2.4 Risk committees

The following committees operate within the risk management structure:
- Audit Committee.
  This committee is comprised of members of the Supervisory Board and also supervises the quality and the activities associated with risk management.
- SNS REAAL Risk Policy Committee (CRG).
  This committee determines the strategic risk policy, structures the group-wide risk management organisation, translates the risk appetite of SNS REAAL into standards and limits, and determines the mandates of the other risk committees.
- Risk policy committees.
  The SNS Retail Bank Risk Policy Committee (CRB), the SNS Property Finance Risk Policy Committee (CR PF) manage the risks on an operational level.
- Integrity and Compliance Committee.
  This committee supervises the creation and safeguarding of the integrity levels desired by the Executive Board.
- SNS REAAL Asset & Liability Committee (ALCO Group).
  As a result of the turmoil on the financial markets, the ALCO Group has been given a more central role within its area of attention: the management of market risks, liquidity and solvency. In the last quarter, the ALM departments monitored all relevant positions on a daily basis and adjusted them where necessary. The board of the banking activities were closely involved in this process. For the time being, the frequency of the ALCO Group meetings has been increased to once every week. Due to the more central role of the ALCO Group, the tasks of the ALCO Bank have been integrated into the ALCO Group.
- Credit committees.
  Separate credit committees at SNS Retail Bank and SNS Property Finance take credit decisions and advise on credit limits, counterparty limits and the approval of large credit facilities.
- Price risk committees.
  The SNS Bank Price Risk Committee provides advice on client rates and manage the volume, risk and return of product portfolios.

## 2.5 Risk management departments

The risk management departments advise on risk management and report on the risk profile in order to promote efficiency and uniformity. SNS REAAL acts as group service centres for the banking and insurance activities. With regard to the risks, they are responsible for modelling, measuring, monitoring, reporting and advising. They are not responsible for formulating definitions and determining the policy. SNS REAAL has the following risk management departments:

### *Group Risk Management (GRM)*

GRM supports the Executive Board and the management boards in:

- Identifying changed as well as changing market conditions and regulations that are relevant to the strategy and policy.
- Determining the desired risk profile of the SNS REAAL entities.
- Translating the desired risk profile into internal standards and risk limits.
- Choosing products and services that correspond with the desired risk profile.
- Determining the value of portfolios for steering structural value creation.
- Determining the prices of products and services on the basis of risk-weighted return.
- Structuring and implementing Asset & Liability Management for the the banking activities
- Structuring and implementing the capitalisation and funding policies.
- Portfolio management and modelling credit risk.
- Setting frameworks for drawing up models and techniques and safeguarding their quality.
- Central and independent implementation of model validation.

### *Compliance & Operational Risk Management (C&O)*

C&O advises the Executive Board and the management boards of the business units on the management of non-financial risks.
These are the risks that are related to the conduct of persons and the structure of the business processes. The main duties of the department are drawing up policies, providing recommendations for ethical and controlled business conduct, and coordinating and promoting operational risk and integrity risk management. The SNS REAAL policy is detailed further by specialist staff departments, which support the line management in the execution of that policy. The key business units each have their own compliance officer. These local compliance officers functionally report to the C&O director.

### *Legal Affairs (LA)*

Legal Affairs prepares policy and supports activities for risk management. The main responsibilities of this department are:

- Identifying and advising on present and future legislation and regulations.
- Advising on aspects of integrity and the duty of care.
- Preparing and implementing policy with respect to the exercise of integrity and the duty of care.

### *Credit Risk Management (CRM)*

Within SNS Bank and SNS Property Finance, two separate and independent departments have been established for credit risk management. The departments focus on policy preparation and operational support of credit risk management and report to the CFOs of SNS Bank and SNS Property Finance. The main responsibilities of these departments are:

- Advising on the credit risk policy.
- Independent analysis of and advice on credit proposals. A separate mid-office has been established for retail and SME credit
- facilities that issues (binding) recommendations for credit facilities that do not satisfy the standard acceptance criteria.
- Administration and management of credit facilities and collateral.
- Administration and settlement of loans in arrears or in default.
- Preparing reports on the operational management in the area of credit risk.

Within SNS Property Finance there is a division between the SNS Property Finance Risk Management staff department and Risk Management within the business units. Hereunder follows a description.

### *Risk Management staff department of SNS Property Finance*

The Risk Management staff department of SNS Property Finance performs central risk management duties. All of these risk management duties have been chosen to be centrally organised. Cooperation is sought with the risk managers from the business units for exchange of information.

The following subjects fall within the responsibility of the Risk Management staff department of SNS Property Finance.
- General risk management strategy and policy in the field of credit risk;
- Portfolio credit risk (concentration risk);
- Preparation of risk reports of the business;
- Monitoring quality return models and PD/LGD models in consultation with the Balance Sheet Management & Risk Management staff department of SNS REAAL;
- Developing and maintaining return models and PD/LGD models, e.g. performing stress testing and back testing;
- Risk Management training in the business units and in the context of models, systems and risks;
- Secretarial approval process for acceptances of financing facilities and other risks;
- Project management or participation in projects such as Basel II, etc. in consultation with the policy department BRM at SNS REAAL;
- Risk control of delegated approval authority;
- Identifying integrity incidents and catastrophes;
- Central monitoring of increased risk clients and provision of assistance in the management of increased risk clients;
- Preparation of the provisions report to the SNS Property Finance Risk Committee.

### *Risk Management in the business units*

The activities of the risk managers in the business units of Property Finance (SNS Property Finance Netherlands and SNS Property Finance International) are specifically oriented towards loan risk and/or participation risk.

The following are some of the subjects which fall within the responsibility of the risk managers in the business units:
- Risk assessment of proposals for loans, revisions, extensions and increases as defined in the Approval Memorandum and Approval Matrix of SNS Property Finance;
- Assessing whether the proposals satisfy the Compliance requirements;
- Providing advice in the structuring of new or complex loans/projects and financing syndications;
- Streamlining the approval process and recording decisions taken (credit secretary);
- Helping to formulate risk reports and portfolio analyses;
- Cooperating in various projects in the field of risk management;
- Monitoring compliance issues, including CDD, portfolio limits, etc.;
- Performing a financial analysis of the creditworthiness of companies connected with the loan, their shareholders and/or other borrowers;
- Managing and monitoring portfolio management such as the review calendar, etc.;
- Evaluating and monitoring ‘special handling files’ and proposing ongoing and future provisions;
- Training business unit staff in the context of models, systems and risks.

The role of the risk managers in the Business Units is to act as sparring partners with the account managers (and loan officers and lawyers) when structuring deals.

### *Internal Control*

The Internal Control department of SNS Bank assesses the effectiveness of the control measures in the procedures on behalf of line management. Their findings are ‘weighed’ against a pre-set standard, generating adequate management information in relation to the organisational and process goals.

### *Group Audit Department of SNS REAAL (GA)*

GA reports to the chairman of the Executive Board and also has a reporting line to the Audit Committee of the Supervisory Board. In this way, the department is able to perform its activities independently of the business units and the departments of SNS REAAL.

GA carries out its audits for the Executive Board. These audits are based on a predetermined risk analysis. The audits focus on internal risk management and control systems, the related processing procedures and the (reliability of) management information.
In addition, various types of audits are performed at the request of the management boards, including certification activities for external parties.

# 3 Scope of application

## 3.1 General

In this chapter, the consolidation principles for the capital base within SNS Bank N.V. (SNS Bank) are described. The starting point for determining the scope of application of the Basel II approaches is the International Financial Reporting Standards (IFRS) consolidation scope of SNS Bank. As a general principle, all the legal entities entering into the IFRS consolidation scope of SNS Bank are also within the scope of application of the Basel approaches.

## 3.2 IFRS consolidation scope

The IFRS consolidation scope of SNS Bank is determined in accordance with IAS 27 Consolidated and Separate Financial Statements, IAS 28 Investments in Associates, IAS 31 Interests in Joint Ventures, and in accordance with SIC-12 Consolidation – Special Purpose Entities.
All companies for which SNS Bank, directly or indirectly, has the power to govern the financial and operating policies so as to obtain benefits from their activities (“control”) enter into the consolidation scope of SNS Bank, and are fully consolidated.
Investments in joint ventures (contractual agreements whereby SNS Bank and other parties undertake an economic activity that is subject to joint control) and investments in associates (investments in which SNS Bank has a significant influence, but which it does not control, generally holding between 20% and 50% of the voting rights) are also part of the consolidation scope, but are accounted for using the equity method.
Subsidiaries, joint ventures and associates are consolidated from the date on which effective control is transferred to SNS Bank and are no longer consolidated from the date that control ceases.
The tables below show the IFRS consolidation scope of only major subsidiaries that are currently active.

*Investments in associates*

Table 1: Group undertakings included in the capital base

| Subsidiary | Voting power | Domicile | Consolidation method |
|---|---|---|---|
| Overview of the investments in subsidiaries | | | |
| ASN Bank N.V. | 100% | The Hague | Purchase method |
| BLG Hypotheekbank N.V. | 100% | Geleen | Purchase method |
| SNS Securities N.V. | 100% | Amsterdam | Purchase method |
| SNS Assurantiën B.V. | 100% | Maastricht | Purchase method |
| SNS Assuradeuren B.V. | 100% | Maastricht | Purchase method |
| SNS Property Finance B.V. | 100% | Leusden | Purchase method |
| SNS Regio Bank N.V. | 100% | Utrecht | Purchase method |
| Zagora Ltd. | 100% | London | Purchase method |
| Hermes I to XVI | 100% | Utrecht | Purchase method |
| Other | 100% | Various | Purchase method |

*Investments in associates*

Table 2: Overview of the most significant investments in associated companies

| Associates | Voting power | Domicile | Consolidation method |
|---|---|---|---|
| ProCom Desarrollos Urbanos SA | 20% | ES | Purchase method |
| Project 2 Holding N.V. | 17% | BE | Purchase method |
| Tarpon Point Associates LLC | 10% | US | Purchase method |
| Überseequartier Beteilingungs GmbH | 33% | DE | Purchase method |
| Other | 20–49% | Various | Purchase method |

*Investments in joint ventures*

SNS Bank has interests in following joint ventures which are real estate companies. These companies are included using the proportionate method:

Table 3: Overview of the investments in joint ventures

| Joint ventures | Voting power | Domicile | Consolidation method |
|---|---|---|---|
| Homburg | 50% | CA | Proportionate method |
| Zom Riveroaks LP | 50% | US | Proportionate method |
| Astro Tower N.V. | 50% | BE | Proportionate method |
| VOF De Boompjes | 20% | NL | Proportionate method |
| Océanis | 35% | F | Proportionate method |
| Fortress/SNS PF Holding BV (before IMCA/BPF Holding BV) | 50% | NL | Proportionate method |
| VOF Multi SNS PF (before VOF AM BPF) | 50% | NL | Proportionate method |
| Other | 50% | Various | Proportionate method |

## 3.3 Basel II consolidation scope

The IFRS consolidation scope is identical to the Basel II consolidation scope.

# 4 Regulatory capital requirements

## 4.1 General

This chapter describes the regulatory capital requirements in SNS Bank. The risk types included are based on pillar 1 in the CRD and contain credit, market and operational risk.
In the table an overview of the capital requirements and the risk weighted assets (RWA) as of 31 December 2008 divided on the different risk types is presented. The credit risk comprises 75.1% of the risk in SNS Bank. Operational risk accounts for 5.8% of the capital requirements and market risk comprises 0.5% of the capital requirements.
The table also includes information about the approach used for calculation of the capital requirements. Out of the total capital requirements for credit risk, 17.9% have been calculated with the internal rating based approach (IRB) and 82.1% with the standardised approach.
Furthermore in the table, the capital requirement for credit, market and operational risk is adjusted with € 3,117 million due to the transitional rules (known as the capital floor). In 2008, the capital requirements could not be lower than 90% of the capital requirements calculated under Basel I regulations. The corresponding floor for 2009 is 80%.

Table 4: Capital requirements and risk weighted assets, 31 December 2008

| In € millions | Basel II RWA | Capital requirement |
|---|---|---|
| **Credit risk** | | |
| Standardised exposure classes: | | |
| - Central governments and central banks | 17 | 1 |
| - Institutions | 706 | 56 |
| - Corporate | 14,612 | 1,170 |
| - Retail | 1,160 | 93 |
| - Equity | 62 | 5 |
| IRB exposure classes: | | |
| - Retail mortgages | 2,789 | 223 |
| - Securitisation | 977 | 78 |
| Other | 770 | 62 |
| | 21,093 | 1,688 |
| **Market risk** | | |
| Standardised | 125 | 10 |
| **Operational risk** | | |
| Standardised | 1,639 | 131 |
| **Other and transitional capital requirements** | 5,198 | 416 |
| **Total** | **28,055** | **2,245** |

## 4.2 Capital requirements for credit risk

SNS Bank received approval by DNB to use the IRB approach for the retail portfolio secured by residential real estate. SNS Bank aims to gradually implement the IRB approach for other portfolios. The standardised approach will continued to be used for portfolios for which approved internal models are not yet in place. With the approval of DNB the standardised approach will continued to be also used for the portfolios Government, Credit institutions and Equity because of the fact that the credit risk for these portfolios is limited.
In the IRB and the standardised approaches, the regulatory capital requirements for credit risk are calculated using the following formula:

Capital requirements = RWA x 8%, where RWA = risk weight x EAD

In the table the exposure, exposure at default (EAD), average risk weight percentage, RWA and capital requirement are distributed by exposure class, which serves as the basis for the reporting of capital requirements. In this report the IRB exposure class is presented that SNS Bank has been approved for. For the remaining portfolios the standardised approach exposure classes are used.
The exposure value of an on-balance sheet exposure in the IRB approach is measured gross of value adjustments such as provisioning. The exposure at default (EAD) for the on-balance sheet items and derivative contracts is 100% of the original exposure. Off-balance sheet exposures are converted into EAD using credit conversion factors (CCF). The risk weight is calculated as RWA divided by EAD for IRB exposures. For exposures in the standardised approach, the risk weight is given by DNB.

