Report on Capital Adequacy and Risk Management

31 December 2010

Table of Contents

1. Introduction

Related to the implementation of the Capital Requirements Directive (CRD), financial institutions have to fulfil several disclosure requirements. The aim is to make information available to the public relating to solvency aspects and risk profile of the institution. The requirements are part of the so-called Pillar 3 of the CRD, or Disclosures and Market Discipline and have been included in the Financial Supervision Act (Wet op het financieel toezicht/Wft). These requirements are effective as of 1 January 2008. This document contains Pillar 3 disclosures of GarantiBank International N.V.'s (hereinafter referred to as "GBI") as at 31 December 2010.

2. Scope of Application

The scope of application of the requirement of the Disclosures and Market Discipline Directive requirement is confined to GBI including its branches.

3. Overview on the Risk Governance at GBI

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

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

The Risk Management Committee (RMC) is responsible for coordination of risk management activities within the Bank and reports directly to the Audit and Risk Management Committee of the Supervisory Board. Other risk committees are established to manage major banking risks more specifically; the Credit Committee for credit risk, Asset & Liability Committee (ALCO) for market and liquidity risks, Legal Committee for legal risk and Compliance Committee for compliance/integrity risks. Internal Audit Department (IAD) is responsible for the monitoring of operational and other risks through FIRM analysis and regular audits and reporting them to Audit and Risk Management Committee of the Supervisory Board.

The Risk Management Department (RMD) is an independent risk control unit, which does not have any involvement in commercial activities. RMD is responsible for the quantification and monitoring of the material risks in terms of economic capital and regulatory capital in order to limit the impact of potential events on the financial performance of the Bank. Risks are continuously monitored through a well established Internal Capital Adequacy Assessment Process (ICAAP) and reported comprehensively to the related committees. RMD develops and implements risk policies, procedures, methodologies and risk management infrastructures that are consistent with the regulatory requirements, best market practices and the needs of business lines. RMD also coordinates all efforts for compliance of GBI's risk management policies and practices with Basel principles and the Financial Supervision Act (FSA, Wet op het financial toezicht / Wft).

ICAAP is designed to support the Audit and Risk Management Committee of the Supervisory Board and RMC to monitor all types of risks and assess capital requirements with regards to GBI's risk perception and regulatory requirements. RMD presents ICAAP report to the Supervisory Board Audit and Risk Management Committee semi-annually and follows up the key financial risks on a monthly basis as per the methodologies set within ICAAP.

During 2010, all rating models have been validated by independent third party experts. The Internal Audit Department has reviewed the use of the models and the data quality.

4. Own Funds

4.1. Own Funds Composition

The own funds of GBI consist of Tier 1 paid-in and called-up capital, profit reserves, Tier 2 revaluation reserves, subordinated debt and IRB provision excess or shortfall.

The subordinated debt comprises of subordinated retail deposits and subordinated lower Tier 2 notes issued. The subordinated debt is subordinate with respect to the other current and future liabilities of GBI. The original maturity of the retail loans is 5, 6, 7, 8 or 10 years.

The subordinated lower Tier 2 notes issued have an original maturity of 10 years.

In line with article 64, paragraph 3 c) of the directive 2006/48/EG the amount of subordinated debt that is included in the own funds is gradually decreased if its remaining maturity falls within 5 years.

IRB Provision Shortfall is the negative difference between the Expected Loss, calculated as per the rules set in CRD and the outstanding provisions set aside by the Bank.

Please find below an overview of GBI's own funds composition as at 31.12.2010:

Table 1

Own Funds (EUR 1,000)		
	31.12.2010	**31.12.2009**
Tier 1		
Paid-in and called-up capital	136,836	136,836
Eligible reserves	185,423	138,426
IRB provision shortfall	(5,176)	-
TOTAL Tier 1	**317,083**	**275,262**
Tier 2		
Revaluation reserves	2,084	2,484
IRB provision excess	-	4,483
IRB provision shortfall	(5,176)	-
Subordinated debt	42,870	37,712
Subordinated retail deposits	*12,870*	*7,712*
Subordinated lower Tier 2 notes	*30,000*	*30,000*
TOTAL Tier 2	**39,778**	**44,679**
TOTAL Eligible Capital	**356,861**	**319,941**

4.2. Minimum Level of Own Funds

GBI applies Foundation Internal Ratings Based Approach for credit risk, Standardized Measurement Approach for market risk and Basic Indicator Approach for operational risk in the calculation of the minimum level of required own funds.

