GarantiBank International N.V.

REPORT ON CAPITAL ADEQUACY and RISK MANAGEMENT
2012

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 the risk profile of the institution. The requirements are part of the so-called Pillar III of the CRD, or Disclosures and Market Discipline and have been included in the Financial Supervision Act (Wet op het financieel toezicht/Wft) in the Netherlands effective as of 1 January 2008. This document contains the Pillar III disclosures of GarantiBank International N.V. (hereinafter referred to as "GBI") as at 31 December 2012.

2. Scope of Application

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

3. Overview on the Risk Governance at GBI

The risk management culture at GBI has been established as a key ingredient of the Bank's strategy, with an emphasis on risk awareness at all levels of the organization. Senior management holds the ultimate responsibility to ensure that GBI is operating with adequate level of capital and liquidity in order to sustain the financial stability of the Bank. Risk Management at GBI is structured as an integrated effort under various levels within the organization. The Audit and Risk Management Committee (A&RMC) of the Supervisory Board is the ultimate authority for the monitoring of all material risks, approving the risk appetite of the Bank and monitoring the adequacy of capital and liquidity at the board level.

GBI defines risk appetite as a core consideration in quantitative and qualitative indicators as well as meeting the imposed regulatory, corporate governance and stakeholder requirements. Bank's appetite with respect to risks is defined via a three-layer structure, which translates these objectives into metrics that can be measured and managed. Those layers consist of capital adequacy, return on equity and liquidity. These layers are supported by the limit framework for each risk type

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

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. RMD develops and implements risk policies, procedures, methodologies and risk management infrastructures that are consistent with the regulatory requirements, best market practices and the needs of business lines. RMD also coordinates all efforts for compliance of the Bank's risk management policies and practices with Basel principles and the Financial Supervision Act (FSA, Wet op het financial toezicht / Wft). The Internal Control Unit (ICU), under RMD, is involved in the monitoring and reporting of operational risks and establishing preventive control processes.

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

During 2012, all rating models have been validated by independent third party experts. IAD has reviewed the use of the models and the data quality. De Nederlandsche Bank N.V. (DNB) has reviewed the Internal Capital Adequacy Assessment Process (ICAAP) report within the scope of Supervisory Review Process.

4. Own Funds

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

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

Please find below an overview of GBI's own funds composition as at 31.12.2012.

Table 4-1

(EUR 1,000)	31.12.2012	31.12.2011
Tier 1		
Paid-up capital	136,836	136,836
Eligible reserves	293,610	239,045
Shortfall of provisions to expected loss	-5,100	-4,684
TOTAL Tier 1	**425,346**	**371,197**
Tier 2		
Shortfall of provisions to expected loss	-5,100	-4,684
Subordinated debt	30,000	41,631
Subordinated retail deposits	-	11,631
Subordinated loan	30,000	30,000
TOTAL Tier 2	**24,900**	**36,947**
TOTAL Eligible Capital	**450,246**	**408,144**

Total own funds of GBI increased by 10% in 2012 mainly due to the strong profit generation of the Bank. GBI recorded a net profit of EUR 54.6 million in 2012, which is 2% higher than 2011's results. Further details of the Bank' own funds may be found in "*GBI Annual Report 2012*".

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

5. Regulatory Capital Requirements

Total of Tier 1 and Tier 2 capital should correspond to at least 8% of the Banks' risk weighted assets, of which Tier 1 capital must constitute at least 4%.

GBI applies the Foundation Internal Ratings Based (F-IRB) Approach for credit risk of Corporate, Institution and Sovereign portfolios since 1 January 2008 based on the permission obtained from DNB. Exposures related with Retail and Private Banking, are subject to permanent exemption from F-IRB and are treated under the Standardised Approach (SA). GBI uses the Standardised Measurement Approach for market risk and the Basic Indicator Approach for operational risk in the calculation of the minimum level of required capital. In the table below, an overview of the capital requirement and gross credit risk exposure[2] at 31 December 2012 is presented.