Table 5: Capital requirement for credit risk, 31 December 2008

| In € millions | EAD | Average risk weight | RWA | Capital requirement |
|---|---|---|---|---|
| **Standardised exposure classes** | | | | |
| Central governments and central banks | 5,695 | 0% | 17 | 1 |
| Institutions | 2,558 | 28% | 706 | 56 |
| Corporate | 16,110 | 91% | 14,612 | 1,170 |
| Retail | 1,664 | 70% | 1,160 | 93 |
| Equity | 62 | 100% | 62 | 5 |
| Total standardised approach | 26,089 | 63% | 16,557 | 1,325 |
| **IRB exposure classes** | | | | |
| Retail | 22.339 | 12% | 2.789 | 223 |
| Securitisation | 6,576 | 15% | 977 | 78 |
| Total IRB approach | 28,915 | 13% | 3,766 | 301 |
| Other | 161 | 478% | 770 | 62 |
| **Total credit risk** | **55,165** | **38%** | **21,093** | **1,688** |

## 4.3 Capital requirements for market risk

SNS Bank uses the standardised approach in the CRD to calculate capital requirements for the trading book. The model covers interest rate risk and equity risk and is based on fixed risk weights.

## 4.4 Capital requirements for operational risk

The capital requirements for operational risk is calculated by SNS Bank according to the standardised approach, in which all of the institution's activities are divided into eight standardised business lines: corporate finance, trading & sales, retail banking, commercial banking, payment & settlement, agency services, asset management and retail brokerage.
The total capital requirement for operational risk is calculated as the sum of the capital requirements for each of the business lines. The risk for each business line is the beta coefficient multiplied by gross income. The beta coefficients differ between business lines and are given by DNB.

# 5 Credit risk

## 5.1 General

In this chapter, the credit risk and its components are described with respect to:

- The exposure classes used in the calculations of RWA and the explanation of the capital requirements;
- The information about exposures is disclosed and presented from several aspects, split by exposure classes, geography and industry;
- The approaches and methods used in the RWA calculations are presented including information about credit risk mitigation and SNS Bank's internal rating system;
- The information about credit risk management, impaired loans and loan losses is disclosed.

## 5.2 Exposure classes

SNS Bank has a diversified credit portfolio, which can be divided into retail and corporate portfolios. As of 1 January 2008, SNS Bank has obtained approval, from the DNB, to use the IRB Advanced Method for the calculation of regulatory capital for its retail mortgage portfolio. For its other retail and corporate portfolios, SNS Bank uses the Standardised Approach for the calculation of regulatory capital.

SNS Bank has scheduled a roll-out plan for the transition of portfolios currently using the Standardised Approach towards the use of the IRB Advanced Method. Loans to institutions, governments as well as equities is and will remain based on the Standardised Approach for the calculation of regulatory capital.

### 5.2.1 Standardised exposure classes

*Central government and Central Banks*

Exposures to central governments and central banks are, subject to national discretion, treated with low risk if the counterparty is within European Economic Area (EEA) member states

*Institutions*

Exposures to institutions and investment firms are classified as exposures to institutions. In addition, exposures to regional governments, local authorities and multilateral development banks are classified as exposures to institutions if they are not treated as exposures to sovereigns according to regulations issued by the authorities.

*Corporates*

Exposures in commercial property development and investment mortgages are classified as corporate exposures. The corporate exposure class contains exposures that are rated in accordance to SNS Property Finance internal guidelines. Also the exposures secured by mortgages on residential or commercial real estate of more than € 1 million, are classified as corporate exposures.

*Retail*

The exposures to private individuals other than mortgages are included in the retail exposure class and include consumer loans, revolving consumer loans and credit limits on the account. Also exposures in the business segment that are secured by mortgages on residential or commercial real estate up to € 1 million, are classified as retail exposures.

*Equity*

The exposure to equity comprises the investments in connection with the company's own liquidity management and held for trading for investment purposes.

*Other*

The exposure to other non credit obligations relates to tangible fixed assets, accruals, other assets and cash and cash equivalents.

*Securitisation positions*

The securitised mortgages comprises only securitised mortgages of which the notes issued by the SPV have been sold to investors. The underlying mortgages of securitisations which have been kept in own book are included in exposure class Retail secured by real estate.

### 5.2.2 Internal rating based approach

*Retail secured by real estate*

Exposures to private individuals that are secured by mortgages on residential real estate are classified as retail exposures.

## 5.3 Information about exposures

*Credit risk profile*

SNS Bank recognises various categories of credit risk. The main categories are loans and advances to customers, loans and advances to banks, and investments. More than 90% of the loans and advances to customers are backed by mortgage security.

Approximately three quarters of all loans and advances to customers concern private residential property financing. Private residential property financing is characterised by very low credit losses and inflation-proof collateral. The change in the tax regime in 2004, aimed at surplus residential property values, and the code of conduct of the Netherlands Bankers' Association affect loan agreements concluded since that time. This has meanwhile led to a noticeably lower risk profile of the entire portfolio. Risk acceptance was also professionalised further in 2008.

Private residential property financings are provided throughout the Netherlands. The south and east of the Netherlands comprise a large portion of the portfolio, although the focus now lies on growth in the west (the Randstad urban area). Our geographic spread contributes to the diversification of risks; the regional differences in the housing market and economy will also create differences in the number of defaults and the level of credit loss, or anticipated credit loss, in each region.

Commercial mortgage loans increased in 2008. These property loans are concentrated at SNS Property Finance. The growth of the portfolio entails a relatively higher amount of loans related to the first phase of financing. These loans have a somewhat higher risk profile, which decreases as the projects progress. Not only did we realise growth, we were also able to realise a margin that is in line with the slightly higher risk profile. At the same time, the existing portfolio's credit quality decreased as a result of last year's unfavourable market conditions.

Diversification benefits are realised as SNS Bank's risks are spread across corporate and retail debtors. The credit quality of the portfolio develops more regularly than that of the various components of the portfolio.

The majority of the loans portfolio comprises loans secured by mortgages. The other loans, which are not secured by mortgages, are mainly amounts due by banks and investments (mainly bonds). The investments in connection with the company's own liquidity management and held for trading have good ratings. The interest-bearing investments can be classified according to rating as follows:

Table 6:

| In € millions | 2008 |
|---|---|
| AAA | 3,168 |
| AA | 201 |
| A | 419 |
| BB | 72 |
| BBB | 8 |
| Below BBB | -- |
| Non-rated | 45 |
| **Total** | **3,913** |

*Information about exposure type by exposure class*

In table 7, the exposures are split by exposure classes and exposure types as of 31 December 2008. The table is split between exposure classes subject to the IRB Advanced approach (retail mortgages and securitisation) and exposure classes subject to the Standardised approach. The main part of the exposure is within the exposure classes Retail and Corporate.

Table 7: Exposure classes split by exposure type, 31 December 2008

| In € millions | On-balance sheet items | Off-balance sheet items | Derivatives | Total exposure |
|---|---|---|---|---|
| **Standardised exposure classes** | | | | |
| Central governments and central banks | 5,218 | 20 | -- | 5,238 |
| Institutions | 3,428 | 1 | 357 | 3,786 |
| Corporate | 17,010 | 12,163 | 357 | 29,530 |
| Retail | 1,722 | 4,182 | -- | 5,904 |
| Equity | 62 | -- | -- | 62 |
| Total standardised approach | 27,440 | 16,366 | 714 | 44,520 |
| **IRB exposure classes** | | | | |
| Retail mortgages | 28,769 | 710 | -- | 29,479 |
| Securitisation | 7,048 | 446 | -- | 7,494 |
| Total IRB approach | 35,817 | 1,156 | -- | 36,973 |
| Other | 161 | -- | -- | 161 |
| **Total exposure** | **63,418** | **17,522** | **714** | **81,654** |

In the following table the exposures are presented as an average during the previous time period. In comparison to previous table, the average exposure during 2008 is slightly lower than the exposure at year end 2008.

Table 8: Exposure classes split by exposure type, average exposure during 2008

| In € millions | On-balance sheet items | Off-balance sheet items | Derivatives | Total exposure |
|---|---|---|---|---|
| **Standardised exposure classes** | | | | |
| Central governments and central banks | 6,596 | 19 | -- | 6,615 |
| Institutions | 3,326 | 1 | 1,256 | 4,583 |
| Corporate | 16,121 | 10,193 | 271 | 26,585 |
| Retail | 1,862 | 7,022 | -- | 8,889 |
| Equity | 72 | -- | -- | 72 |
| Total standardised approach | 27,977 | 17,235 | 1,532 | 46,744 |
| **IRB exposure classes** | | | | |
| Retail mortgages | 31,513 | 724 | -- | 32,237 |
| Securitisation | 2,163 | 375 | -- | 2,538 |
| Total IRB approach | 33,676 | 1,099 | -- | 34,775 |
| Other | 133 | -- | -- | 133 |
| **Total exposure** | **61,786** | **18,334** | **1,532** | **81,652** |

*Information about exposure by geography (per exposure class)*

In the table the on-balance exposures are split by main geographical areas and exposure classes based on where the credit risk is referable. The main market for SNS Bank is The Netherlands.

Table 9: **On-balance exposure split by geography and exposure classes, 31 December 2008**

| In € millions | Central governments and central banks | Institutions | Corporate | Other retail and Equity | IRB Retail | Securitisation | Other | Total exposure |
|---|---|---|---|---|---|---|---|---|
| The Netherlands | 3,177 | 630 | 12,930 | 1,706 | 28,769 | 7,048 | 161 | 54,421 |
| EMU | 2,024 | 623 | 2,553 | 41 | -- | -- | -- | 5,241 |
| Outside EMU | 17 | 2,175 | 1,527 | 37 | -- | -- | -- | 3,756 |
| **Total exposure** | **5,218** | **3,428** | **17,010** | **1,784** | **28,769** | **7,048** | **161** | **63,418** |

*Information about exposure by industry*

In the table the on-balance exposures are split by SNS Bank's important industry groups for the exposure classes. The exposures in the IRB Retail relate to Private clients. The main exposures in the corporate portfolio relate Construction and property and Service sector companies. The two largest industry groups, Private clients and Construction and property comprise 80.1% of the total exposure in the portfolio.

Table 10: **On-balance exposure split by industry and exposure classes, 31 December 2008**

| In € millions | Central governments and central banks | Institutions | Corporate | Other retail and Equity | IRB Retail | Securitisation | Other | Total exposure |
|---|---|---|---|---|---|---|---|---|
| Construction and property | -- | -- | 14,232 | -- | -- | -- | -- | 14,232 |
| Public sector | 5,218 | -- | -- | -- | -- | -- | -- | 5,218 |
| Agriculture, horticulture, forestry and fishery | -- | -- | 58 | -- | -- | -- | | 58 |
| Industry | -- | -- | 358 | -- | -- | -- | -- | 358 |
| Service sector companies | -- | -- | 2,087 | 1,138 | -- | -- | -- | 3,225 |
| Financial institutions | -- | 3,428 | -- | 62 | -- | -- | -- | 3,490 |
| Other commercial | -- | -- | 275 | -- | -- | -- | -- | 275 |
| Private clients | -- | -- | -- | 584 | 28,769 | 7,048 | 161 | 36,562 |
| **Total exposure** | **5,218** | **3,428** | **17,010** | **1,784** | **28,769** | **7,048** | **161** | **63,418** |

*Information about exposure by maturity*

In the table the on-balance exposure is divided by maturity, which is defined as the contractual maturity. The on-balance exposure is divided between the exposure classes.

Table 11: On-balance exposure by maturity, 31 December 2008

| In € millions | ≤ 1 month | > 1 month ≤ 3 months | > 3 months ≤ 1 year | > 1 year ≤ 5 years | > 5 years | Total exposure |
|---|---|---|---|---|---|---|
| **Standardised exposure classes** | | | | | | |
| Central governments and central banks | 1,517 | 8 | 347 | 739 | 2,607 | 5,218 |
| Institutions | 2,824 | 6 | 90 | 484 | 24 | 3,428 |
| Corporate | 1,721 | 494 | 2,364 | 4,171 | 8,260 | 17,010 |
| Retail | 294 | 22 | 102 | 233 | 1,070 | 1,722 |
| Equity | 62 | -- | -- | -- | -- | 62 |
| Total standardised approach | 6,418 | 530 | 2,903 | 5,627 | 11,962 | 27,440 |
| **IRB exposure classes** | | | | | | |
| Retail | 17 | 8 | 61 | 287 | 28,396 | 28,768 |
| Securitisation | -- | -- | 110 | 168 | 6,770 | 7,048 |
| Total IRB approach | 17 | 8 | 171 | 455 | 35,166 | 35,817 |
| Other | 161 | -- | -- | -- | -- | 161 |
| **Total** | **6,596** | **538** | **3,074** | **6,082** | **47,128** | **63,418** |

*Information about equity*

In the exposure class Equity, SNS Bank's equity holdings outside the trading book are included. In the table the exposure of SNS Bank's equity holdings outside the trading book are shown in groups based on the intention of SNS Bank.