Table 2

Solvency as at 31.12.2010 (EUR 1,000)	
Credit Risk	158,581
Market Risk	7,923
Operational Risk	11,600
Total Capital Requirement	**178,104**
Total RWA	2,226,300
Tier 1 Ratio	14.24%
Solvency ratio	16.03%

GBI operates at a comfortable solvency level of 16.03% with a strong Tier 1 ingredient of 14.24%. The high common equity level provides an adequate cushion for the upcoming capital requirements, namely Basel III.

5. Credit Risk

5.1. Organization of the Credit Function

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

At GBI, credit risk arises mainly from trade finance lending and treasury activities but also from various other sources. GBI is mainly involved in low default portfolios such as sovereigns, banks, large corporate companies and trade finance activities. The credit risk framework of GBI is built in a way that allows classifying counterparties, segregating them and subsequently applying specific processes to effectively cope with credit risks. All business flows implying credit risk are rooted via the Credit Division that in turn is subdivided into separate teams responsible for assessing and managing credit risks pertinent to corporate counterparties, financial institutions and sovereigns. The aggregation of business flows in Credit Division allows adequate evaluation of the global balance of risks and exposures.

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

The measurement systems have been built in line with the general structure of GBI and they differ depending on the type of counterparty. GBI has dedicated internal rating models for all asset classes for evaluating the creditworthiness of the counterparties. The rating models are integrated in the credit allocation and monitoring processes. Risk rating models serve as a basis for calculation of the regulatory capital and economic capital that GBI has to maintain to cover possible losses from its lending activities. Ratings are also integral parts of pricing and risk based performance measurement processes.

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

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

The credit follow-up process is divided into two main parts:

- follow-up of the customer, and
- follow-up of the credit facility itself.

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

For problematic loans on the provision list, GBI attempts to ensure recovery of problematic loans by restructuring, obtaining additional security and/or proceeding with legal actions. Provisions are established for the outstanding amount of the defaulted credit facility after deduction of expected recoveries and/or liquidation value of the collaterals. The provisioned credit facility is proposed to the Credit Committee for write-off after all possible ways of recovery have been exhausted.

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

5.2. Information about Exposures

5.2.1. Exposure Amounts before Credit Risk Mitigation

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

Table 3

Exposure Class	Average Exposure Q1-2010/Q4-2010 (EUR 1,000)	Total Exposure Q4-2010	Total Exposure Q3-2010	Total Exposure Q2-2010	Total Exposure Q1-2010
Central governments and central banks	624,750	634,451	425,324	518,185	921,040
Institutions	1,660,270	1,978,637	1,611,317	1,607,480	1,443,647
Corporates	1,760,921	1,754,141	1,592,051	1,744,907	1,952,585
Retail	78,796	11,957	8,969	9,607	284,652
Equity	401	318	649	318	318
Other non credit-obligation assets	34,174	29,988	28,481	28,754	49,472
Total	**4,159,312**	**4,409,492**	**3,666,791**	**3,909,251**	**4,651,714**

5.2.2. Geographical Breakdown of the Exposures

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

Table 4

Geographical Region / Exposure class	Total exposure (EUR 1,000)	Share in exposure
European Union	**1,617,148**	**36.7%**
Central governments and central banks	540,375	
Institutions	569,788	
Corporates	473,128	
Retail	3,551	
Equity	318	
Other non credit-obligation assets	29,988	
Turkey	**1,668,489**	**37.8%**
Central governments and central banks	86,572	
Institutions	875,975	
Corporates	697,951	
Retail	7,991	
CIS countries	**409,208**	**9.3%**
Central governments and central banks	7,504	
Institutions	344,514	
Corporates	57,190	
Other Europe	**213,766**	**4.8%**
Institutions	14,856	
Corporates	198,495	
Retail	415	
Rest of the World	**500,880**	**11.4%**
Institutions	173,504	
Corporates	327,376	
Total	**4,409,492**	**100.0%**

