

## 8. ACTIVITIES OF THE BANK

### 8.1. Supervision of credit institutions and financial companies, and guarantee of deposits

#### 8.1.1. Overview

In 2008 the supervisory activity in Banco de Portugal was marked by the financial crisis and market instability at both the domestic and international levels. Against this background, monitoring the institutions and the regular contact with their senior management were stepped up, and a range of specific measures were adopted. In particular, the Bank:

- strengthened procedures to monitor the institutions' liquidity;
- adopted anti-cyclical measures, with a view to mitigating the effects of high volatility and liquidity shortage of certain financial assets;
- adopted the recommendations of the Committee of European Banking Supervisors (CEBS) and of the Financial Stability Forum (FSF) regarding the transparency of market information and asset valuation;
- issued recommendations advising the institutions to strengthen their solvency levels, in view of the financial market turbulence, also taking into account the Financial Stabilisation Programme approved by the Parliament, as well as the measures adopted in this field by other EU Member States;
- reduced data reporting frequency regarding the capital adequacy for financial groups and banks.

Within the scope of initiatives taken by the Parliament to strengthen financial stability and the provision of liquidity in financial markets, Banco de Portugal cooperated with the Government in the operationalisation and implementation of the respective measures. In particular, after the publication of Law No 60-A/2008 of 20 October, on the extraordinary provision of State guarantees, the Bank examined and issued its opinion on the applications submitted by credit institutions, thus contributing to the timely provision of State guarantees under the above Law. This enabled several Portuguese banking groups to obtain loans in international markets, which were essential for maintaining balanced financing structures and adequate liquidity levels, and for ensuring the development of loans to households and corporations.

The serious financial imbalances and irregularities detected in two banks culminated in the nationalisation of one bank and intervention in the other bank, including the appointment of interim managers. This led to the permanent monitoring of their financial situation and to special audits carried out by independent entities, in compliance with the provisions of Article 116 (2) of the Legal Framework of Credit Institutions and Financial Companies and brought about an in-depth investigation process in order to determine responsibilities.

Moreover, the ceiling on the deposit guarantee was raised from €25,000 to €100,000, and the repayment deadlines were reduced in case of unavailability of deposits (Decree-Law No 211-A/2008 of 3 November).

In terms of legislative developments in 2008, special mention should be made to the strengthening of the supervisory powers of Banco de Portugal with the publication of Decree-Law No 1/2008 of 3 January, which creates the market conduct supervision system, laying down a number of rules of conduct and information requirements to be complied with by credit institutions and financial companies in their relationships with the customers.

The new legal framework, reinforced by Decree-Law No 126/2008 of 21 July and Decree-Law No 211-A/2008 of 3 November, assigns to Banco de Portugal competences to establish rules of

conduct for these entities and to ensure the transparency of information and equity in transactions of financial products and services between the entities subject to its supervisions and their customers. It also establishes the right of the customers to submit complaints directly to Banco de Portugal. The Bank also has powers to carry out inspections in this field and to impose sanctions in the case of non-compliance with pre-defined rules, whether on its own initiative, or in response to complaints submitted by customers of the entities subject to its supervision.

The *Portal do Cliente Bancário* (Bank Customer Website) was launched in April 2008, aimed at creating a direct and privileged communication channel between Banco de Portugal and bank customers. The main purpose of this website is to inform bank customers and shed light on the acquisition of products and services from credit institutions and financial companies, to facilitate access to relevant data, to promote greater transparency as regards the operation of retail financial services markets, and to allow for a better understanding of Banco de Portugal's activity in the different aspects of its mission.

As concerns the implementation of the new capital adequacy framework (known as "Basel II"), particular mention should be made of the validation of internal models approaches for calculating own funds requirements to cover credit, market and operational risks, some of which in cooperation with the other supervisory authorities involved.

In terms of the refinement of supervisory instruments and processes, it is worth mentioning the implementation of the risk assessment integrated system, known as *Modelo de Avaliação de Riscos – MAR* (Risk Assessment Model). Overall, this supervisory instrument defines objective and systematised criteria and procedures to evaluate the size of the risks underlying the activity developed by each institution and financial group, as well as the quality and soundness of corporate management and internal control mechanisms and also the adequacy of the respective solvency and liquidity.