Book value equals fair value for all the equities shown in the table. The evidence of published price quotations in an active market is the best evidence of fair value and when they exist they are used to measure financial assets and financial liabilities. SNS Bank predominantly uses published quotations to establish fair value for shares.

Table 12: Exposure of equity outside trading book , 31 December 2008

| In € millions | Book value | Fair value | Fair value of listed shares | Quoted share value | Unrealised gains/losses | Realised gains/losses period YTD | Capital requirement |
|---|---|---|---|---|---|---|---|
| Associates | 37 | 37 | -- | -- | (2) | (29) | 2 |
| Joint ventures | 10 | 10 | -- | -- | -- | 1 | 1 |
| Investments available for sale | 16 | 16 | 7 | 7 | -- | 8 | 2 |
| **Total** | **63** | **63** | **7** | **7** | **(2)** | **(20)** | **5** |

## 5.4 Calculation of RWA

### 5.4.1 General

The RWA calculations in SNS Bank differ between the exposure classes depending on the approach SNS Bank uses. SNS Bank has received approval to calculate the credit risk by using the IRB Advanced approach for the retail mortgages. For the other asset classes the Standardised approach is used. The following section describes the principles for calculating RWA with the Standardised approach and the IRB Advanced approach respectively.

### 5.4.2 Calculation of RWA with the Standardised approach

The standardised approach measures credit risk pursuant to fixed risk weight. The application of risk weight in standardised approach is given by a set of fixed rules and is based on the exposure class to which the exposure is assigned. In calculating RWA with the standardised approach external ratings coming from eligible rating agencies are in some cases a necessary input to calculate the fixed risk weight.

The effect of credit risk mitigation is minor. No exposure values are deducted from own funds.

Table 13: Risk weights per industry, 31 December 2008

| | Risk weight | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| In € millions | 0% | 20% | 35% | 50% | 75% | 100% | 150% | Total |
| **Standardised approach** | | | | | | | | |
| Central Government and Central Banks | 5,141 | 97 | -- | -- | -- | -- | -- | 5,238 |
| Institutions | -- | 2,026 | -- | 1,692 | -- | 68 | -- | 3,786 |
| Corporates | 64 | 77 | 2,429 | 1 | -- | 26,707 | 252 | 29,530 |
| Retail | -- | -- | 226 | -- | 5,678 | -- | -- | 5,904 |
| Equity | -- | -- | -- | -- | -- | 62 | -- | 62 |
| **Total Standardised** | **5,205** | **2,200** | **2,655** | **1,693** | **5,678** | **26,837** | **252** | **44,520** |

Table 14: Risk weighted assets and capital requirements 31 December 2008

| | Risk weight | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| In € millions | 0% | 20% | 35% | 50% | 75% | 100% | 150% | Total |
| **Standardised approach** | | | | | | | | |
| **Central Government and Central Banks** | | | | | | | | |
| Risk weighted assets | -- | 17 | -- | -- | -- | -- | -- | 17 |
| Capital requirements | -- | 1 | -- | -- | -- | -- | -- | 1 |
| **Institutions** | | | | | | | | |
| Risk weighted assets | -- | 405 | -- | 234 | -- | 67 | -- | 706 |
| Capital requirements | -- | 32 | -- | 19 | -- | 5 | -- | 56 |
| **Corporates** | | | | | | | | |
| Risk weighted assets | -- | 12 | 842 | 1 | -- | 13,413 | 344 | 14,612 |
| Capital requirements | -- | 1 | 67 | -- | -- | 1,074 | 28 | 1,170 |
| **Retail** | | | | | | | | |
| Risk weighted assets | -- | -- | 78 | -- | 1,081 | -- | 1 | 1,160 |
| Capital requirements | -- | -- | 6 | -- | 87 | -- | -- | 93 |
| **Equity** | | | | | | | | |
| Risk weighted assets | -- | -- | -- | -- | -- | 62 | -- | 62 |
| Capital requirements | -- | -- | -- | -- | -- | 5 | -- | 5 |
| **Total risk weighted assets** | **--** | **434** | **920** | **235** | **1,081** | **13,542** | **345** | **16,557** |
| **Total capital requirements** | **--** | **34** | **73** | **19** | **87** | **1,084** | **28** | **1,325** |

### 5.4.3 Calculation of RWA with the IRB advanced approach

The IRB Advanced approach measures credit risk using formulas with internal input for the calculation of Probability of Defaults (PD), Loss Given Default (LGD), Exposure at Default (EAD) and Maturity (M). In the following paragraphs, these parameters and rating system are described in more detail.

#### 5.4.3.1 Advanced internal rating procedure

*Retail mortgages*

The internal rating process on SNS Bank's Retail mortgages exposures is based on a number of data elements in order to ensure risk is measured correctly. The rating process consists of the following main elements:

- Regulatory policy rules (mainly rules driven by the AFM en DNB, for example, affordability modelling).
- High-risk policy rules (rules relating to negative internal and external data).
- Application scoring (combination of application and credit bureau data).

#### 5.4.3.2 Control mechanisms for the internal rating system

The potential for incorrect risk model outputs, which would negatively affect management decision-making, is mitigated through the independent Model validation department. The Model validation department ensures that models are developed as specified and operated as intended. The Credit Risk department performs regular model reviews and performance-monitoring exercises. All these processes together are governed in accordance with DNB guidelines.

*Model documentation*

Documentation is sufficiently detailed to allow independent validation of the model from the original data sources. It includes a description of the data used for model development, the methodology used (and the rationale for choosing such a methodology), and all assumptions used in the model.

*Initial model validation*

All models are subject to an independent validation and review process before they can be signed off for implementation. For credit risk models an independent Model validation department and Model Governance Board ensures that the model build and approval process is followed. Furthermore, Basel II compliance is checked, and independent reviews are performed as part of the technical and business approval of models. The model validation exercise must demonstrate that the model fits its purpose and that it provides accurate estimates.

*Model sign-off*

There are clearly laid out rules for the sign-off process for models. The most material credit risk models in SNS Bank receive their final sign-off for implementation from the "Committee Risk policy Bank" committee. Members of the Management Board of SNS Bank are seated in the CRB.

*Ongoing model validation and monitoring*

All credit risk models are subject to frequent performance monitoring (quarterly review), which ensures that deficiencies in models are identified early and corrective action can be taken before the deficiency becomes serious and affects the decision-making process. Regular monitoring (quarterly) is reported to the "Price Risk Committee".

*Stress Testing*

SNS Bank stress testing exercises provide an indication of the potential size of losses that could arise under different conditions.

Table 15: Exposure split by probability of default class, 31 December 2008

| Probability of default class | Risk weight | | | |
|---|---|---|---|---|
| | Exposure weighted average LGD | Exposure weighted average PD | EAD (in € millions) | Exposure weighted average risk weight (in € millions) |
| 1 | 8.40% | 0.04% | 4,892 | 51 |
| 2 | 8.21% | 0.14% | 6,402 | 171 |
| 3 | 9.29% | 0.25% | 6,374 | 297 |
| 4 | 9.87% | 0.43% | 3,999 | 293 |
| 5 | 10.01% | 0.93% | 2,898 | 367 |
| 6 | 10.38% | 1.04% | 412 | 58 |
| 7 | 9.52% | 1.66% | 1,151 | 202 |
| 8 | 9.65% | 4.51% | 1,305 | 417 |
| 9 | 9.51% | 12.14% | 1,227 | 605 |
| 10 | 9.67% | 32.25% | 516 | 307 |
| 11 | 12.08% | 100.00% | 303 | 21 |
| **Total** | | | **29,479** | **2,789** |

The credit quality on the retail mortgage portfolio decreases from class 1 to class 11.

### 5.4.3.3 Comparison between expected and actual losses

For retail mortgages, which is the only asset class running IRB Advanced in 2008, the expected loss for non-defaulted exposures was € 25.6 million at the end of 2008. This is to be compared to the realised loss of € 31 million. The counterparty weighted probability of default for 2008 was 1.34% and the corresponding observed default frequency was 0.88%. The realised loss for 2008 was higher than the expected loss due to the deteriorating economic situation in The Netherlands.

Note that the expected loss will vary over time due to the migration of the rating and the security coverage distributions with the business cycle. This manifests that SNS Bank's rating models are neither perfectly through-the-cycle nor perfectly point-in-time. The implications are that the expected loss calculated at the top of the business cycle not will represent the expected loss over a full business cycle and that migrations will not explain the full variation in actual losses. It is expected that the average long term net loss will match the average expected loss over time.

### 5.4.3.4 Alternative uses of the internal rating approach

SNS Bank also uses the internal ratings system, other than for the calculation of regulatory capital, in the following processes:

- Acceptance scoring;
- Collection processes, early and late collections; and
- Provision process.

*Acceptance Scoring*

The implementation of the IRB Advanced method was complemented with the introduction of a credit score card for the mortgage and the corporate and retail business portfolios. The implementation of the credit score card improves SNS Bank's ability to determine the credit risk of new and existing clients (refinancing) at origination.

### *Collection Process*

SNS Bank uses its IRB Advanced model for the routing of delinquent clients to the different treatment paths in both the early and late collections process. The IRB Advanced approach helps to determine the risk category (high, middle or low risk) of delinquent clients who are past due. Delinquent clients are treated according to risk category by the early (1 - 90 days in arrears) and late (90 + days in arrears) collection departments.

### *Provision Process*

The IRB Advanced model helps to determine the required provisions for the retail and retail business portfolios in default. Also, the IRB Advanced model is used in the calculation of provisions for Incurred But Not Identified (IBNI) losses for the retail and corporate portfolios not in default.

## 5.5 Credit risk mitigation

### *Credit Risk Mitigation*

SNS Bank applies a range of risk management procedures to mitigate credit risk on its loan portfolios. The most fundamental of these is to assess the ability, at origination, of a borrower to service the proposed level of debt without distress at the outset. It is a SNS Bank policy to establish that loans are within the customer's capacity to repay rather than to rely solely on collateral.

### *Collateral*

SNS Bank's credit policies also include the assessment of collateral. This information is also used in the calculation of the LGD. The recognition of collateral to mitigate credit risk is managed in terms of the credit policy that clearly defines the following:

- The definition of what qualifies as collateral;
- The requirements for the valuation of collateral;
- Foreclosure values applied to collateral values.

### *Collateral Valuation – what qualifies as collateral*

SNS Bank accepts primarily residential and commercial real estate as collateral. SNS Bank's credit policy determines what type of residential and commercial properties qualify as collateral.

### *Collateral Valuation - requirements*

Valuation of the collateral taken will be within agreed parameters and will be conservative in value. Collateral, in the form of residential and commercial property, long-term insurance policies and so on is maintained in a specific system. The market value of collateral, at its origination date, is also captured in this system. The market value of residential properties is indexed to the development of the residential housing market.

### *Collateral Valuation - foreclosure*

Collateral within the retail mortgage portfolios is subject to revaluation when an account enters the legal process to ensure that the impairment allowance is appropriate given the current valuation. The proceeds realised are being used to reduce or repay the outstanding loan. Any additional funds are returned to the customer.

Within the corporate portfolios, collateral for impaired loans, including guarantees and insurance, is reviewed regularly and at least annually. The review ensures the impairment allowance remains appropriate given the current valuation. In the case of a decrease in the value of collateral, an additional impairment allowance may be considered. On the other hand, increases in the value of collateral may result in a release of the impairment allowance.
Guarantees and legal covenants are subject to regular review, at least annually, to ensure that they remain fit for purpose and remain consistent with accepted local market practice.

SNS Bank also uses netting agreements, financial guarantees and the use of covenants in commercial lending agreements to reduce risk. SNS Bank's principal collateral types are:

- Retail sector – mortgages over residential properties, equity, bonds etc in case of trading exposures.
- Commercial sector – business assets such as premises, stock and debtors.
- Commercial real estate sector – properties being financed.

Table 16: On balance exposure secured by collaterals, guarantees and credit derivatives, 31 December 2008

| In € millions | Exposure | Of which secured by guarantees | Of which secured by credit derivatives | Of which secured by collateral |
|---|---|---|---|---|
| **Standardised exposure classes** | | | | |
| Central government and central banks | 5,238 | 5 | -- | -- |
| Institutions | 3,786 | 20 | -- | 1,224 |
| Corporate | 29,530 | 480 | -- | 8,679 |
| Retail | 5,904 | 4 | -- | 3,390 |
| Equity | 62 | -- | -- | -- |
| Total standardised approach | 44,520 | 509 | -- | 13,293 |
| **IRB exposure classes** | | | | |
| Retail | 29,479 | 7,140 | -- | -- |
| Securitisation | 7,494 | -- | -- | -- |
| Total IRB approach | 36,973 | 7,140 | -- | -- |
| Other | 161 | -- | -- | -- |
| **Total** | **81,654** | **7,649** | **--** | **13,293** |

Table 17: Collateral concentration, 31 December 2008

| | |
|---|---|
| Guarantees | 37% |
| Collateral: | |
| - of which real estate | 52% |
| - of which financial collateral | 11% |
| | 100% |

## 5.6 Information about credit risk management, impaired loans and loan losses

### 5.6.1 Credit risk management

A distinction has been made in credit management between retail clients on the one hand and property finance and other corporate clients on the other. In addition, there is a distinction between credit management for individual clients and credit management on a portfolio level.