5.2.3. Breakdown of the Exposures by Industry

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

Table 5

Exposure class	Sector DNB	Total Exposure (EUR 1,000)
Central governments and central banks	Government	**634,451**
Institutions	Banks and financial intermediation	**1,978,637**
Corporates		**1,754,141**
	Agriculture, farming and fishing	70,227
	Automotive	35,793
	Banks and financial intermediation	295,303
	Basic materials	476,027
	Capital goods	165,303
	Chemicals	151,990
	Construction and Infrastructure	49,170
	Consumer products non-food	71,999
	Diversified / other	82,779
	Food, beverages and tobacco	77,540
	Insurance and pension funds	17,172
	Leisure and Tourism	1,406
	Media	8,671
	Oil and Gas	115,001
	Private individuals	4,323
	Retail Shops	678
	Services	6,109
	Telecom	86,147
	Transport and logistics	7,032
	Utilities	31,471
Retail		**11,957**
	Construction and infrastructure	1,651
	Consumer products non-food	112
	Private individuals	10,194
Equity	Diversified / other	**318**
Other non credit-obligation assets	Diversified / other	**29,988**
Total		**4,409,492**

5.2.4.Effective Maturity Breakdown

The effective maturity breakdown of gross exposure broken down by exposure classes is as follows:

Table 6

	Effective Maturity (EUR 1,000)						
Exposure class	**≤ 3 months**	**≤ 6 months**	**≤ 12 months**	**≤ 24 months**	**≤ 36 months**	**≤ 60 months**	**Total**
Centr.Gov's and Centr.Banks	425,726	-	39,800	55,255	6,258	107,412	**634,451**
Institutions	702,922	315,929	466,527	135,995	107,397	249,868	**1,978,637**
Corporates	956,996	185,975	179,580	216,152	93,846	121,593	**1,754,141**
Retail	4,501	137	1,192	971	222	4,934	**11,957**
Equity	318	-	-	-	-	-	**318**
Other non credit-obl. Assets	29,988	-	-	-	-	-	**29,988**
Total	**2,090,463**	**502,040**	**687,098**	**408,373**	**207,723**	**483,807**	**4,409,492**

5.2.5.Impaired and Past Due Exposures, Value Adjustments and Provisions

Below table gives an overview of the outstanding specific loan provision and the related additions to provisions:

Table 7

	(EUR 1,000)					
Geographical Region / Exposure class	**31-12-2009**	**Write-offs**	**Repayments**	**Additions**	**FX differences**	**31-12-2010**
European Union	**24,846**	**(21,749)**	**(3,610)**	**10,840**	**914**	**11,241**
- Institutions	9,287	(7,319)	(2,746)	-	778	-
- Corporates	7,560	(4,379)	(864)	7,755	136	10,209
- Retail	7,999	(10,051)	-	3,085	-	1,033
Turkey	**389**	**-**	**(215)**	**2,616**	**13**	**2,804**
- Corporates	238	-	(39)	2,616	(11)	2,804
- Retail	151	-	(175)	-	24	-
CIS Countries	**2,406**	**(472)**	**(1,952)**	**-**	**18**	**-**
- Institutions	2,406	(472)	(1,952)	-	18	-
Other Europe	**516**	**-**	**(130)**	**7,533**	**(43)**	**7,876**
- Corporates	516	-	(130)	7,533	(43)	7,876
Rest of the world	**4,716**	**-**	**(1,135)**	**-**	**389**	**3,970**
- Corporates	4,716	-	(1,135)	-	389	3,970
Total Specific Provisions	**32,873**	**(22,221)**	**(7,041)**	**20,989**	**1,291**	**25,891**

Exposure is past due if a debtor has failed to make a payment of principal and/or interest when contractually due. The 90 days past due amounts broken down by geographical areas as of 31 December 2010 is presented in the table below. The 90 days past due amounts are inclusive of the specific provisions.