The requirements in terms of the internal control of the institutions were reviewed (Notice No 5/2008 of 1 July), taking into consideration that an appropriate and efficient internal control system is instrumental so that institutions may ensure actual compliance with the legal obligations and applicable duties and the appropriate management of the risks inherent in the activities carried on, ensuring their stability and soundness, and hence the stability of the financial system.

As regards the prevention of money laundering and terrorist financing, Law No 25/2008 of 5 June transposes into national legislation Directives 2005/60/CE and 2006/70/CE. Inter alia, this Law widens the preventive system against the risk of money laundering, so as to include the prevention of terrorist financing.

The *Conselho Nacional de Supervisão de Auditoria – CNSA* (National Council for Audit Supervision) was created in late 2008, pursuant to Decree-Law No 225/2008 of 20 November. It is responsible for organising a public supervision system of all statutory auditors and audit firms, simultaneously ensuring sound cooperation and coordination in the field of audit supervision. This Council includes representatives of Banco de Portugal, *Comissão do Mercado de Valores Mobiliários* (the Portuguese Securities Market Commission), *Instituto de Seguros de Portugal* (the Portuguese Insurance Institute), *Ordem dos Revisores Oficiais de Contas* (the Portuguese Statutory Auditor Institute) and *Inspecção-Geral de Finanças* (Portuguese Inspectorate-General for Tax). Banco de Portugal will chair in its first year of activity.

## 8.1.2. Prudential supervision

### 8.1.2.1. Authorisation, non-opposition and registration

Banco de Portugal's tasks include the authorisation for the setting up of credit institutions and financial companies and the decision on the items subject to registration.

The requirements for the taking up of business include the suitability and professional qualifications of the members of the management and auditing boards, the control of qualifying holdings, minimum share capital, as well as the viability of the business plan and the adequacy of human, technical and financial resources. Institutions are not allowed to start business prior to registration with Banco de Portugal.

The registration of institutions subject to the supervision of Banco de Portugal covers, inter alia, the identification of board members and qualifying holders.

Turning to the registration of board members and members of the General Meeting, 1,677 registrations were made in 2008, of which 1,158 concern the evaluation of the suitability and professional qualifications, and 519 correspond to checking possible incompatibilities. Moreover, processes were opened for the re-evaluation of the suitability of members of the management and auditing boards of credit institutions and financial companies.

	2007	2008
Suitability//Professional Qualifications	818	1,158
Incompatibilities	391	519
<b>Registrations</b>	<b>1,209</b>	<b>1,677</b>

As regards the control of qualifying holdings, stress is laid on shareholdings, either direct or indirect, isolated or as a whole, which may allow their holder, on his own or as a result of voting rights assigned by another holder, to exert significant influence on the management of the participated entity.

Against this background, an analysis was made of: 54 proposals submitted by potential buyers of qualifying holdings in credit institutions, investment companies and other financial companies having their head office in Portugal, with a view to evaluating their suitability and the project's characteristics; and 15 proposals relating to the acquisition of qualifying holdings by Portuguese credit institutions in companies having their head office abroad.

The number of credit institutions and financial companies registered with Banco de Portugal rose from 336 on 31 December 2007 to 337 on 31 December 2008, thus reversing the downward trend observed in recent years (Tables I, II and III).

In 2008 the total number of credit institutions remained unchanged. However, there was an increase in the number of banks, credit financial institutions and branches of other foreign credit institutions, which was offset by the decline in the number of mutual agricultural credit banks.

Four new banks were registered. Two of these were set up as Portuguese law organisations, one of them resulting from the transformation of a dealer. The other two registrations refer to branches of banks having their head office abroad.

More than one third of the 64 banks in operation at the end of 2008 were branches of banks having their head office abroad.

As regards other types of credit institutions, the registrations of four mutual agricultural credit banks were cancelled, in the wake of restructuring processes. Two of these were due to the incorporation of mutual agricultural credit banks into other agricultural credit banks, while the other two were due to the merger of two mutual agricultural credit banks, resulting in the setting up of a new mutual agricultural credit bank. In recent years, a number of restructuring operations occurred within the scope of the mutual agricultural credit among institutions operating in neighbouring municipalities, usually with a view to better financial soundness and wider geographical penetration. These concentration processes led to a gradual decline in the number of this type of institution.