Table 5-1

(EUR 1,000)	31.12.2012		31.12.2011	
	Gross Exposure	**Capital Requirement**	**Gross Exposure**	**Capital Requirement**
Credit Risk				
F-IRB approach:				
Central governments and central banks[3]	835,280	12,054	928,268	15,731
Institutions	1,627,818	64,311	1,866,780	57,648
Corporates	2,327,995	77,503	1,742,117	59,002
Corporates (Specialised Lending)[4]	388,049	14,676	384,899	19,037
Total F-IRB approach	5,179,142	168,544	4,922,064	151,418
Standardised approach:				
Central governments and central banks[3]	-	-	-	-
Institutions	-	-	-	-
Corporates	81,158	1,416	143,296	4,170
Retail	12,826	703	21,142	1,150
Equity	250	20	250	20
Other non credit-obligation assets	19,911	1,593	21,724	1,738
Total Standardised approach	114,145	3,732	186,412	7,078
Total Credit Risk	**5,293,287**	**172,276**	**5,108,476**	**158,496**
Total Market Risk, standardised approach	**-**	**320**		**504**
Total Operational Risk, basic indicator approach	**-**	**14,075**		**12,332**
Total Capital Requirement		**186,671**		**171,332**
Total RWA		**2,333,388**		**2,141,650**
Tier 1 Ratio		**18.23%**		**17.33%**
Solvency Ratio		**19.30%**		**19.06%**

[2] Balance sheet and off balance sheet items, before collateral mitigation and after provisions

[3] GBI applies IRB approach for the capital requirement calculation of exposures to central governments and central banks. However the capital requirement calculation for the exposures to central governments and central banks that satisfy the conditions for 0% weighting is performed by using SA, as per DNB's national discretion. These exposures amount to EUR 656.5 million (2011: EUR 750 million) and are classified under IRB in this table.

[4] GBI applies Supervisory Slotting Criteria (SSC) approach for the calculation of the capital requirement for Specialised Lending (SL) exposures.

The capital requirement under Pillar 1 is EUR 186.7 millon. The largest part (92%) of the capital requirement relates to credit risk. 98% of the credit risk weighted assets are treated under F-IRB approach.

GBI operates at a comfortable solvency level of 19.30% with a strong Tier 1 ingredient of 18.23%. This solvency level provides a strong base to the Bank for the implementation of Basel III. An overview of new regulations is provided in Section 7.

5.1. Credit Risk

Credit risk is inevitably associated with the counterparties of a bank, with whom it has either direct or indirect credit relations and is exposed to the risk of loss if counterparties fail to fulfil their agreed obligations and the collateral does not cover GBI's claims.

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

The risk assessment approaches for different types of counterparties within the 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, corporates etc.) and to the variety of transactions typically handled (e.g. trade finance, shipping finance, treasury, private banking etc).

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

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

The effectiveness of risk monitoring is supported by internal systems ensuring proper compliance with the principle of segregation of duties and authorization levels. Every transaction under approved credit limits requires a number of authorizations and controls prior to execution and cannot be finalized without those processes. Under this structure, every commercial initiative goes through multiple checks and is inputted in the system by authorized personnel who are functionally separated from the personnel with commercial targets. Regular monitoring of GBI's exposure and compliance with the established credit limits ensures 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 Credits Division 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 the credit facility (e.g. documentation) is related to credit risk mitigation and operational risk. The credit facility follow-up is a dynamic process and is categorized as performing, watch list, default, provision and write-off stages. All shifts within those categories either in the direction of downgrading or upgrading, require the approval of GBI's Credit Committee. A loan may be shifted to the 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 impaired loan list.

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

5.1.1. Exposure Amounts before Credit Risk Mitigation

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

Table 5.1.1

(EUR 1,000)	Average Exposure Q1-Q4 2012	Total Exposure Q4-2012	Q3-2012	Q2-2012	Q1-2012
Central Gov. and Central Banks	657,600	835,280	600,853	623,891	570,377
Institutions	1,776,378	1,627,818	1,776,066	2,138,722	1,562,907
Corporate	2,761,553	2,797,202	2,915,522	2,746,274	2,587,213
Retail	19,702	12,826	13,852	16,029	36,099
Equity	250	250	250	250	250
Other non credit-obligation assets	21,230	19,911	21,550	21,584	21,876
Total	**5,236,713**	**5,293,287**	**5,328,093**	**5,546,750**	**4,778,722**

The average exposure increased by 11% compared to the average exposure in 2011. The main component of the increase in average exposure is corporate asset class where the increase in average exposure is 30%.