Table 8

90 Days past due amounts	31-12-2010 (EUR 1,000)
European Union	24,974
Turkey	220
Other Europe	438
Rest of the world	4,406
Total amount past due	**30,038**

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

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

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

Table 9

	(EUR 1,000)			
Year	**Retail**	**Corporates**	**Institutions**	**TOTAL**
2010	3,085	17,904	-	20,989
2009	5,693	7,172	11,588	24,453
2008	1,857	5,935	-	7,792
2007	278	470	-	748
2006	71	270	-	341

5.2.6.Counterparty Credit Risk of Derivative Instruments

GBI applies Original Exposure Method for determining the counterparty credit risk exposure of derivative instruments. In this method, the exposure value of the counterparty credit risk is calculated by multiplying the notional principal amounts of each derivative instrument by the percentages as given in table 3 of Annex III, part 1 of the EC directive. The determination of the credit limits for counterparty credit risk follows a similar methodology.

Establishment of a credit limit for counterparty credit risk includes but is not limited to credit limits for:

- Spot and forward foreign exchange (FX) transactions
- Currency transactions including currency swaps
- Options

- Forward rate agreement (FRA)
- Interest rate swaps
- Credit default swaps (CDS), etc

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

Table 10

	(EUR 1,000)		
Derivatives and Repurchase Transactions	**Gross positive fair value**	**Collateral held**	**Net exposure**
Repurchase transactions	460,886	359,272	101,614
Interest rate swaps	-	-	-
FX swaps	35,669	2,617	33,052
FX spot and forwards	384	140	244
Currency options	9,843	7,565	6,448
Other options	960	7	953
TOTAL	**507,742**	**369,601**	**142,311**

5.2.7. Specialized Lending

Within the corporate exposure class, credit institutions have to distinguish specialized lending exposures. Specialized lending exposures possess the following characteristics:

(a) the exposure is to an entity which was created specifically to finance and/or operate physical assets;

(b) the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate; and

(c) the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.

The following table discloses the gross specialized lending exposures after provision, assigned to the different risk categories as at 31 December 2010:

Table 11

Exposure Amounts (EUR 1,000)						
Remaining Maturity	**Strong**	**Good**	**Satisfactory**	**Weak**	**Default**	**TOTAL**
Less than 2.5 years	93,234	149,431	78,311	556	3,745	**325,276**
Equal or more than 2.5 years	-	40	33,105	103	**-**	**33,249**
TOTAL	**93,234**	**149,471**	**111,416**	**659**	**3,745**	**358,525**

5.2.8.Credit Risk Mitigation

GBI applies diversified collateral requirements and systematic approaches to collaterals submitted by customers, which depend on the transaction type and purpose, including but not limited to cash margins, physical commodities, receivables, cash flows, guarantees, accounts, financial instruments and physical commodities. The value of collateral is usually monitored on a daily basis to ensure timely corrections or measures to be taken, if necessary. Next to that, there are types of guarantors that are accepted as main risk party or additional security. Among those are distinguished high net worth individuals and legal entities having extensive asset bases.

The total exposure value that is covered by eligible financial and other eligible collateral is as follows:

Table 12

Exposure Class	Sum of Eligible Collateral (EUR 1,000)
Central governments and central banks	160,000
Institutions	239,987
Corporates	196,907
Retail	4,959
Total	**601,853**

5.3. Scope of Acceptance for F-IRB Approach

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

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

Retail exposures (including sub classes Retail and Private Banking) are subject to permanent exemption from F-IRB and are treated under SA. Please find below an overview of the portfolios within the scope of F-IRB methodology as of 31 December 2010:

Table 13

IRB Exposure Class	Exposure Amounts (EUR 1,000)	Risk Weighted Amounts (EUR 1,000)	Average PD
Central governments and Central Banks (*)	634,451	137,770	0.16%
Institutions	1,963,329	923,617	0.82%
Corporates	1,299,506	577,324	0.75%
Total	**3,968,590**	**1,675,756**	**0.69%**

(*) IRB recognition of 0% weighting of Sovereign exposures are included

All necessary approvals have been received from DNB regarding the use of models for the purpose of calculation of minimum required own funds.

GBI complies with the requirements set out in Directive 2006-48 EC Annex VII, Part 4. The compliance is assured by several internal and external audit and validation processes.