#### *Retail clients*

Loans to private clients consisting of mortgage loans or consumer credit are approved by the relevant authorised officers on the basis of acceptance standards and policy rules. The acceptance standards and policy rules are determined by the Bank Price Risk Committee. The acceptance procedure for mortgage loans is carried out at the central level, as this contributes to uniformity and efficiency. Acceptance score models are used as support.
Credit management for established private clients takes place at client level by actively monitoring and following up on payments in arrears. This process is supported by automated systems that categorise and prioritise clients with payments in arrears.

At the portfolio level, mortgage risks are managed by the 'Portfolio Management Procedure'. The process consists of three components: rating, monitoring and intervention. Intervention can take place through pricing policy, the acceptance and management policies, specific (marketing) activities, product development and securitisations.

### *Property finance and other corporate clients*

Acceptance standards and policy rules also apply to property finance and other corporate clients. Moreover, acceptance score models are being developed for loans up to € 1 million. Property loans in excess of € 1 million is mainly provided by SNS Property Finance, although SNS Bank does occasionally provide property finance up to € 5 million. Where loans over € 1 million are concerned, the loan proposal is always analysed by SNS Property Finance's risk management department, which attaches its advice. Any deviation from the advice must be supported in writing. Participation finance is always submitted to the SNS Property Finance Risk Committee. SNS Retail Bank does not engage in participation finance itself.

Property finance clients and other corporate clients mainly have receivables in the 'Construction and Real Estate' industry. This generally concerns mortgage-backed finance of commercial property, business premises and residential/retail premises. The value of other securities is negligible.

For the property loans clients and other corporate clients, credit monitoring takes place at client level, using an information system geared to the identification and monitoring of overdrafts and compliance with the provisions in the loan agreement. By quickly contacting the borrower, adequate steps can then be taken. In highly exceptional circumstances, the loan agreement may be amended.

SNS Property Finance has guidelines in place on how to identify default indicators and on relevant decision-making. If notice of default needs to be given, this is done by the body that gave approval.

At portfolio level, the risks of property loans and other corporate clients are monitored on the basis of detailed reporting of the developments in the portfolios. In addition to the contamination rate, the distribution across various segments, countries and the type of property investment are monitored, and adjusted where necessary. Adjustments are made by revising the pricing, easing or in fact tightening loan conditions, and by making choices when acquiring new clients. In addition, SNS Property Finance may manage projects itself under special circumstances.

### *Special Credits department SNS Bank*

An essential part of the risk policy is the timely deployment of the Special Credits department. Special Credits distinguishes between loans to private customers and small and medium enterprises (SME).

The Special Credits department, which is part of Credit Risk Management, focuses on retail clients and SME. It applies a uniform working method that is aimed at identifying items with risk exposure.

The management of retail and SME client payment arrears has been almost completely computerised. It compares the costs involved in arrears monitoring to the combination of the probability of default and the expected credit loss amount. Based on past experience, an estimate is made of the measures required, such as contacting the client by telephone or writing a letter. This estimation is supported by a computer model.

Obviously, the file is handled by the Special Credits department if the client no longer meets his obligations, but also if it is unlikely that the debtor will be able to continue to meet his obligations. This uniform procedure is aimed at rapid foreclosure.

Every quarter, the Special Credits department proposes a provisions level to SNS Bank's Credit Committee.

At SNS Property Finance, the default notice decision is made on the basis of established default indicators. In the event of default, Risk Management develops a settlement and restructuring plan. In addition, a proposal is immediately made on the amount of the provision. The provisions are determined by the Risk Committee.

### *Restructuring and Recovery Department SNS Property Finance*

At SNS Property Finance, the default notice decision is made on the basis of established default indicators. In the event of default, the Restructuring and Recovery department takes over the monitoring and handling of the loan. Case by case the restructuring and recovery strategy is being determined. In case a provision is necessary, a proposal is immediately made on the amount of the provision. The provisions are determined by the Risk Committee.

## 5.6.2 Information about impaired loans and loan losses

An exposure is impaired and a provision is recognised, if there are objective indications that SNS Bank will not be able to collect all the amounts due in accordance with the original contract. An objective evidence of impairment normally means that a facility has been in arrears for 90 days or more. Past due amounts are debts that are in arrears.

In determining the amount of the provisions, account is taken of defaults and the experience that credit loss may also be caused by non-defaults (IBNR).

In the event of a default in property loans, a proposal is made for each debtor with regard to the amount of the provision. The provision is made by the Credit Committee of SNS Retail Bank or by the Risk Committee of SNS Property Finance. For private customers, the provision for credit in default is determined on the basis of a computer model, instead of for each individual debtor. The model takes various factors into account, e.g. the number of months in arrears.

The credit provision in relation to the risk-weighted assets of SNS Bank increased from the 2007 value of 0.67% to 0.87%.

SNS Retail Bank's mortgage portfolio's credit quality shows a stable picture over 2008. In 2008, the credit quality of SNS Property Finance deteriorated to some extent. The growth of the portfolio entails a relatively higher amount of loans related to the first phase of financing. These loans have a somewhat higher risk profile, which decreases as the projects progress.

In addition, last year's unfavourable market conditions are affecting the credit quality of SNS Property Finance's existing portfolio. In order to further limit the balance sheet risk, SNS Property Finance decided to reduce the international project financing portfolio as regards liabilities vis-à-vis debtors, particularly in Spain and the US.

Table 18: **Financial assets in arrears SNS Bank**

| In € millions | No arrears | ≤ 3 months | > 3 months ≤ 6 months | > 6 months ≤ 1 year | > 1 year | Provision | Total |
|---|---|---|---|---|---|---|---|
| **2008** | | | | | | | |
| Investments | 3,942 | -- | -- | -- | -- | -- | 3,942 |
| Derivatives | 1,113 | -- | -- | -- | -- | -- | 1,113 |
| Mortgages and other loans and advances to clients | 51,049 | 876 | 119 | 111 | 203 | (147) | 52,211 |
| Property finance | 13,129 | -- | 552 | -- | -- | (98) | 13,583 |
| Loans and advances to banks | 2,783 | -- | -- | -- | -- | -- | 2,783 |
| Other assets | 2,942 | -- | 197 | -- | -- | (76) | 3,063 |
| **Total** | **74,958** | **876** | **868** | **111** | **203** | **(321)** | **76,695** |
| **2007** | | | | | | | |
| Investments | 4,056 | -- | -- | -- | -- | -- | 4,056 |
| Derivatives | 1,041 | -- | -- | -- | -- | -- | 1,041 |
| Mortgages and other loans and advances to clients | 47,567 | 770 | 124 | 96 | 249 | (145) | 48,661 |
| Property finance | 11,354 | -- | 283 | -- | -- | (62) | 11,575 |
| Loans and advances to banks | 1,092 | -- | -- | -- | -- | -- | 1,092 |
| Other assets | 4,159 | -- | -- | -- | -- | -- | 4,159 |
| **Total** | **69,269** | **770** | **407** | **96** | **249** | **(207)** | **70,584** |

Table 19: **Provisions in 2008**

| In € millions | Specific | IBNR | Total |
|---|---|---|---|
| Balance as at 1 January 2008 | 195 | 12 | 207 |
| Reclassification | (76) | -- | (76) |
| Acquisitions | -- | -- | -- |
| Usage | (42) | -- | (42) |
| Additions | 187 | 9 | 196 |
| Releases | (43) | (2) | (45) |
| Other changes | 5 | -- | 5 |
| **Balance as at 31 December 2008** | **226** | **19** | **245** |

Table 20: **Loan impairment by geography, 31 December 2008**

| In € millions | Book value non-provisioned loans | Book value provisioned loans (gross receivable) | Specific provision | IBNR provision | Total book value | Impairment charges |
|---|---|---|---|---|---|---|
| The Netherlands | 60,841 | 1,431 | (155) | (15) | 62,102 | 69 |
| EMU | 2,168 | 276 | (59) | (2) | 2,383 | 53 |
| Outside EMU | 1,169 | 154 | (12) | (2) | 1,309 | 51 |
| **Total** | **64,178** | **1,861** | **(226)** | **(19)** | **65,794** | **173** |

Table 21: **Loan provisions by industry, 31 December 2008**

| In € millions | Book value non-provisioned loans | Book value provisioned loans (gross receivable) | Specific provision | IBNR provision | Total book value |
|---|---|---|---|---|---|
| Construction and property | 13,127 | 564 | (101) | (7) | 13,583 |
| Public sector | 736 | -- | -- | -- | 736 |
| Agriculture, horticulture, forestry and fishery | 57 | 3 | (3) | -- | 57 |
| Industry | 346 | 4 | (2) | -- | 347 |
| Service sector companies | 822 | 114 | (14) | (4) | 919 |
| Financial institutions | 2,877 | 5 | (6) | -- | 2,876 |
| Other commercial | 274 | -- | -- | -- | 274 |
| Private clients | 45,939 | 1,171 | (100) | (8) | 47,002 |
| **Total** | **64,178** | **1,861** | **(226)** | **(19)** | **65,794** |

# 6 Market risk

## 6.1 General

Market risk is the risk that changes in market prices will have a negative impact on the results and net asset value of SNS Bank. Market prices include interest rates, stock prices and exchange rates.

SNS Bank uses the standard approach in the CRD to calculate capital requirements for the trading book. The model covers interest rate risk and equity risk and is based on fixed risk weights.

Interest rate risk is a significant component of SNS Bank's moderate risk profile. Interest rate risks arise due to the fact that SNS Bank's assets and liabilities have a different interest rate sensitivity. The assets on the bank's balance sheet generally have a longer duration than the liabilities. Given this balance sheet structure, SNS Bank will normally benefit from a decreasing interest rate environment. The bank's market risks, including both SNS Retail Bank and SNS Property Finance, are managed by the ALCO Group. When managing SNS Bank's interest rate position, assessments are made to establish whether the risks fall within pre-set limits.
Managing within those limits takes place on the basis of risk/return considerations in conjunction with the short-term and medium-term expectations for interest rate movements.
When managing interest rate risk, SNS Bank looks at the total of interest-bearing assets and liabilities, including interest rate swaps and not at separate balance sheet items. Interest rate swaps are used to steer the sensitivity of the present value of the cash flows of mostly (new) mortgages arising from changes in interest rates.

## 6.2 Market risk of bank book

The interest rate risk in the bank's portfolio is measured, monitored and managed using duration, Value-at-Risk (VaR), Earnings-at-Risk (EaR) and gapping analyses.
The yield curve sharply fell and steepened in the final quarter of 2008, increasing SNS Bank's sensitivity to changes in short-term interest rates. In anticipation of a decline in short-term interest rates, SNS lowered its Earnings-at-Risk limit to € 25 million in September 2008. In addition, SNS Bank's duration limit was extended from 8 to 10 in the final quarter of 2008. This bandwidth is reviewed by the ALCO Group at least once a year. This promotes a more effective use of opportunities presenting themselves when the yield curve steepens, whilst maintaining a low Earnings-at-Risk. SNS Bank proactively steered the interest rate sensitivity of the net financial results to below the new limit. This resulted in a more balanced interest rate sensitivity across the entire yield curve.

The duration of shareholders' equity amounted to 8.4 at year-end 2008 (year-end 2007: nil). During the year 2008, the duration of total equity amounted to a maximum of 8.5.

During 2008, the Value-at-Risk was € 204 million on average, with a maximum of € 526 million at the end of November, and a minimum of € 75 million at the end of January 2008. At year-end 2008, the VaR was € 501 million. The Earnings-at-Risk limit was changed as per September 2008 from a level of € 40 million to € 25 million (95%). On average, the EaR was approximately € 27 million, with a maximum of € 38 million in February 2008. At year-end 2008, the EaR was € 20 million.

Both VaR and EaR are determined based on scenario analyses. Changes in the fair value of total equity and changes in the interest margin are determined for many underlying interest rate scenarios. The fair value of total equity is obtained by discounting the cash flows from the total balance sheet with the cost-of-fund curve of SNS Bank. This curve is also used as the base yield curve to simulate changes in interest rates. At a confidence level of 99%, the VaR is equal to the 1% worst outcome of changes in the fair value of total equity. A fixed interest rate position is used as the basis for EaR, with a confidence level of 95%: how much does it cost to refinance the interest rate gaps in one year given the current interest rate position and taking into account various interest rate scenarios. For VaR, too, the balance sheet position at the reporting date is used for simulating the value adjustments. VaR and EaR are both calculated using a 1-year horizon calculated as from the reporting date. The VaR figures are before taxation, the EaR figures are after taxation.

Quotation risk is the risk that the bank runs due to increasing interest rates between the time the quotation is made and the time the loan is extended. Each month a trade-off is made between the hedging costs and risk exposure of SNS Bank as a result of this quotation risk. The quotation risk has a VaR limit of € 16 million. The average quotation VaR amounted to € 4 million in 2008. The quotation VaR remained within the limit throughout 2008.

All of SNS Bank's currency positions are measured monthly and hedged on a structural basis. The table below gives an indication of the foreign currency position of SNS Bank.