5.1.2. Geographical Breakdown of the Exposures

The following table gives an overview of the geographical breakdown[5] of gross exposure by material exposure classes based on customer residence:

Table 5.1.2

(EUR 1,000)	The Netherlands	Other Europe	Turkey	CIS countries	Rest of the World	Total
31.12.2012						
Central gov. and central banks	641,925	118,777	74,578	-	-	835,280
Institutions	47,584	292,253	884,043	335,570	68,368	1,627,818
Corporates	242,044	665,129	1,331,469	122,270	436,290	2,797,202
Retail	1,283	1,261	10,282	-	-	12,826
Equity	250	-	-	-	-	250
Other non credit-obligation assets	19,737	174	-	-	-	19,911
Total	**952,823**	**1,077,594**	**2,300,372**	**457,840**	**504,658**	**5,293,287**
Percentage of total	18.00%	20.36%	43.46%	8.65%	9.53%	100.00%
31.12.2011						
Central gov. and central banks	561,544	277,425	69,847	19,451	-	928,267
Institutions	140,748	609,019	757,459	229,929	129,625	1,866,780
Corporates	176,587	611,254	926,561	36,715	519,196	2,270,313
Retail	2,916	973	17,253	-	-	21,142
Equity	250	-	-	-	-	250
Other non credit-obligation assets	21,502	222	-	-	-	21,724
Total	**903,547**	**1,498,892**	**1,771,120**	**286,095**	**648,821**	**5,108,476**
Percentage of total	17.69%	29.34%	34.67%	5.60%	12.70%	100.00%

[5] The geographical breakdown of assets and off-balance sheet liabilities is also provided in Section 34.1.a of "*GBI Annual Report 2012*". The difference between the two tables arises from the fact that the table in this report includes counterparty credit risk arising from securities financing transactions (SFTs) and derivative transactions.

5.1.3. Effective Maturity Breakdown

GBI mainly enters into transactions with short maturities. 77.3% of the total credit exposures have effective maturity of lower than one year. The effective maturity breakdown of gross exposure based on exposure classes is as follows:

Table 5.1.3

(EUR 1,000)	< 3 Months	< 6 Months	< 1 Year	< 2 Years	< 3 Years	>= 3 Years	Total
31.12.2012							
Central gov. and central banks	544,056	-	-	-	147,998	143,226	835,280
Institutions	568,526	322,337	286,617	127,484	450	322,404	1,627,818
Corporates	1,564,578	332,107	463,441	118,696	155,054	163,326	2,797,202
Retail	5,967	966	1,789	1,789	223	2,092	12,826
Equity	250	-	-	-	-	-	250
Other non credit-obligation assets	-	-	-	-	-	19,911	19,911
Total	**2,683,377**	**655,410**	**751,847**	**247,969**	**303,725**	**650,959**	**5,293,287**
Percentage of total	50.7%	12.4%	14.2%	4.7%	5.7%	12.3%	100.0%
31.12.2011							
Central gov. and central banks	749,688	-	-	5,432	31,250	141,897	928,267
Institutions	883,383	239,751	329,388	68,516	141,573	204,169	1,866,780
Corporates	1,349,431	271,589	295,092	122,830	91,740	139,631	2,270,313
Retail	12,467	1,522	1,767	255	1,771	3,360	21,142
Equity	250	-	-	-	-	-	250
Other non credit-obligation assets	-	-	-	-	-	21,724	21,724
Total	**2,995,219**	**512,862**	**626,247**	**197,033**	**266,334**	**510,780**	**5,108,476**
Percentage of total	58.6%	10.0%	12.3%	3.9%	5.2%	10.0%	100.0%

The vast majority of the exposures are with residual maturity less than one year. However, the share of exposures with maturity less than 1 year decreased to 77.3% for 2012 year end compared to 2011 year end figure of 80.9%. Therefore, the average residual maturity of the Bank increased slightly.