Also, the registrations of two financial leasing companies were cancelled. One was due to the dissolution of the company and the other one to its incorporation into a credit financial institution. Actually, the number of financial leasing companies has been decreasing in Portugal, with only one such institution presently registered with Banco de Portugal. That decline has been due, in most cases, to the restructuring of the groups where they are inserted, leading to the change or incorporation of such companies into other larger types of credit institutions. In previous years, this contributed to the decline in, and winding up of, credit-purchase financing companies in Portugal.

The total number of financial companies registered in Portugal rose from 113 to 114. In 2008 four new investment fund managing companies and one exchange office were registered, whereas four registrations were cancelled. These new investment fund managing companies were created within the scope of mainly non-financial groups, some of which with the original purpose of attracting the management of funds of which they were already holders.

In the year under review, the number of representative offices of credit institutions and financial companies having their head office abroad remained unchanged, notwithstanding the cancellation of two offices and the registration of two new offices. The number of registered holding companies declined from 51 to 50.

Finally, there were thirty eight registrations of credit institutions having their head office in the European Economic Area and providing cross-border services in Portugal, which largely exceeded the ten registrations cancelled. By geographical origin, new registrations were as follows: ten credit institutions having their head office in the United Kingdom, five in France, five in Luxembourg, three in Ireland and the remaining in Germany, Austria, Malta, Italy, Finland, Poland, Hungary, Netherlands, Cyprus, Sweden and Iceland.

Table I

## INSTITUTIONS REGISTERED AS AT 31 DEC. 2008

	No of institutions	
	2008	2007
<b>Credit Institutions</b>		
Banks, including	67	64
Branches of banks of other EU Member States	23	23
Branches of banks of non-EU countries	3	2
Savings banks <sup>(1)</sup>	8	8
Central and mutual agricultural credit banks	104	107
Credit financial institutions	21	20
Investment companies <sup>(2)</sup>	3	3
Financial leasing companies	1	3
Factoring companies	3	3
Credit purchase financing companies	-	-
Mutual guarantee companies	4	4
Branches of other foreign credit institutions	12	11
<b>Sub-total</b>	<b>223</b>	<b>223</b>
<b>Financial companies</b>		
Dealers <sup>(3)</sup>	3	4
Brokers <sup>(4)</sup>	10	10
Foreign-exchange or money market mediating companies <sup>(5)</sup>	1	1
Investment fund management companies <sup>(6)</sup>	52	49
Credit card issuing or management companies	1	1
Wealth management companies <sup>(7)</sup>	14	15
Group purchase management companies <sup>(8)</sup>	6	6
Exchange offices <sup>(9)</sup>	21	21
Credit securitisation fund management companies	4	4
Other companies <sup>(10)</sup>	2	2
<b>Sub-total</b>	<b>114</b>	<b>113</b>
<b>Representative offices of credit institutions and financial companies having their head office abroad</b>	29	29
<b>Holding companies</b>	50	51
<b>Total</b>	<b>416</b>	<b>416</b>
<b>Credit institutions having their head office in an EEA <sup>(*)</sup> country and providing cross-border services</b>	427	399

(1) Of which, on 31 December 2008, three had undergone winding-up proceedings.

(2) Of which, on 31 December 2008, one had undergone winding-up proceedings.

(3) Of which, on 31 December 2008, one had undergone winding-up proceedings.

(4) Of which, on 31 December 2008, two had undergone winding-up proceedings.

(5) Which, on 31 December 2008, had undergone winding-up proceedings.

(6) Of which, on 31 December 2008, one had undergone winding-up proceedings.

(7) Of which, on 31 December 2008, one had undergone winding-up proceedings.

(8) Of which, on 31 December 2008, two had undergone winding-up proceedings.

(9) Of which, on 31 December 2008, one had undergone winding-up proceedings.

(10) Of which, on 31 December 2008, one had undergone winding-up proceedings.

(\*) European Economic Area.