Table 22: Foreign currency positions

| In € millions | Balance debit | | Balance credit | | Balance | | Hedge derivatives | |
|---|---|---|---|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| US dollar | 1,048 | 848 | 1,579 | 1,928 | (531) | (1,080) | 474 | 1,051 |
| Japanese yen | 35 | 1 | 419 | 266 | (384) | (265) | 357 | 258 |
| Pound Sterling | 131 | 90 | 335 | 451 | (204) | (361) | 187 | 379 |
| Swiss franc | 3 | 12 | 222 | 108 | (219) | (96) | 218 | 97 |
| Canadian dollar | 135 | 55 | 98 | 143 | 37 | (88) | (43) | 92 |
| Australian dollar | 3 | 15 | 501 | 781 | (498) | (766) | 494 | 766 |
| Hongkong dollar | 4 | 7 | 341 | 383 | (337) | (376) | 300 | 391 |
| Danish krone | 194 | 256 | 7 | 3 | 187 | 253 | (192) | (253) |
| Other | 6 | 6 | 494 | 500 | (488) | (494) | 496 | 504 |
| **Total** | **1,559** | **1,290** | **3,996** | **4,563** | **(2,437)** | **(3,273)** | **2,291** | **3,285** |

The maturities of the hedged positions and the derivatives in the context of foreign currency are almost equal.

## 6.3 Sensitivity test

The market risks of SNS Bank can be illustrated by the results of a sensitivity analysis. This analysis shows the impact of an immediate parallel shift of the interest rate curve of + 1 and -1%, and an immediate shock in stock prices of -10% and + 10% on total equity, the result and the fair value of total equity. In 2008, an improvement was made to the interest rate sensitivity model of the fair value of total equity. The table shows the effects of the immediate parallel interest rate shift at year-end 2008 on the fair value of total equity, including embedded options. The duration of total equity at year-end 2008 is higher than at year-end 2007, which is expressed by the increased market value sensitivity in the + 1% scenario. Due to the positive duration, an increase in interest rates negatively affects market value, but this is partly offset by the embedded options in the products. The sensitivity for a parallel 1% decrease in interest rates is also reduced by the embedded options.
The sensitivity of the result to interest rate fluctuations is calculated in the following statistic method: for the first 12 monthly gaps in the year-end 2008 balance sheet, the refinancing expenses and income is calculated in the event that interest rates immediately rise or fall by 1% (parallel shift). The results are after tax.

Table 23: Sensitivity test

| In € millions | Fair value equity | | Result | | Total equity | |
|---|---|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| Interest rate + 1% | (84) | 13 | 24 | 42 | (147) | 118 |
| Interest rate - 1% | (10) | (8) | (21) | (42) | 147 | 118 |
| Shares +10% | 1 | 2 | -- | -- | 1 | 2 |
| Shares -10% | (1) | (2) | -- | -- | (1) | (2) |

## 6.4 Interest maturity calendar

In addition to the duration of total equity, Value-at-Risk and Earnings-at-Risk, the bank uses a gap profile as a risk management tool. A gap profile outlines the net position of redeeming nominal amounts per interest rate maturity from both assets and liabilities. The table below illustrates the interest maturity gap profile of SNS Bank on the basis of expected remaining interest maturity. This includes the estimates for early redemption behaviour in the mortgage and loan portfolios of SNS Retail Bank and SNS Property Finance. An estimate is also made of the outflow of savings and loans at SNS Bank. The gap profile is used to determine which maturities in the gap profile need to be adjusted to the desired level using interest rate swaps. Hence, duration of total equity and the interest maturity gaps are the main tools to manage the interest rate position of SNS Bank.

Table 24: Interest rate sensitivity gap

| In € millions | ≤ 1 month | > 1 month ≤ 3 months | > 3 months ≤ 1 year | > 1 year ≤ 5 years | > 5 years | Provision | Total |
|---|---|---|---|---|---|---|---|
| **2008** | | | | | | | |
| **Assets** | | | | | | | |
| Investments (interest-bearing) | 107 | 438 | 461 | 747 | 2,160 | -- | 3,913 |
| Derivatives | 187 | 543 | 225 | 56 | 102 | -- | 1,113 |
| Loans and advances to clients | 14,283 | 5,696 | 7,496 | 22,919 | 15,645 | (245) | 65,794 |
| Loans and advances to banks | 1,615 | 1,044 | 124 | -- | -- | -- | 2,783 |
| Other assets | 1,281 | 166 | -- | 30 | -- | (76) | 1,401 |
| Cash and cash equivalents | 1,692 | -- | -- | -- | -- | -- | 1,692 |
| | 19,165 | 7,887 | 8,306 | 23,752 | 17,907 | (321) | 76,696 |
| Off-balance sheet products | 8,058 | 22,740 | 6,730 | 243 | 2,616 | -- | 40,387 |
| **Total assets** | **27,223** | **30,627** | **15,036** | **23,995** | **20,523** | **(321)** | **117,083** |
| **Liabilities** | | | | | | | |
| Participation certificates and subordinated debt | 150 | 304 | 1,235 | -- | -- | -- | 1,689 |
| Debt certificates | 3,196 | 22,517 | 895 | 2,391 | 1,283 | -- | 30,282 |
| Derivatives | 494 | 318 | 278 | 563 | 491 | -- | 2,144 |
| Savings | 1,404 | 2,811 | 6,433 | 7,305 | 3,906 | -- | 21,859 |
| Other amounts due to clients | 4,460 | 1,616 | 1,124 | 1,415 | 1,569 | -- | 10,184 |
| Amounts due to banks | 1,827 | 2,546 | 2,118 | -- | -- | -- | 6,491 |
| Other liabilities | 1,642 | -- | -- | -- | -- | -- | 1,642 |
| | 13,173 | 30,112 | 12,083 | 11,674 | 7,249 | -- | 74,291 |
| Off-balance sheet products | 9,153 | 5,988 | 5,235 | 10,758 | 9,253 | -- | 40,387 |
| **Total liabilities** | **22,326** | **36,100** | **17,318** | **22,432** | **16,502** | **--** | **114,678** |
| **Interest rate sensitivity gap (assets-liabilities)** | **4,897** | **(5,473)** | **(2,282)** | **1,563** | **4,021** | **(321)** | **2,405** |

Table 24: Interest rate sensitivity gap

| In € millions | ≤ 1 month | > 1 month ≤ 3 months | > 3 months ≤ 1 year | > 1 year ≤ 5 years | > 5 years | Provision | Total |
|---|---|---|---|---|---|---|---|
| **2007** | | | | | | | |
| **Assets** | | | | | | | |
| Investments (interest-bearing) | 197 | 58 | 429 | 779 | 2,549 | -- | 4,012 |
| Derivatives | 336 | 400 | 246 | 16 | 43 | -- | 1,041 |
| Loans and advances to clients | 14,118 | 5,105 | 8,170 | 20,747 | 12,303 | (207) | 60,236 |
| Loans and advances to banks | 633 | 410 | 49 | -- | -- | -- | 1,092 |
| Other assets | 1,062 | -- | -- | -- | -- | -- | 1,062 |
| Cash and cash equivalents | 3,141 | -- | -- | -- | -- | -- | 3,141 |
| | 19,487 | 5,973 | 8,894 | 21,542 | 14,895 | (207) | 70,584 |
| Off-balance sheet products | 9,450 | 11,265 | 6,931 | 453 | 1,213 | -- | 29,312 |
| **Total assets** | **28,937** | **17,238** | **15,825** | **21,995** | **16,108** | **(207)** | **99,896** |
| **Liabilities** | | | | | | | |
| Participation cetificates and subordinanted debt | 100 | 472 | 1,106 | -- | -- | -- | 1,678 |
| Debt certificates | 3,642 | 19,427 | 2,148 | 4,448 | 2,517 | -- | 32,182 |
| Derivatives | 54 | 132 | 263 | 260 | 229 | -- | 938 |
| Savings | 1,011 | 2,021 | 5,412 | 6,809 | 3,926 | -- | 19,179 |
| Other amounts due to clients | 3,965 | 753 | 538 | 1,154 | 1,436 | -- | 7,846 |
| Amounts due to banks | 3,533 | 1,183 | 350 | -- | -- | -- | 5,066 |
| Other liabilities | 1,484 | -- | -- | -- | -- | -- | 1,484 |
| | 13,789 | 23,988 | 9,817 | 12,671 | 8,108 | -- | 68,373 |
| Off-balance sheet products | 19 | 160 | 8,843 | 11,851 | 8,439 | -- | 29,312 |
| **Total liabilities** | **13,808** | **24,148** | **18,660** | **24,522** | **16,547** | **--** | **97,685** |
| **Interest rate sensitivity gap (assets-liabilities)** | **15,129** | **(6,910)** | **(2,835)** | **(2,527)** | **(439)** | **(207)** | **2,211** |

## 6.5 Effective interest rates

The table below shows the average effective interest rate percentages of SNS Bank throughout the year with respect to monetary financial instruments not held for trading.

Table 25: Average effective interest rates

| In percentages | 2008 | 2007 |
|---|---|---|
| **Assets** | | |
| Investments held for sale (interest bearing) | 4.3% | 4.2% |
| Mortgages | 4.9% | 4.8% |
| Property finance | 5.8% | 5.7% |
| Other loans and advances to clients | 6.8% | 9.7% |
| Loans and advances to banks | 3.5% | 3.0% |
| **Liabilities** | | |
| Participation cetificates and subordinanted debt | 6.1% | 5.9% |
| Debt certificates | 4.7% | 4.1% |
| Savings | 3.7% | 3.1% |
| Other amounts due to clients | 3.8% | 4.3% |
| Amounts due to banks | 2.8% | 2.5% |

## 6.6 Market risk - bank trading portfolio

The market risk of SNS Bank's trading portfolio is calculated daily in terms of VaR (99%) and stress tests. The following tables show the limits for the different trading portfolios. The total limit in terms of VaR for the trading portfolio amounted to € 3 million. The system of limits functioned well in 2008. The VaR methodology consists of (Monte Carlo) scenario analyses.

The underlying scenarios for the Monte Carlo method are based on historical data. Stress tests are carried out on a regular basis by all trading desks. These, too, have defined limits.

Table 26: Market risk limits

| In € thousands | Limit | | | |
|---|---|---|---|---|
| | Value-at risk *(99% on daily basis)* | | Stress test | |
| | 2008 | 2007 | 2008 | 2007 |
| Client desk | 100 | 100 | 300 | 300 |
| Money market desk foreign currency | 600 | 700 | 1,800 | 2,100 |
| Money market desk euro | 150 | 500 | 450 | 1,500 |
| Capital market desk | 600 | 400 | 1,800 | 1,200 |
| Interest rate desk | 150 | 250 | 450 | 750 |
| Off-balance desk | 300 | 800 | 900 | 2,400 |
| Equity desk | 500 | 750 | 1,500 | 2,250 |
| Bond desk | 850 | 600 | 2,550 | 1,800 |
| **Total** | **3,250** | **4,100** | **9,750** | **12,300** |

# 7 Operational risk

## 7.1 General

Upon implementing the Corporate Governance Code, SNS Bank has chosen to realise as much synergy as possible between the risk management demands of this code and compliance with Basel II requirements. In the day to day operations, this enables the use of one framework for an adequate management of the risks.

The capital requirements for operational risk is in SNS Bank calculated according to the standardised approach, in which all of the institution's activities are divided into eight standardised business lines: corporate finance, trading & sales, retail banking, commercial banking, payment & settlement, agency services, asset management and retail brokerage.
The total capital requirement for operational risk is calculated as the sum of the capital requirements for each of the business lines. The risk for each business line is the beta coefficient multiplied by gross income. The beta coefficient multiplied by gross income. The beta coefficients differ between business lines and are in the range of 12% to 18%.

## 7.2 Managing non-financial risks

The types of non-financial risk that SNS Bank distinguishes are strategic risks, integrity risks and operational risks.

*Compliance and integrity*

Integrity is essential to keep the trust of clients, employees, shareholders and other stakeholders. In 2008, too, we paid much attention to the integrity of employees, clients, products (including duty of care) and partnerships.

*Employee integrity*

SNS Bank does not only want employees to gain insight into our standards and values, but also that they learn how to deal with dilemmas in day-to-day activities. Through workshops, training, discussions following soap strips developed especially for this purpose, and other methods, they focused on the practical application of the code of conduct 'Gezond verstand, gezond geweten' ('Common sense, clear conscience') and the business principles, as well as on how to proceed when confronted with a dilemma, and making integrity measurable by reviewing performance on the basis of integrity requirements.

*Client integrity*

One of SNS Bank's key business principles is client focus. However, it is also important to assess clients' integrity. SNS Bank does not want to participate in any possible criminal activities, money laundering, fraud or terrorist financing. For that purpose, we limit our services by not providing services or providing only limited services to certain sectors or business activities. In 2008, the policy was again compared against market conditions and laws and regulations, and the harmonisation between business units was improved. The principles of our integrity policy in respect of clients are: knowing the client, the client's integrity as a precondition for doing business, the client's meeting standards of decency, meaning that clients must refrain from expressing threats or showing violent behaviour, and the client's providing honest and transparent information. SNS Bank teaches its employees how to deal with the relevant risks and incidents.

*Product integrity*

SNS Bank systematically tests its products, the design of new products and its services against legal and social requirements. Central issues are transparent product structure, accessible product information, cautious return forecasts, more protection against negative market factors, more guarantees on terminal funding capital and fewer options for the consumer.

*Improvements to operational risk management*

The logical access security for all employees of SNS Bank was improved by structuring and centrally administrating and monitoring the rights of access to the operational systems. A separation of duties combined with smart cards limits the chances of abuse.