5.1.4. Breakdown of the Exposures by Industry

The breakdown of gross exposure[6] by industry and exposure class is as follows:

Table 5.1.4

(EUR 1,000)	31.12.2012		31.12.2011	
	Total	**% of Total**	**Total**	**% of Total**
Central governments and central banks	**835,280**	**15.78%**	**928,267**	**18.17%**
Institutions	**1,627,818**	**30.75%**	**1,866,780**	**36.54%**
Corporates				
Agriculture	179,544	3.39%	97,731	1.91%
Basic materials	545,122	10.30%	633,726	12.41%
Services	4,791	0.09%	4,863	0.10%
Chemicals	251,421	4.75%	162,640	3.18%
Food, beverages and Tobacco	31,748	0.60%	27,934	0.55%
Construction	126,179	2.38%	119,749	2.34%
Consumer products	129,695	2.45%	118,042	2.31%
Financial services	655,770	12.39%	397,188	7.78%
Insurance and pension funds	16,263	0.31%	16,717	0.33%
Leisure and Tourism	10,360	0.20%	10,014	0.20%
Media	1,752	0.03%	40,569	0.79%
Oil & Gas	258,942	4.89%	153,464	3.00%
Other	124,905	2.36%	152,082	2.98%
Wholesale	12,030	0.23%	10,587	0.21%
Telecom	166,004	3.14%	60,607	1.19%
Transport & logistics	251,535	4.75%	233,110	4.56%
Utilities	31,141	0.59%	31,290	0.61%
Retail	**12,826**	**0.24%**	**21,142**	**0.41%**
Equity	**250**	**0.00%**	**250**	**0.00%**
Other non-credit obligation assets	**19,911**	**0.38%**	**21,724**	**0.43%**
Total	**5,293,287**	**100.00%**	**5,108,476**	**100.00%**

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

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

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

For problematic loans on the impairment list, GBI attempts to ensure recovery by restructuring, obtaining additional security and/or proceeding with legal actions. Provisions are established by the Credit Committee, for the outstanding amount of the defaulted credit facility after deduction of expected recoveries and/or liquidation value of the collaterals. The provisioned credit facility is further

[6] Breakdown by industry for loans and advances is also provided in Section 34.1.c of "*GBI Annual Report 2012*". However, the table above includes all exposures subject to credit risk calculation.

proposed to the Credit Committee for write-off after all possible means of recovery have been exhausted. Below table provides information on the impaired loans and provisions by exposure class:

Table 5.1.5-1

(EUR 1,000)	31.12.2012		31.12.2011	
	Impairment[7]	Provisions	Impairment[7]	Provisions
Corporates	64,174	30,796	49,020	24,551
Retail	746	746	993	993
Total	**64,920**	**31,542**	**50,013**	**25,544**
Loan Loss Reserve Ratio	**48.6%**		**51.1%**	

Loan loss provisions are at the 48.6% level and reflect the robust recoveries expected due to the collateralised nature of the credit portfolio. The table below gives an overview of the impaired and past due exposures and the provisions set aside by the residence of the counterparty:

Table 5.1.5-2

(EUR 1,000)	Impaired Exposures	90 Days Past Due[8]	Provisions for Impairment
31.12.2012			
The Netherlands	2,891	-	2,481
Other Europe	7,148	2,206	7,148
CIS countries	24,889	-	7,252
Rest of the world	26,761	-	11,597
Turkey	3,231	-	3,064
Total	**64,920**	**2,206**	**31,542**
31.12.2011			
The Netherlands	2,612	176	1,454
Other Europe	8,529	-	8,217
CIS countries	26,411	-	6,827
Rest of the world	9,155	-	5,833
Turkey	3,305	-	3,213
Total	**50,012**	**176**	**25,544**

An exposure is past due if a debtor has failed to make a payment of principal and/or interest when contractually due. The 90 days past due amount which is not provisioned is EUR 2.2 million at 31.12.2012.

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

Table 5.1.5-3

(EUR 1,000)	31.12.2012	31.12.2011
Position as of 1 January	25,544	25,891
Additions	10,785	6,203
Write-offs	(2,659)	(39)
Releases	(1,410)	(6,776)
Exchange rate differences	(718)	265
Position as of 31 December	**31,542**	**25,544**

The net provision for loan losses increased to EUR 31.5 million from EUR 24.5 million.