5.3.1.Governance Framework around F-IRB Models and Processes

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

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

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

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

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

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

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

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

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

5.3.2. General Description of Models

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

- Probability of Default (PD) Models: These models provide obligor grades based on the masterscale defined by GBI. The masterscale has 22 rating grades and provide sufficient granularity for risk assessment. The rating grades are converted to PD via masterscale. Masterscale is reviewed on an annual basis and updated where necessary based on the internal and external changes in circumstances.

- Supervisory Slotting Criteria (SSC) Models: GBI has developed rating models for Specialized Lending exposure classes of Commodities Finance and Shipping Finance based on the SSC as per the conditions stated in CRD. SSC Models provide 5 grades, which are mapped to risk weights set by the regulator.

All rating methodologies within GBI have similar and consistent methodologies, which are based on two steps. The first step contains financial and non-financial models that produce a combined score. This score is further adjusted with a score for a number of warning signals. The second step has three layers of override mechanisms. These mechanisms include risk factors related with country of the obligor and parental support. The final override is the transfer risk policy, which caps the foreign currency rating, based on the country ceiling of the country of the counterparty.

6. Market Risk

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

GBI assumes market risk in trading activities by taking positions in various financial instruments such as foreign exchange and fixed income. The Bank has historically been conservative in its trading activities. The strategy mainly focuses on client driven intraday trading with limited overnight exposures. GBI uses Standardized Measurement Approach for the calculation of required capital under Pillar 1.

ALCO bears the overall responsibility for the market risk and sets the limits for trading positions and stop loss levels on product and authority levels. Treasury Department actively manages the market risk within the limits provided by ALCO.

Treasury Middle Office and ICU control and follow-up the transactions and positions regularly based on the pre-established limits, whereas Financial Control Department follows-up the positions and profit and loss on transactions. RMD monitors market risk through regulatory and economic capital models and reports to ALCO, RMC and Audit and Risk Management Committee of the Supervisory Board.

Below table gives the breakdown of the capital requirement for market risk as at 31.12.2010:

Table 14

Market Risk	Amount (EUR 1,000)
Foreign Exchange Risk	7,085
Equity	838
Total Capital Requirement	**7,923**

7. Operational Risk

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

Credit institutions are required to hold own funds against operational risks. Several approaches may be used for the quantification of this requirement. GBI applies the Basic Indicator Approach in order to determine the capital requirement which is arising from operational risk.

Under the Basic Indicator Approach the capital requirement is equal to 15% of the relevant indicator, which is the average over three years of the sum of net interest income and net non-interest income. The three-year average is calculated on the basis of the last three financial year observations. If audited figures are not available at the time, business estimates may be used. The average of net interest income and net non-interest income over the past three years amounted to EUR 77.3 mio in 2010, which resulted in a capital requirement for operational risk of EUR 11.6 mio.

8. ICAAP Framework

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

ICAAP starts with the assessment of the capital allocated for Pillar 1 risks. The capital calculations under Pillar 1 are referred as Regulatory Capital (RCAP). GBI has dedicated assessment methodologies for credit, market and operational risks, which are used to come up with an Economic Capital (ECAP) figure. RCAP and ECAP are compared for each risk type under Pillar 1 and the one with higher result is taken as the outcome of the comparison. The total of the outcomes for each risk type is the final outcome of ICAAP for Pillar 1 risks.

The second step is to take into account the additional capital requirements arising from the risks, which are not taken into account in Pillar 1. GBI has a dedicated assessment methodology for each material Pillar 2 risk. The capital requirement for the concentration risk and interest rate risk in the Banking Book are calculated through quantitative techniques, whereas the strategic risk is assessed within the scope of capital plan.

Table 15

Risk Type	Materiality	Covered in
Credit Risk	Material	Pillar 1 and Pillar 2
Concentration Risk	Material	Pillar 2
Market Risk	Material	Pillar 1 and Pillar 2
Operational Risk	Material	Pillar 1 and Pillar 2
Interest Rate Risk on the Banking Book	Material	Pillar 2
Liquidity Risk	Material	Pillar 2
Strategic Risk	Material	Pillar 2
Business Risk	Immaterial	Pillar 2
Reputation Risk	Immaterial	Pillar 2
Residual Risk	Immaterial	Pillar 2
Pension Risk	Immaterial	Pillar 2
Legal Risk	Immaterial	Pillar 2
Settlement Risk	Immaterial	Pillar 2
Underwriting Risk	Not Applicable	-
Securitisation Risk	Not Applicable	-

8.1. Credit Risk

GBI has a dedicated ECAP model for credit risk, which is used as a benchmark to assess the adequacy of regulatory capital allocated for credit risk under Pillar 1. A 99.9% confidence level, which is in line with GBI's external rating target, is used in the ECAP calculations.