SNS Bank updated its prevention, detection and follow-up policy for countering third-party fraud and its policy for the prevention of internal fraud by having the coordination investigation take place at an earlier stage and by safeguarding the interests of stakeholders that may be directly involved. Senior management will follow the developments via regular reports.

## 7.3 Framework for business control

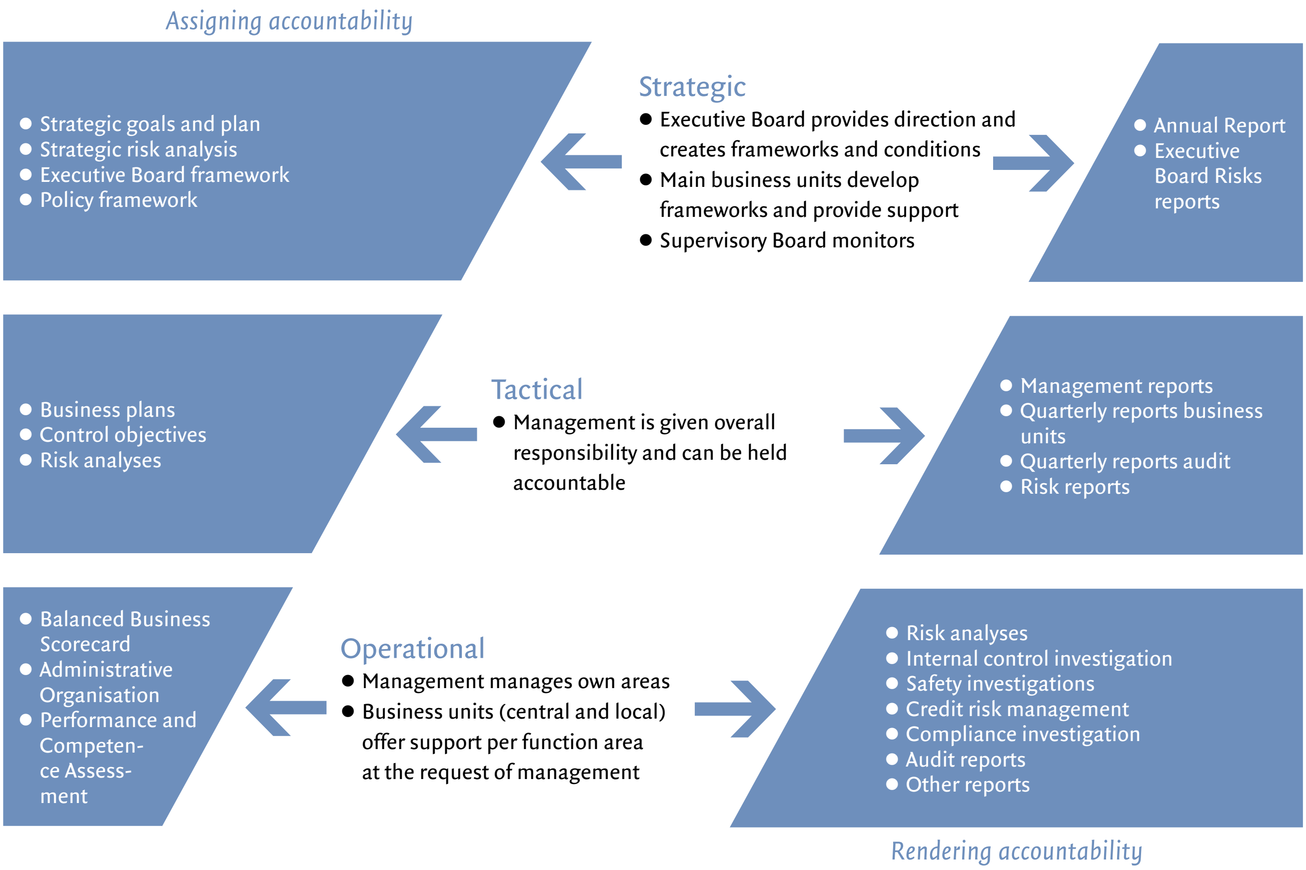
Doing business always requires taking risks and demands a consistent and transparent assessment of opportunities and risks, aimed at growth and the continuity of the company. The Executive Board of SNS REAAL has established frameworks for the management boards in order to properly steer such assessments. The framework principles are:

- The strategy and strategic risk analyses, to direct the activities of the business units and the organisation as a whole.
- The moderate risk profile, which sets limits for taking and managing risks.
- The management structure, to streamline management focus, to allocate tasks and responsibilities, and to deal with changes e.g. through takeovers and reorganisations.
- Management development programmes, to manage staff quality and appoint the right person in the right place.
- The remuneration structure, to manage the conduct of our employees in order to achieve goals.
- Requirements for internal processes, to steer predictability of performance, prevent unforeseen losses and ensure the reliability of information.

The management board of SNS Bank is responsible for day-to-day operations within these frameworks and each year draw up operational plans that are approved by the Executive Board of SNS REAAL.

The internal risk management and control system is geared towards the strategic objectives of SNS REAAL and inherent risks are amongst others exposure to financial markets. The framework for business control (see Figure 1) sets out how responsibility is awarded within SNS REAAL and how accountability is assumed. This process is similar to the COSO Enterprise Risk Management system (ERM).

1 **Framework for business control**



This framework forms the basis for controlling (risk) management processes in areas such as strategy, operations, integrity (including compliance) and (financial) reporting and reports.

The framework for business control is based on an assessment of risks and does not guarantee, for instance, that human error, the deliberate circumvention of control procedures by employees and third parties acting in concert, or the evasion of control mechanisms by management will not occur.
SNS REAAL has set up a procedure to determine biannually the extent to which the management boards of each business unit are demonstrably ‘in control’. This particularly concerns the review of risks in the business operations and if necessary the measures taken in this respect. Key inputs for this procedure are the regular in-control reports per business unit. In each half-year report the management board of each business unit states, with due observance of changes to internal and external factors, whether they have identified the main risks and corresponding control measures with a reasonable degree of certainty, which improvements have been made to the (risk) management procedures, whether the established control measures function adequately, whether the provision of information is sufficient and which aspects the relevant business unit intends to improve further. The management boards state whether they expect the risk management system to work adequately during the next one-year period.
The Executive Board of SNS REAAL assesses the internal statements by the various business units and group staff departments. Together with a strategic risk analysis, these assessments form the basis for the internal statement that every Executive Board member prepares. The statements from the management boards translate into the external in-control statement, which is discussed with the Audit Committee.

## 7.4 In-control statement

The design of SNS Bank’s risk management and control systems, as described in the framework for business control, supplemented with frequent research into the effectiveness of essential control measures gives the Management Board reasonable assurance that the main risks are recognised and controlled adequately.
SNS Bank is active in different financial markets and is exposed to movements and changes, such as interest rates, capital markets and actuarial assumptions.
The unprecedented downward trend of these markets in 2008 has strongly influenced our financial results, also intensified by the IFRS framework. As far as we know, risk management systems in the financial sector were not immune to these extreme circumstances.
Based on these insights the key issues are:

- The public has lost confidence in the financial sector.
  In spite of all its efforts and the increase in number of clients, SNS Bank has been unable to avoid this development. Working to restore lasting confidence in a time of recession is essential in the coming years. A new balance will be found between the interests of customers, shareholders, employees and other stakeholders.
- SNS Bank is still known to savers and investors in bonds. In 2008 savings continued to increase. This can be adversely influenced by negative perceptions on SNS Bank. Focus on communication with stakeholders wherever possible is a means in preventing this.
- The speed and extent of the credit crisis has surprised many including SNS Bank. We have learned important lessons and have taken measures in the areas of risk management, stress testing, risk information and risk models. SNS Bank aims at maintaining the moderate risk profile, with consistent market capital ratios as expected by the market.
- It is essential to SNS Bank’s success to have – and keep – the right staff on board. A positive mindset is needed to emerge from the crisis stronger than before. Against the backdrop of the recession and the announced staff reductions, this is a major point of attention.
- The national and international real estate markets are under great pressure and prices and demand are dropping. SNS Bank has extensive loan portfolios collateralised by real estate. It mainly concerns Dutch residential property, but also some other properties, including Spain and the USA. Risk management systems are already adapted and are regularly reviewed and improved.

The system of demonstrable measures for controlling the financial reporting risk functioned adequately throughout 2008. Based on that, we have obtained a reasonable degree of certainty that the financial reporting does not contain any material misstatements. The financial reporting process at this time gives us no reason to expect that it should not work adequately in 2009.

A major point of attention for 2009 is the difficulty of determining the correct fair value of non-liquid investments. Although all measures have been taken and a cautious approach was adopted, it cannot be ruled out that differences may arise between the valuation included now and the ultimate value upon realisation.

# 8 Disclosure of off-balance items

## 8.1 General

In this chapter, SNS Bank discloses information about off-balance items with focus on derivatives. Off-balance sheet items are divided into two different exposure types in accordance with calculation of credit risk RWA in the CRD:

1. Off-balance sheet items: main categories of off-balance sheet items are guarantees, credit commitments and unutilised portion of approved credit facilities.
2. Derivatives: financial instruments that derive their value from underlying interest rates, currencies, equities, credit spreads or commodity prices. Derivatives do not only result in counterparty risk measured within the credit risk RWA but also affect the market risk.

For the different off-balance exposure types mentioned above, there are different possible values for the calculation base. For the off-balance items, the nominal value of the guarantee is applied with a credit conversion factor (CCF) for calculating the exposure at default (EAD). The CCF factor is 50% or 100% depending of the type of guarantee, i e lowering the risk weight compared with the same exposure on balance. Credit commitments and unutilised amounts are the part of the external commitment that has not been utilized. This amount forms the calculation base for which a CCF is used for calculating the EAD. The CCF factor is multiplied with the calculation base and is 0%, 20%, 50%, 75% or 100% depending of approach, product type and whether the unutilized amounts are unconditionally cancellable or not. For derivatives it is a combination of the market value and the nominal amount. The overall capital requirements for these items are available in the table where the figures for derivatives stem from counterparty risk. It can be concluded that although off balance items have large exposure amounts, the effect on RWA is reduced due to the use of CCF in the calculation of EAD.

Table 27: Exposure, RWA and capital requirements by exposure type, 31 December 2008

| In € millions | On-balance sheet items | Off-balance sheet items | Derivatives | Total |
|---|---|---|---|---|
| Exposure | 63,418 | 17,522 | 714 | 81,654 |
| EAD | 53,170 | 1,281 | 714 | 55,165 |
| RWA | 20,012 | 622 | 459 | 21,093 |
| Capital requirement | 1,601 | 50 | 37 | 1,688 |
| Average risk weight | 38% | 49% | 64% | 38% |

## 8.2 Risk in derivatives

### 8.2.1 General information about derivatives

Derivative contracts are financial instruments that derive their value from underlying interest rates, currencies, equities or credit spreads. SNS Bank uses derivatives to manage market risks on an economic basis. Derivatives affect counterparty risk and market risk.

### 8.2.2 Counterparty risk

Counterparty risk is the risk that SNS Bank's counterpart in a FX, interest, commodity, equity or credit derivative contract defaults prior to maturity of the contract and that SNS Bank at that time has a claim on the counterpart. Counterparty risk in SNS Bank is subject to credit limits like other credit exposures and is treated accordingly.

*Pillar 1 method for counterparty risk*

SNS Bank uses the mark-to-market method to calculate the EAD for counterparty risk in accordance with the credit risk framework in CRD, i e the sum of current exposure (replacement cost) and potential future exposure. The potential future exposure is an estimate, which reflects possible changes in the market value of the individual contract during the remaining lifetime, and is measured as the notional principal amount multiplied by a risk weight. The size of the risk weight depends on the contract's remaining lifetime and the underlying asset. Netting of

potential future exposures on contracts within the same legally enforceable netting agreement is done as a function of the gross potential future exposure of all the contracts and the quotient between the net current exposure and the gross current exposure.
In the table the EAD as well as the RWA and capital requirement split on the exposure classes are available. As stated above, EAD equals the sum of current exposure and potential future exposure and as of 31 December 2008 the potential future exposure is the major part of the EAD.

Table 28: **Counterparty risk exposures, 31 December 2008**

| In € millions | EAD | RWA | Capital requirement |
|---|---|---|---|
| Central governments and central banks | -- | -- | -- |
| Institutions | 357 | 103 | 8 |
| Corporate | 357 | 356 | 29 |
| Other | -- | -- | -- |
| **Total** | **714** | **459** | **37** |

*Internal credit limits and internal capital*

Counterparty risk for internal credit limits and internal capital purposes are calculated using a similar method to the pillar 1 method.

*Mitigation of counterparty risk exposure*

SNS Bank enters into money and capital market transactions with various financial institutions as part of its treasury and funding activities. This concerns, among others, derivative transactions for the hedging of interest rate and currency risks. Derivative transactions that are subject to a Credit Support Annex (CSA) of the International Swaps and Derivatives Association agreement, have terms to maturity varying from 1 year to a maximum of 20 years. The emphasis is on longer maturities. These CSAs are primarily aimed at minimising counterparty risk. Changes in the present value of all existing transactions are settled periodically on a cash basis with the counterparty in question. In addition, a system with counterparty limits applies. This system reduces the concentration risk.
SNS Bank's financial collateral agreements do typically not contain any trigger dependent features, for example rating triggers.