[7] Impaired exposures after deduction of financial collaterals and includes also the noncash exposures to the impaired customers.
[8] This amount refers to 90 days past due, but not provisioned exposures.

5.1.6. Counterparty Credit Risk

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

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

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

Net derivative exposure decreased by 10% compared to previous year due to the decrease in positive replacement value. The derivative exposures are treated under Current Exposure Method (CEM). Table 5.1.6 demonstrates the steps in the calculation of net derivatives credit exposure.

Table 5.1.6

(EUR 1,000)	Positive Replacement Value	Potential Future Credit Exposure	Current Credit Exposure[9]	Collateral Held	Net Exposure[10]
31.12.2012					
Repurchase transactions			182,099	149,754	32,345
Interest rate derivatives	-	1,106	1,106	-	1,106
FX derivatives and Options	75,011	57,455	132,467	26,578	105,889
Total	**75,011**	**58,561**	**315,672**	**176,332**	**139,340**
31.12.2011					
Repurchase transactions			499,069	418,861	80,208
Interest rate derivatives	-	1,659	1,659	-	1,659
FX derivatives and Options	94,109	29,361	123,470	50,108	73,362
Total	**94,109**	**31,021**	**624,199**	**468,969**	**155,226**

The distribution of derivatives notional amounts by residual maturity is provided in Section 34.1.e of GBI's "*Annual Report 2012*".

[9] Current credit exposure is calculated as the sum of positive replacement cost and potential future credit exposure, however for Repurchased transactions, it includes mark-to-market volume of the securities provided as collateral

[10] Exposure after collateral mitigation

5.1.7. Credit Risk Mitigation

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

Credit risk mitigants are financial collaterals and guarantees which directly decrease the credit exposure or transfer the credit risk from obligor to guarantor. The range of collateral that is eligible for the use of credit risk mitigation is based on the regulatory capital calculation method that is used. GBI uses the Comprehensive – IRB method in the calculation of credit risk mitigation factors. The total exposure value that is covered by financial and other collaterals recognized as eligible credit risk mitigation[11] by the capital requirements directive is as follows:

Table 5.1.7-1

(EUR 1,000)	Financial Collateral	Guarantees	Other Collateral	Total
31.12.2012				
Central governments and central banks	100,000	-	-	**100,000**
Institutions	151,899	-	-	**151,899**
Corporates	279,355	55,302	112,459	**447,116**
Retail	5,985	-	-	**5,985**
Total	**537,239**	**55,302**	**112,459**	**705,000**
31.12.2011				
Central governments and central banks	165,000	-	-	**165,000**
Institutions	335,848	-	-	**335,848**
Corporates	198,295	116,321	63,987	**378,603**
Retail	6,677	-	-	**6,677**
Total	**705,820**	**116,321**	**63,987**	**886,128**

5.2. Scope of Acceptance for F-IRB Approach

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

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

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

5.2.1. General Description of Models

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

- Probability of Default (PD) Models: These models provide obligor grades based on the master scale defined by GBI. The master scale has 22 rating grades and provide sufficient granularity

[11] Similar table in Section 34.1.b of GBI's "*Annual Report 2012*" presents the collateral allocated only for loans and advances.

for risk assessment. The rating grades are converted to PD via a master scale. The master scale is reviewed on an annual basis and updated where necessary based on the internal and external changes in observed default rates.

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

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

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

5.2.2. Governance Framework around F-IRB Models and Processes

Credit rating models at GBI are based on a model-life cycle framework consisting 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 materials regarding the model development are submitted to the RMC for approval. The models are approved based on the criteria that the model should reflect the risk perception of GBI, meet regulatory requirements, have a consistent methodology with the other models used by GBI, and perform adequately for that specific asset class. The proposed model is also subject to supervisory review if the impact of the model on risk weighted assets is significant[12].

Model implementation starts once the model is approved by the 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 Division reviews the rating which is then approved by the Credit Committee. The assigned ratings are used for all relevant transactions of the

[12] As defined by DNB, a change in a rating model is “significant” if it leads to a change in the capital requirement of more than 20% for the related portfolio, and/or 5% for the whole credit risk portfolio.

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 the on-going monitoring of the performance of the models. Model accuracy, stability, granularity, use of overrides and the data quality are key performance indicators for model performance.