8.2. Concentration Risk

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

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

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

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

8.3. Market Risk

GBI uses Value-at-Risk (VaR) methodology as a risk measure for the market risk on the trading book, in order to assess the adequacy of the capital allocated under Pillar 1. VaR quantifies the maximum loss that could occur due to changes in risk factors (e.g. interest rates, foreign exchange rates, equity prices, etc) for a time interval of one day, with a confidence level of 99.9%. VaR is supplemented by stress tests to determine the effects of potential extreme market developments on the value of market risk sensitive exposures.

8.4. Interest Rate Risk on the Banking Book (IRRBB)

Day-to-day interest rate risk management is carried out by the Treasury Department in line with the policies and limits set by ALCO.

Interest Rate Risk is measured and monitored by using Duration, Re-pricing Gap Analysis, Earning at Risk and Economic Value Sensitivity measures. Standard regulatory stress tests form a basis for the quantification of interest rate risk in the banking book for Pillar 2. All calculations are carried out on a weekly basis and discussed at ALCO level.

Sensitivity analyses are based on both economic value and earnings perspectives. Interest sensitivity is measured by applying standard parallel yield curve shifts, historical simulation approach and user defined yield curve twist scenarios. All analyses are based on the interest rate re-pricing maturities of the transactions and GBI applies a full pricing methodology for the quantification. GBI makes use of behavioral analysis for the products that do not have contractual maturities, i.e. saving deposits. The repricing frequency of these products are measured based on historical observations. The prepayments are not taken into account as this risk is mitigated to a large extent by the legally enforceable contracts that do not allow for prepayments or require prepayment penalties.

Interest rate sensitivity analysis is also used for evaluating hedging strategies, internal limit setting and limits monitoring purposes, which enables GBI to manage the interest rate risk in a proactive manner. The outcomes of these analyses are discussed at ALCO and used effectively in decision making processes for hedging and pricing

Table 16

Economic Value Perspective (EVE) [1]					
	EUR	**USD**	**TRY**	**OTHER**	**TOTAL**
Shift Up Net (Eur 1000) [2]	-15,486	-8,486	416	-418	-23,975
Shift Down Net (Eur 1000) [2]	17,924	13,873	-410	193	31,580
Change in EVE	**23,975**	**Change in EVE / Own Funds**	**6.72%**		

(1) Static balance sheet, based on instant liquidation

(2) 200 Bps shock for G10 and 300 Bps shock for non-G10

GBI follows-up the regulatory scenario (200 bps parallel shock) for IRRBB as per the regulatory requirements. The standard parallel shock in yield curve leads to a potential decrease in economic value of EUR 24.0 mio (6.72% of the total own funds), which is well below the regulatory threshold of 20%. This is a reflection of the limited interest rate risk profile of GBI.

8.5. Liquidity Risk

The main objective of GBI's liquidity risk policy is to maintain sufficient liquidity in order to ensure safe and sound operations. ALCO bears overall responsibility for the liquidity risk strategy. ALCO has delegated day-to-day liquidity management to the Treasury Department, which is responsible for managing the overall liquidity risk position of GBI. The Treasury Department monitors all maturing cash flows along with expected changes in core-business funding requirements in order to maintain the adequate level of day-to-day funding.

GBI aims for a well-diversified funding mix in terms of instrument types, fund providers, geographic markets and currencies. RMD monitors liquidity risk through gap analysis, which is supplemented by scenario analysis. These analyses apply shocks with different magnitudes on the liquidity position of GBI. Scenarios are set based on bank-specific and market specific liquidity squeezes. In addition, the cash capital concept, which shows the excess of long term funds over illiquid assets, is used as a measure for long-term funding mismatch. GBI has a detailed contingency funding plan in place for management of a liquidity crisis situation. All liquidity analyses are reported to ALCO on a regular basis by RMD. ALCO reviews and plans the necessary actions to manage the liquidity gaps.