In the table information is available of how the counterparty risk exposure is reduced with risk mitigation techniques.

Table 29: **Mitigation of counterparty risk exposure due to closeout netting and collateral agreements, 31 December 2008**

| In € millions | Current exposure (gross) | Reduction from closeout netting agreements | Reduction from held collateral (net) | Current exposure (net) |
|---|---|---|---|---|
| Total | 1,113 | 307 | 92 | 714 |

## 8.2.3 Hedging

SNS Bank uses various hedge strategies to cover its interest rate, market value and exchange rate risks. To achieve this, it uses instruments such as currency swaps, (foreign currency) interest rate swaps and (interest rate) options. SNS Bank uses interest rate swaps to manage the interest rate risk of the bank book. The policy here is that the duration of interest-bearing total equity must be between 0 and 10 and the EaR must stay below the limit of € 25 million. In addition, SNS Bank uses interest rate derivatives to hedge specific embedded options in mortgages by means of options. This relates to mortgages of which the interest rate is capped or where movements in interest rates are transferred to clients gradually. SNS Bank also uses interest rate derivatives to hedge the quotation risk of the mortgages offered. SNS Bank also uses (foreign currency) swaps to convert non-euro funding into euro funding and to convert fixed-rate funding into floating-rate funding. SNS Bank also uses options to hedge the risks relating to hybrid savings products. Finally, SNS Bank applies interest rate swaps to hedge investment portfolio risks.

# 9 Information about securitisation

## 9.1 General

SNS Bank has securitised mortgage receivables in special purpose entities (SPVs). With these transactions, the economic ownership of the mortgage receivables is transferred to separate entities. SNS Bank does not have direct or indirect interests in these entities. The reasons for SNS Bank to securitise a part of the mortgage receivables are:

- Funding: through securitisation, SNS Bank is able to reduce the funding costs by borrowing at lower rates.
- Lower capital requirements: by securitising some the mortgage receivables SNS Bank is able to manage the RWA and hence capital requirement to lower levels while maintaining the “earning power” of the asset.
- Liquidity: future cashflows out of mortgage receivables are currently not available in the liquidity position either as cash or as liquid asset. By securitising the mortgage receivables, the cash is available for funding new business or investment.

## 9.2 Roles

SNS Bank is active in various roles in connection to securitisation activities. In order to support its business development while meeting regulatory capital requirements, SNS Bank, as originator, has launched securitisation programmes based on its Dutch residential mortgage portfolio. As investor bank, SNS Bank provides a liquidity facility to the Hermes SPVs.
As arranger and underwriter SNS Bank is active as an arranger of MBS transactions. SNS Bank is responsible for structuring the transaction including negotiations with the rating agencies and coordination with legal counsel for documenting the transaction.
As an underwriter SNS Bank is, in cooperation with related financial institutions, responsible for placing the notes issued by the SPV with institutional investors. Such underwriting is typically done on a best effort basis with no obligation to purchase any unsold positions at a pre-determined spread.
SNS Bank is, as manager of a securitisation (administrator), responsible for the daily management of the securitised assets regarding the collection of principal and interest, which is then passed to the holders of the securitisation positions.
In addition, SNS Bank acts as investor for a limited amount of activities.

## 9.3 Approaches

In order to account for the securitisation exposures, SNS Bank has decided to adopt the Advanced Internal Rating Approach and the use of the Rating Based Apporoach (RBA) for rated assets.
Under the RBA, the risk-weighted assets (RWA) are determined by multiplying the amount of the exposure by the appropriate risk weights. The risk weights depend on the external rating and the seniority of the position. Based on each pool’s characteristics, the RBA will provide a risk weight, which is applied in the formula.

## 9.4 Accounting principles

SNS Bank fully consolidates these SPEs in its financial statements if, on the basis of the economic reality of the relationship between SNS Bank and the SPE, SNS Bank controls the SPE, or if SNS Bank retains the majority of the risks and rewards.

## 9.5 Information about securitisation

SNS Bank has securitised part of its mortgage loans. With these securitisation transactions, the economic ownership of mortgages is transferred to separate companies. These loans are transferred at nominal value plus a deferred selling price. A positive result within the separate companies creates a positive value of the deferred purchase price. In this way, SNS Bank retains an economic interest in the companies, and consolidates these companies in its consolidated financial statements in full.

SNS Bank has also structured a synthetic securitisation in the form of credit guarantees, whereby the credit risk protection has been bought.
SNS Bank has purchased subordinated bonds issued by various Pearl companies and also taken positions in bonds issued by various Hermes companies. In 2008 REAAL Verzekeringen purchased bonds issued by various Hermes companies. In 2008 Hermes XIV, XV and XVI were to a large extent not placed with third parties and qualify as assets eligible at the Dutch Central Bank.

Table 30: **Outstanding amounts of exposures securitised, 31 December 2008**

| In € millions | Outstanding amounts of exposures securitised | | | |
|---|---|---|---|---|
| | Traditional | | Synthetic | |
| Underlying Portfolio | Originator | Investor | Originator | Investor |
| Residential mortgages | 483 | 6,575 | 436 | -- |
| **Total** | **483** | **6,575** | **436** | **--** |

Table 31: **Outstanding amounts of exposures securitised and impaired, 31 December 2008**

| In € millions | Outstanding amounts of exposures securitised | | | |
|---|---|---|---|---|
| | Impaired/past due | | Losses | |
| Underlying Portfolio | Originator | Investor | Originator | Investor |
| Residential mortgages | 14 | 1 | 1 | 1 |
| **Total** | **14** | **1** | **1** | **1** |

Table 32: **Exposure and capital charges of securitisation positions retained or purchased per risk weight band, 31 December 2008**

| In € millions<br>Risk Weight Bands | Aggregate exposure amount of securitisation positions retained or purchased | |
|---|---|---|
| | Exposure amount<br>Current year | Capital charges, IRB approach<br>Current year |
| ≤ 10% | 127 | -- |
| > 10% ≤ 1,250% | -- | -- |
| **Total** | **127** | **--** |

Table 33: **Securitisation activity in 2008**

| Underlying portfolio | Securitisation activity in 2008 (exposures securitised) | | | | |
|---|---|---|---|---|---|
| | Traditional | | | Synthetic | |
| In € millions | Originator | Sponsor | Realised gains/losses on traditional securitisati-ons | Originator | Sponsor |
| Residential mortgages | 807 | 5,876 | 7 | -- | -- |
| Commercial mortgages | -- | -- | -- | -- | -- |
| **Total** | **807** | **5,876** | **7** | **--** | **--** |

SNS Bank uses the credit rating agencies Standard & Poor, Moody and Fitch to rate its securitisation positions.

# Internal capital adequacy Assessment Process

According to Article 75 of the Capital Requirements Directive (CRD) SNS Bank is required to hold an adequate amount of capital for credit risk, market risk (trading book, including position risk, settlement risk, counterparty risk, foreign exchange and commodities risk) and operational risk. Large exposures risk is also included in the scope of Pillar 1.
The responsible risk management departments prepare input parameters for these so called Pillar 1 risks of the Basel Accord. The Group Finance Department translates these inputs to the capital requirement. Risk Management reports and discusses on relevant developments within risk parameters between the business units before they are actually reported internally as well as externally. Apart from that the processes underlying the preparation are surrounded by regular procedures and internal controls within the banking and Group Risk Management environment.

Input parameters used for calculating the capital requirement under Pillar 1, are also used as input in the Internal Capital Adequacy Assessment Process (ICAAP as described in Article 123 of the CRD). The purpose of this ICAAP is to guarantee that the bank's own funds are at an adequate level to carry its current and future risks. The ICAAP framework is built upon four major input parameters. These are:

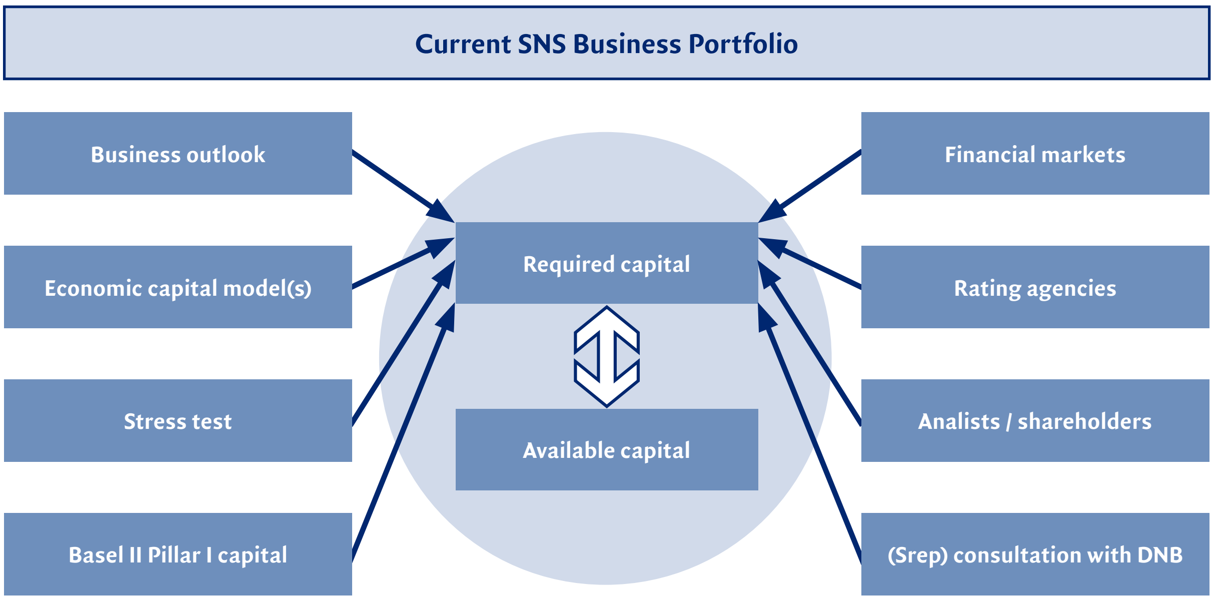
- the business outlook,
- the Pillar 1 risk capital
- the economic capital modelling framework
- stress testing

In the ICAAP framework capital needs are considered in a multidimensional perspective. This means that the four input parameters each need to be addressed adequately in the calculation of the minimum capital requirement. The stakeholders in the external environment have to be accounted for as well, because they need to be able create a complete picture of the capital adequacy and can influence the decision making process on ICAAP. This external environment consists of:

- the financial markets
- the rating agencies
- analysts and shareholders
- DNB

Next schedule shows the interplay of forces within the ICAAP framework.

2 **ICAAP framework**



The ICAAP finds its main ground in the actual material risk positions, i.e. the business portfolio. The Pillar 1 capital requirement as well as the required economic capital are calculated using internal capital models.

Next to these calculations future changes in the portfolio or positions have to be accounted for. In the business outlook the consequences of business planning (operational plans) and expected strategic decisions as well as changes in the business cycle therefore need to be considered.

The assessment of the economic capital requirement is based upon risks as recognised in Pillar I. On top of that a capital requirement is calculated for so called Pillar II risks: interest rate risk in the banking book, business risk, (credit) concentration risk and model risk.

- Interest rate risk for SNS Bank is applicable for mismatch risks and embedded options in the savings and mortgage portfolio. The economic capital requirement for interest rate risk is calculated according to a Value at Risk methodology.
- Business risk is quantified by simulating six adverse economical scenarios, based on shocks in costs, margins and/or volumes which materialize simultaneously. These stress events last two to three years.
- A surcharge for model risk is assessed by qualitative judgement. The surcharge is necessary because we take into account the possibility that model requirements are not fully met.
- Credit concentration risk is quantified implicitly. This means that the internal model to calculate economic capital for credit risk also includes parameters for concentration risk relating to large exposures and geographical concentration.

SNS Bank performs annual stress tests to evaluate if the available capital is adequate for a number of predefined stress situations as described in its stress test procedures. These stress scenarios are evaluated as well once a year prior to the actual stress testing.

The stress tests are performed on credit risk, business risk, interest rate risk in the banking book, operational risk, liquidity risk and market risk.

The procedures and internal controls in preparing the ICAAP are embedded within GRM environment.
The Group Risk Management Department reports and discusses outcomes on ICAAP four times a year with the board of the bank or more frequently if required by the circumstances. The external stakeholders are interested in outcomes as well. From them DNB and the rating agencies are informed directly. DNB uses these reports for its supervision on the ICAAP process and outcomes.
Other stakeholders are informed indirectly, for example by rating outcomes.

# 11 Liquidity risk

Liquidity risk is the risk that SNS Bank does not have (sufficient) funding and liquidity to meet its financial obligations in the short term. SNS Bank manages its exposure to this risk to the extent that it has sufficient reserves at its disposal and always remains able to meet its financial obligations. The liquidity risk management has been organised in such a way that SNS Bank is capable of absorbing the impact of banking-specific stress factors, for example, tension in the money and capital markets.

SNS Bank is the largest borrower within SNS REAAL. The bank has a broad investor base, an extensive range of financing instruments, and relatively easy access to the international money and capital markets. Due to the credit crisis, a number of instruments and markets were (temporarily) unavailable in 2008. In the first half of 2008, SNS Bank effected a large number of funding transactions, attracting € 4.6 billion of new funding. To further reinforce its liquidity position, SNS Bank effected three on-balance securitisation transactions in 2008, keeping practically all securities issued in its own books. These securities may serve as collateral for loans taken out at the ECB. In addition, SNS Bank greatly improved its position on the savings market, thanks to successful savings campaigns. Total savings volume increased by € 2.7 billion in 2008. In the beginning of 2009, SNS Bank further reinforced its liquidity position by issuing three-year State guaranteed funding in the amount of € 2 billion. SNS Bank's low risk profile is emphasised as SNS Bank has no subprime mortgages, conduits / asset-backed commercial paper (ABCP) or Special Investment Vehicles (SIVs).