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

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

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

Below is an overview of the portfolios within the scope of F-IRB methodology as at 31 December 2012:

Table 5.2.3-1

(EUR 1,000)	Gross Exposure[13]	RWA	Average PD[14]
31.12.2012			
Central governments and Central Banks[15]	835,280	150,672	0.43%
Institutions	1,617,979	803,877	0.54%
Corporates	2,305,865	968,790	0.65%
Total	**4,759,124**	**1,923,339**	**0.60%**
31.12.2011			
Central governments and Central Banks[15]	928,268	196,635	0.89%
Institutions	1,866,780	720,601	0.54%
Corporates	1,742,117	737,523	0.69%
Total	**4,537,165**	**1,654,759**	**0.61%**

[13] Gross exposure excluding nonperforming loans

[14] Expected probability of default of the performing portfolio

[15] The capital requirement calculations for the exposures to central governments and central banks that satisfy the conditions for 0% risk weighting are calculated by using SA, as per DNB's national discretion. These exposures amount to EUR 656.5 mio (2011: EUR 750 mio) and are classified under IRB in this table.

5.2.4. Specialized Lending

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

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

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

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

The following table discloses the gross specialized lending exposures after provisions, assigned to the different risk categories as at 31 December 2012:

Table 5.2.4-1

(EUR 1,000)		31.12.2012		31.12.2011	
Risk Weight Category	**Risk Weight**	**Gross Exposure**	**RWA**	**Gross Exposure**	**RWA**
Strong	50% - 70%	189,717	69,171	113,061	48,200
Good	70% - 90%	152,413	87,491	207,861	123,603
Satisfactory	115%	30,660	26,791	57,864	64,084
Weak	250%	-	-	1,205	2,077
Default[16]	0%	15,259	-	4,907	-
Total		**388,049**	**183,453**	**384,898**	**237,964**

5.3. Market Risk

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

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

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

The below table gives the breakdown of the capital requirement as at 31 December 2012:

Table 5.3-1

(EUR 1,000)	31.12.2012	31.12.2011
Foreign Exchange Risk	320	504
Total Capital Requirement	**320**	**504**

[16] Exposures categorised as 'default' do not attract a risk weighting but are instead treated as expected loss deductions at a rate of 50% of the exposure value.

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

5.4. Operational Risk

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

Table 5.4-1

(EUR 1,000)	**31.12.2012**	**31.12.2011**
Operational Risk Exposure	105,311	100,419
Total Capital Requirement	**14,075**	**12,332**

The average of the sum of net interest income and net non-interest income over the past three years amounts to EUR 93.8 million in 2012, which results in a capital requirement of EUR 14.1 million.

6. ICAAP Framework

GBI has designed a comprehensive ICAAP framework by making use of qualitative and quantitative assessment methodologies to assess the adequacy of the Bank's capital to cover various risks. The methodologies used are believed to be the most appropriate ones in line with the risk profile of GBI and they reflect the underlying risks in a prudent manner.

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

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

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

Table 6-1

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

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

Table 6-2

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

6.1. Credit Risk

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

6.2. Concentration Risk

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

Follow-up of large exposures is also an integral part of this process. GBI monitors the large credit exposures to group of customers and proactively manages single name concentration. Large exposures are also reviewed by the 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. The concentration risk model, which is another form of economic capital methodology, takes into account the main concentration elements in the portfolio, namely single name concentration, country concentration and industry concentration, in a more conservative manner. The outcomes of the concentration risk model are supplemented by various stress tests.

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

6.3. Market Risk

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

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

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

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

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

The Bank has a low duration structure. Therefore sensitivity to interest rate shocks is limited. The standard parallel shock to yield curve leads to a potential decrease in economic value of EUR 29.9 million (6.66% of the total own funds), which is well below the regulatory threshold of 20%. The increase in the change in economic value is mainly due to the increase in the securities portfolio dominated in USD. (2011: EUR 287 mio. to 2012: EUR 497 mio.)