The following table provides a maturity analysis of assets and liabilities according to their remaining maturity:

Table 17

(EUR 1,000)	On demand	≤3M	> 3M / ≤1Y	>1Y / ≤ 5Y	> 5Y	Provisions	Total
Assets							
Cash	**266,255**	**–**	**–**	**–**	**–**	**–**	**266,255**
Banks	**91,817**	**244,643**	**683,655**	**89,228**	**–**	**–**	**1,109,343**
Loans and advances	**44,996**	**793,598**	**314,616**	**242,647**	**38,284**	**(25,891)**	**1,408,250**
Interest bearing securities	**–**	**31,659**	**71,764**	**329,506**	**195,082**	**–**	**628,011**
Shares	**3,654**	**–**	**–**	**–**	**–**	**–**	**3,654**
Participating interests	**318**	**–**	**–**	**–**	**–**	**–**	**318**
Property and equipment	**–**	**4,750**	**–**	**–**	**25,238**	**–**	**29,988**
Other assets	**113**	**–**	**–**	**13,296**	**–**	**–**	**13,409**
Prepayments and accrued income	**72,783**	**–**	**–**	**–**	**–**	**–**	**72,783**
31 Dec. 2010	**479,936**	**1,074,650**	**1,070,035**	**674,677**	**258,604**	**(25,891)**	**3,532,011**
Liabilities							
Banks	**58,816**	**398,136**	**130,520**	**9,500**	**–**	**–**	**596,972**
Funds entrusted *	**1,113,502**	**586,612**	**456,932**	**329,128**	**248**	**–**	**2,486,422**
Debt securities	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Other liabilities	**29,996**	**–**	**–**	**–**	**–**	**–**	**29,996**
Accruals and deferred income	**45,723**	**–**	**–**	**–**	**–**	**–**	**45,723**
Provisions	**–**	**–**	**–**	**–**	**1,390**	**–**	**1,390**
Subordinated liabilities	**–**	**–**	**–**	**3,941**	**41,749**	**–**	**45,690**
Shareholders' equity	**–**	**–**	**–**	**–**	**325,818**	**–**	**325,818**
31 Dec. 2010	**1,248,037**	**984,748**	**587,452**	**342,569**	**369,205**	**–**	**3,532,011**
Net liquidity 31.12.2010	**(768,101)**	**89,902**	**482,583**	**332,108**	**(110,601)**	**(25,891)**	**–**
Total Assets 31 Dec. 2009	*609,041*	*838,376*	*1,017,123*	*906,146*	*328,936*	*(42,327)*	*3,657,295*
Total Liabilities 31 Dec. 2009	*1,527,938*	*921,259*	*475,820*	*400,338*	*331,940*	*–*	*3,657,295*
Net liquidity 31.12.2009	*(918,897)*	*(82,883)*	*541,303*	*505,808*	*(3,004)*	*(42,327)*	*–*

* This includes on demand retail funding which has a longer term characteristic.

8.6. Operational Risk

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

FIRM questionnaires are also used during the ICAAP process by the use of a scoring methodology. The answers to the questions are translated into scores in a similar way that is explained in the FIRM manual of DNB.

8.7. Other Risks

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

8.8. Capital Planning

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

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

9. New Regulatory Standards

CRD II

The changes in the treatment of large exposures and the new liquidity risk monitoring framework have been the most important regulatory changes for GBI within the CRD II package. The Bank has successfully finalized the implementation of these new regimes, together with the other aspects of CRD II. GBI has applied several impact studies throughout 2010 to analyze the financial impact of the regulatory changes in detail and has already taken the necessary measures to sustain the sound financial position and strong business franchise.

Basel III

GBI has actively taken part in BCBS/CEBS Comprehensive Quantitative Impact Study for the implementation of Basel III. It has been observed that the impact of the upcoming regulations is at a very limited level since the Bank has: a high common equity Tier I ratio, high liquidity buffer, strong retail funding base, limited trading portfolio, no exotic products and strong risk governance structure.

The initial analysis has revealed that GBI is already equipped and well positioned for the smooth transition to the regulatory environment.