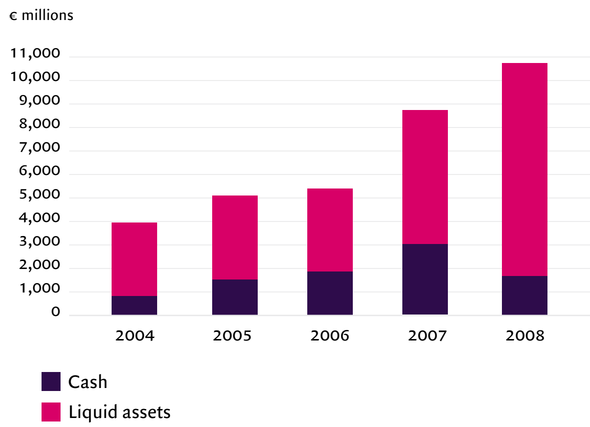
The liquidity risk policy of SNS Bank has four elements:

1. Liquidity management on a going concern basis
2. Diversification in the funding portfolio
3. Liquidity of assets
4. Planning for unforeseen events

SNS Bank's liquidity risk management is based on the composition of its funding portfolio as a going concern. The daily cash management activities of the central treasury are in line with the operational requirements of SNS Bank and take place in accordance with the regulatory guidelines in this field. An important indicator of liquidity risk is the surplus in the liquidity test of the Dutch Central Bank (weekly and monthly). A going concern situation is assumed with expiration of existing funding and a certain degree of stress on savings and credits.

SNS Bank strives to diversify the funding portfolio with respect to maturity, instrument, currency and type of investor. SNS Bank also has a large portfolio of very liquid assets, such as government bonds. The graph presents the development of the liquidity position (cash position + liquid assets) for 2008. The graph shows that, SNS Bank succeeded in maintaining a strong liquidity position in spite of unfavourable market conditions.

**3 Development liquidity position**




In addition to the above, SNS Bank also has a liquidity contingency plan that contains planning for unforeseen events. The bank also periodically carries out stress tests across the bank in which liquidity risk plays an important role. This test takes into account the drying-up of funding on the money and capital markets as well as a downgrade of SNS Bank with 2 notches by the rating agencies.

### *Management of liquidity risks*

Liquidity risks are managed on the basis of the net (assets less liabilities) nominal amounts due per contractual maturity in a liquidity gap profile. The table below represents the gap profile of SNS Bank at year-end 2007 and 2008 on the basis of the remaining contractual maturity. With regard to the table below, it should be noted that savings due on demand and other amounts due to clients on demand are presented in the 'less than one month' bucket. In practice, the products are presented with a longer liquidity profile. For mortgages, the contractual maturity is maintained without taking into account prepayments.

Table 34: Liquidity gap profile

| In € millions | ≤ 1 month | > 1 month ≤ 3 months | > 3 months ≤ 1 year | > 1 year ≤ 5 years | > 5 years | Provision | Total |
|---|---|---|---|---|---|---|---|
| **2008** | | | | | | | |
| **Assets** | | | | | | | |
| Investments (interest-bearing) | 110 | 91 | 550 | 1,261 | 1,901 | -- | 3,913 |
| Derivatives | 34 | 45 | 209 | 437 | 388 | -- | 1,113 |
| Loans and advances to clients | 1,998 | 446 | 2,390 | 4,704 | 56,501 | (245) | 65,794 |
| Loans and advances to banks | 2,752 | 4 | 6 | 21 | -- | -- | 2,783 |
| Other assets | 2,972 | -- | -- | 196 | -- | (76) | 3,092 |
| **Total assets** | **7,866** | **586** | **3,155** | **6,619** | **58,790** | **(321)** | **76,695** |
| **Liabilities** | | | | | | | |
| Share holders' equity | -- | -- | -- | -- | 2,404 | -- | 2,404 |
| Participation certificates and subordinated debts | -- | -- | 136 | 422 | 1,131 | -- | 1,689 |
| Debt certificates | 574 | 1,531 | 3,111 | 9,397 | 15,669 | -- | 30,282 |
| Derivatives | 46 | 64 | 265 | 909 | 860 | -- | 2,144 |
| Savings | 13,404 | 1,916 | 3,828 | 2,207 | 504 | -- | 21,859 |
| Other amounts due to clients | 6,040 | 417 | 1,285 | 1,145 | 1,297 | -- | 10,184 |
| Loans and advances to banks | 2,542 | 185 | 1,221 | 1,234 | 1,309 | -- | 6,491 |
| Other liabilities | 1,642 | -- | -- | -- | -- | -- | 1,642 |
| **Total liabilities** | **24,248** | **4,113** | **9,846** | **15,314** | **23,174** | **--** | **76,695** |
| **Net liquidity gap** | **(16,382)** | **(3,527)** | **(6,691)** | **(8,695)** | **35,616** | **(321)** | **--** |
| **2007** | | | | | | | |
| **Assets** | | | | | | | |
| Investments (interest-bearing) | 185 | 178 | 513 | 1,383 | 1,753 | -- | 4,012 |
| Derivatives | 27 | 47 | 106 | 475 | 386 | -- | 1,041 |
| Loans and advances to clients | 1,683 | 995 | 1,429 | 3,075 | 53,261 | (207) | 60,236 |
| Loans and advances to banks | 500 | -- | 14 | 8 | 570 | -- | 1,092 |
| Other assets | 4,203 | -- | -- | -- | -- | -- | 4,203 |
| **Total assets** | **6,598** | **1,220** | **2,062** | **4,941** | **55,970** | **(207)** | **70,584** |
| **Liabilities** | | | | | | | |
| Share holders' equity | -- | -- | -- | -- | 2,211 | -- | 2,211 |
| Participation certificates and subordinated debts | -- | -- | 5 | 501 | 1,172 | -- | 1,678 |
| Debt certificates | 566 | 892 | 2,648 | 11,624 | 16,452 | -- | 32,182 |
| Derivatives | 58 | 23 | 303 | 325 | 229 | -- | 938 |
| Savings | 17,367 | 75 | 779 | 758 | 200 | -- | 19,179 |
| Other amounts due to clients | 5,731 | 233 | 208 | 533 | 1,141 | -- | 7,846 |
| Loans and advances to banks | 1,293 | 1,375 | 207 | 775 | 1,416 | -- | 5,066 |
| Other liabilities | 1,484 | | | | | -- | 1,484 |
| **Total liabilities** | **26,499** | **2,598** | **4,150** | **14,516** | **22,821** | **--** | **70,584** |
| **Net liquidity gap** | **(19,901)** | **(1,378)** | **(2,088)** | **(9,575)** | **33,149** | **(207)** | **--** |

# 12 Capital adequacy

## 12.1 General

This chapter describes the conditions and major components of the capital base.
The calculation of capital base is done in accordance with the CRD and the Dutch legislation. The outcome must as a minimum correspond to the sum of the capital requirement for credit risks, market risks and operational risks and capital requirement related to transition rules. In the capital base for SNS Bank only capital contributed by subsidiaries or firms that are covered by the consolidated accounts are to be included.
Items included in the capital base should without restrictions or time constrains be available for the institution to cover risk and absorb potential losses. All amounts are included net of any tax charge. Generally, SNS Bank has the ability to transfer capital within its legal entities without material restrictions.
A summary of items included in the capital base is available in table 37.
The capital base (referred to as own funds in the CRD) is the sum of tier 1 capital and tier 2 capital after deductions. The two main components in the capital base are core equity in the balance sheet and subordinated debt. Below a detailed description is given of the items included in the capital base. The capital ratio is calculated by dividing the capital base with risk weighted assets.

## 12.2 Capital base and conditions for items to be included in the capital base

### 12.2.1 Tier 1 capital

Tier 1 capital is defined as capital of the same or close to the character of eligible capital, eligible reserves and also a limited part (up to 25% of tier 1) of the hybrid capital loans (perpetual loans).

*Eligible capital*

Eligible capital consists of the paid up capital which is equal to the share capital contributed by shareholders.

*Eligible reserves*

Eligible reserves consist primarily of retained earnings, other reserves, minority interest and income from current year. Retained earning are earnings from previous years reported via the income statement. Other reserves are related to the capital part of untaxed reserves, revaluation and translation reserves referred to acquisitions and associated companies under the equity method. The equity interests of minority shareholdings in companies that are fully consolidated in the financial companies group are also included. Positive income from current year is included as eligible capital after verification by the external auditors. However, negative income must always be included as a deduction.

*Hybrid capital loans subject to limits*

The requirements for including undated loans in tier 1 capital is restricted and repurchase can normally not take place until five years after the loan originally is issued. Hybrid capital loans, undated subordinated loans, may be repaid only by decision from the Board of Directors of SNS REAAL and with the permission of the DNB. Further, there are restrictions related to step up conditions, order of priority, interest payments under constraint conditions and the level of amount that can be part of the tier 1 capital. If there is any surplus after applying the legal limit of 25%, exceeding amount can be transferred to tier 2 capital.

### 12.2.2 Deductions from Tier 1 capital

*Intangible assets*

The significant part of deducted intangible assets contains of goodwill. Other intangible assets relates to it software and client relations.

### *IRB provisions excess (+) / shortfall*

The calculation of the capital base is in accordance with the CRD and the Dutch legislation. The difference between expected loss (EL) and actual provision made for the related exposures is adjusted for in the capital base. Note that this only relates to the IRB exposures. The negative difference (when the EL amount is larger than the provision amount) is included in the capital base as shortfall. According to the rules in the CRD, the shortfall amount is deducted from the capital base and be divided into both tier 1 capital and tier 2 capital. For the purpose of the CRD transitional rules the shortfall is under Dutch regulation deducted from the RWA to be neutralised in a Basel I perspective. A positive difference (provisions exceed EL) can be included in tier 2 capital with certain limitations.

### *Profit on securitisation / Significant risk*

SNS REAAL has securitised part of the mortgage loans. With these securitisation transactions, the economic ownership of mortgage loans is transferred to separate companies. These loans are transferred at nominal value plus a deferred selling price. A positive result within the separate companies creates a positive value of the deferred selling price. According to the rules in the CRD, these deferred selling prices related to securitisations are deducted from the tier 1 capital.

SNS Bank has purchased subordinated bonds issued by various Pearl companies and also taken positions in bonds issued by various Hermes companies. In 2008 REAAL Verzekeringen purchased bonds issued by various Hermes companies. Hermes XIV, XV and XVI were not (fully) placed with third parties and qualify as assets eligible at the Dutch Central Bank. According to the rules in the CRD, an amount for significant risk is deducted from the tier 1 capital.

### *Changes in Tier 1 capital in 2008*

The solvency of SNS REAAL was increased in 2008 by the issue of € 500 million capital securities to the trust and € 750 million securities capital to the Dutch State. With the proceeds of these last two transactions SNS REAAL strengthened SNS Bank's core capital position with € 260 million.

## 12.2.3 Tier 2 capital

The tier 2 capital is mainly related to subordinated debt with some specific deductions. Tier 2 capital includes two different types of subordinated loan capital; perpetual loans and dated loans. The total tier 2 amount may not exceed tier 1 and dated tier 2 loans may not exceed half the amount of tier 1. The limits are set after deductions.
The basic principle for subordinated debt in the capital base is the order of priority in a default or bankruptcy situation. Under such conditions, the holder of the subordinated loan would be repaid after other creditors, but before shareholders. The subordinated debt will to some extent prevent the institution to go into liquidation.
The amount possible to include in the tier 2 capital related to dated loans is reduced if the remaining maturity is less then five years. Outstanding amount in the specific issue is deducted by 20% for each year beyond five years.
As of end year 2008, SNS Bank holds EUR 789 million in dated subordinated debenture loans and EUR 81 million in undated subordinated debenture loans.

A summary of items included in the capital base is as follows:

Table 35: Calculation of total capital base

| In € millions | 31 December 2008 |
|---|---|
| **Tier 1 capital** | |
| Paid up capital | 381 |
| Share premium | 688 |
| **Eligible capital** | **1,069** |
| | |
| Reserves | 943 |
| Minority interests | -- |
| Income (positive/negative) from current year | 70 |
| **Eligible reserves** | **1,013** |
| **Tier 1 capital (before hybrid capital and deductions)** | **2,082** |
| | |
| **Hybrid capital loans subject to limits** | **598** |
| | |
| Intangible assets | (250) |
| IRB provisions excess (+) / shortfall (–) | (16) |
| Other items, net | 222 |
| **Deductions from Tier 1 capital** | **(44)** |
| **Tier 1 capital including hybrid capital (net after deduction)** | **2,636** |
| - of which hybrid capital | 589 |
| | |
| **Tier 2 capital** | |
| Subordinate loan capital | 789 |
| Other additional own funds | 84 |
| **Tier 2 capital (before deductions)** | **873** |
| | |
| IRB provisions excess (+) / shortfall (–) | (14) |
| **Deductions from Tier 2 capital** | **(14)** |
| **Tier 2 capital (net after deductions)** | **859** |
| **Capital base** | **3,495** |

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