Table 6.4-1

Economic Value Sensitivity Analysis[17] (EUR 1,000)	**EUR**	**USD**	**TRY**	**OTHER**	**TOTAL**
31.12.2012					
Shift Up Net[18]	-2,479	-27,583	-109	173	-29,998
Shift Down Net[18]	669	22,167	117	-6	22,947
Change in Economic Value					29,998
Own Funds					**450,246**
Change in Economic Value / Own Funds					**6.66%**
31.12.2011					
Shift Up Net	1,325	-4,801	1,642	-370	-2,204
Shift Down Net	437	6,879	-1,707	417	6,026
Change in Economic Value					2,204
Own Funds					**408,144**
Change in Economic Value / Own Funds					**0.54%**

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

[17] Static balance sheet, based on instant liquidation
[18] 200 Bps shock for G10 and 300 Bps shock for non-G10

6.5. Liquidity Risk

The main objective of GBI's liquidity risk policy is to maintain sufficient liquidity in order to ensure safe operations and a sound financial condition under both normal and stressed market conditions and a stable long term liquidity profile.

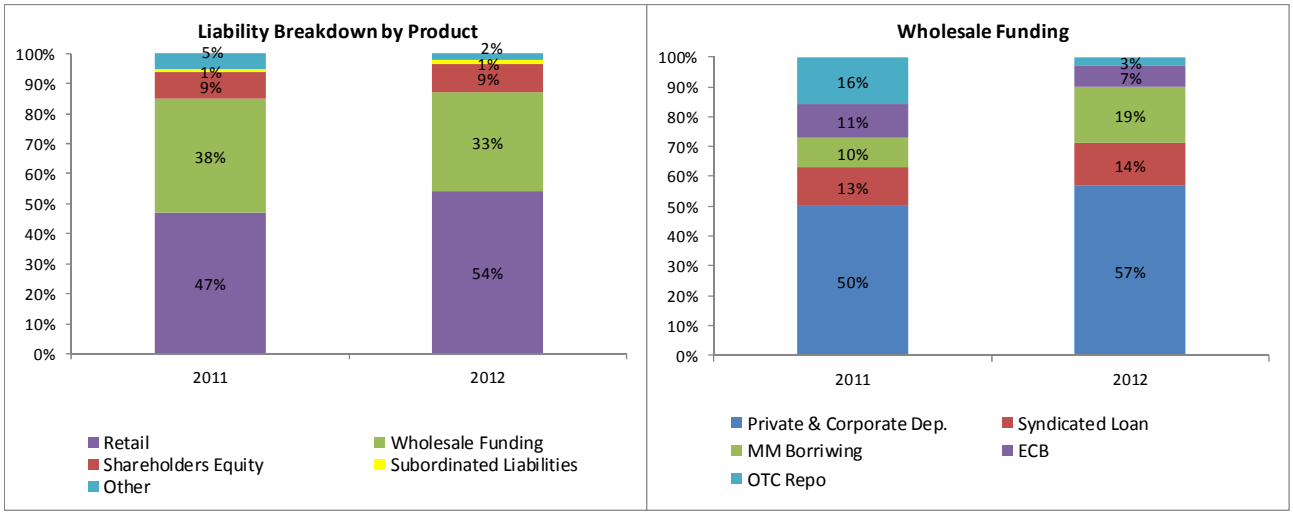
The A&RMC of the Supervisory Board bears the overall responsibility for the liquidity risk appetite of GBI and ensuring that effective risk management is conducted by the Bank in line with the appetite setting. At the Bank level, the ALCO is responsible for monitoring liquidity risk and implementing the appropriate policies and limit framework. The business strategy of GBI precludes the development of large liquidity gaps in the balance sheet, so the Bank makes use of a number of general, aggregate limits to effectively manage liquidity risk. Liquidity risk limits are established by using several measures including stress tests and gap analysis.

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, and bears overall responsibility for the liquidity risk strategy. ALCO has delegated day-to-day liquidity management to the Treasury Department, which is responsible for managing the overall liquidity risk position of GBI within the limits established by ALCO. The Treasury Department manages all maturing cash flows along with expected changes in business related funding requirements. The Treasury Operations Department performs the role of collateral management and executes the settlements of all transactions.

RMD performs the liquidity risk assessment, develops the required methodologies and conducts regular stress tests to ensure the Bank operates with sufficient liquidity. Liquidity risk is monitored through gap analyses, supplemented by multiple stress tests designed based on different scenarios. These analyses apply shocks with different magnitudes on the liquidity position. Scenarios are set based on bank-specific and market-wide liquidity squeezes. The Bank's secured funding capacity is also included in the scenarios, taking into account conservative volatility haircuts on the underlying assets. In addition to the stress tests, cash capital, which shows the excess of long term funds over long term assets, is monitored as a measure for long-term funding mismatch.

Guidelines set by Basel Committee on Banking Supervision on the management of liquidity risk have already been incorporated within the scope of liquidity stress testing framework, which enables the Bank to manage the liquidity risk in a prudent manner based on the prospective regulatory requirements as well. GBI also has a detailed contingency funding plan in place for management of a liquidity crisis situation.

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



GBI's short term lending strategy provides a natural mitigant for liquidity risk. This strategy enables the quick accumulation of a liquidity buffer in stressed financial environments, and the equally efficient build-up of short term assets once the stress is past. The Bank has not endured liquidity shortages owing to the prudent liquidity strategy. The Bank maintains a high quality liquidity buffer as short term placements to central banks or governments in Europe and to a limited number of creditworthy counterparties, as well as investments in high quality debt securities.

6.6. Operational Risk

GBI applies the Basel II definition for operational risk, which is 'the risk of direct or indirect loss resulting from inadequate or failed processes or systems, from human error or external events'. It also encompasses IT, legal, business, integrity, reputational, and settlement risk.

The Bank has embedded the 3 Lines of Defence model in its day-to-day activities, with the first line being the business as the experts in their field, ICU as the second line responsible for creating and implementing the relevant tools, in addition to challenging and advising the business, and finally Internal Audit acting as the third line by performing independent audits throughout the year and reporting directly to the Managing Board and A&RMC of the Supervisory Board. The operational risk framework of GBI is based on the principle that senior management, in addition to the Managing Board and Supervisory Board, are actively involved in risk management, and that the risk management system is independent, sound and implemented with integrity.

GBI uses policies and procedures to set the rules, and event management to monitor the events that are not in compliance with these rules. The Bank's internal control framework consists of daily controls performed by business lines and by ICU, to ensure that the activities of the Bank are in compliance with the internal policies and that corrections are done in a timely manner on a consolidated basis. Findings of ICU are presented to RMC and A&RMC of the Supervisory Board periodically.

GBI follows the Financial Institutions Risk Analysis Method (FIRM) for its operational risk. FIRM questionnaires are also used during the ICAAP via a scoring methodology. The answers to the questions are translated into scores in a similar manner to that explained in the FIRM manual. The score outcomes are reviewed in order to make the necessary decisions (if any) to take mitigating action.

IT risk assessments are performed by an independent external party based on the international Control Objectives for Information and Related Technology (COBIT) and national FIRM standards. The Bank has accepted ISO 27001 as its IT security standard and is currently in the implementation stage.

6.7. Other Risks

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

6.8. Capital Plan

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

The 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.

7. New Regulatory Standards

With the introduction of the Basel III, the new minimum capital requirements will be in place. The Common Equity Tier 1 (CET1) requirement of 2% will be increased to 7% (4.5% plus 2.5% of capital conservation buffer), by the year 2019. In addition to that, the minimum total capital ratio requirement of 8% will be increased to 10.5% (8% plus 2.5% of capital conservation buffer). A countercyclical buffer between 0% and 2.5% will be introduced on top of these required minimums in order to achieve the broader macro-prudential goal of protecting the banking sector from periods of excess aggregate credit growth. Finally the definition of eligible instruments for capital treatment is changed to increase the loss absorbance quality.

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

GBI has taken part in Basel III Monitoring Exercises in 2011 and 2012, supervised by DNB and the Basel Committee. In addition, the Bank has prepared a migration plan to outline the projected transition towards Basel III. The results of the monitoring exercises indicate that the impact of the upcoming regulations is at a very limited level since the Bank has: a high CET1 ratio, no Tier 1 hybrid capital products, a high liquidity buffer, a strong funding base, a limited trading portfolio, no exotic products and a strong risk governance structure. The initial analysis has revealed that GBI is already equipped and well positioned for the smooth transition to the new regulatory environment.