Table II

## REGISTRATIONS IN 2008 (NEW INSTITUTIONS)

	No of institutions	
	2008	2007
<b>Credit institutions</b>		
Banks, including <sup>(1)</sup>	4	2
Branches of banks of other EU Member States	1	
Branches of banks of non-EU countries	1	1
Savings banks		
Central and mutual agricultural credit banks <sup>(2)</sup>	1	1
Credit financial institutions	1	5
Investment companies		
Financial leasing companies		
Factoring companies		
Credit purchase financing companies		
Mutual guarantee companies		
Branches of other foreign credit institutions	2	4
<b>Sub-total</b>	<b>8</b>	<b>12</b>
<b>Financial companies</b>		
Dealers		
Brokers		
Foreign-exchange or money market mediating companies		
Investment fund management companies	4	1
Credit card issuing or management companies		
Wealth management companies		
Group purchase management companies		
Exchange offices	1	1
Credit securitisation fund management companies		
Other companies		
<b>Sub-total</b>	<b>5</b>	<b>2</b>
<b>Representative offices of credit institutions and financial companies having their head office abroad</b>	2	2
<b>Holding companies</b>	2	4
<b>Total</b>	<b>17</b>	<b>20</b>
<b>Credit institutions having their head office in an EEA<sup>(*)</sup> country and providing cross-border services</b>	38	37

(1) Of which one bank due to transformation of a dealer.

(2) Due to the merger by integration of two mutual agricultural credit banks.

(\*) European Economic Area.

Table III

## CANCELLATIONS IN 2008

	No of institutions	
	2008	2007
<b>Credit institutions</b>		
Banks, including	1	1
Branches of banks of other EU Member States	1	
Branches of banks of non-EU countries		
Savings banks		
Central and mutual agricultural credit banks <sup>(1)</sup>	4	5
Credit financial institutions		1
Investment companies		
Financial leasing companies <sup>(2)</sup>	2	1
Factoring companies		1
Credit purchase financing companies		1
Mutual guarantee companies		
Branches of other foreign credit institutions	1	6
<b>Sub-total</b>	<b>8</b>	<b>16</b>
<b>Financial companies</b>		
Dealers <sup>(3)</sup>	1	
Brokers		
Foreign-exchange or money market mediating companies		
Investment fund management companies <sup>(4)</sup>	1	
Credit card issuing or management companies		
Wealth management companies <sup>(5)</sup>	1	1
Group purchase management companies		6
Exchange offices <sup>(6)</sup>	1	
Credit securitisation fund management companies		
Other companies		
<b>Sub-total</b>	<b>4</b>	<b>7</b>
<b>Representative offices of credit institutions and financial companies having their head office abroad</b>	<b>2</b>	<b>3</b>
<b>Holding companies <sup>(7)</sup></b>	<b>3</b>	<b>4</b>
<b>Total</b>	<b>17</b>	<b>30</b>
<b>Credit institutions having their head office in an EEA<sup>(*)</sup> country and providing cross-border services</b>	<b>10</b>	<b>8</b>

(1) Of which two due to incorporation into other mutual agricultural credit banks and two due to merger by integration.

(2) Of which one due to winding-up and one due to incorporation into a credit financial institution.

(3) Due to transformation into a bank.

(4) Due to incorporation into another investment fund management company.

(5) Due to incorporation into a dealer.

(6) Due to winding-up.

(7) Of which one for having ceased to be subject to the provisions of Article 117 of the Legal Framework of Credit Institutions and Financial Companies, one due to incorporation into a broker, and one due to incorporation into a company not subject to special registration.

(\*) European Economic Area.

### 8.1.2.2. Monitoring of institutions and financial groups

Prudential monitoring of credit institutions and financial companies, as well as of the financial groups to which they belong, is based on monthly, quarterly or semi-annual data reported to Banco de Portugal (accounting and prudential reporting on an individual and/or consolidated basis), on data obtained during inspections and other on-site checks, and also on data produced by rating agencies and market analysts.

As regards data reported to Banco de Portugal the analysis of the level and structure of own funds is particularly relevant, as well as their adequacy to capital requirements for credit, market and operational risks, large risk exposures, the quality of credit and other assets and respective provisioning levels, compliance with other prudential ratios and limits, financial statements – balance-sheet and profit and loss account, as well as profitability, productivity and liquidity indicators.

Among other aspects the analysis also focuses on the economic provisions of institutions, impairments on a consolidated basis, liabilities on account of retirement pensions, credit granted to board members and to offshore entities, securitisations and their prudential impact, reports on internal control systems and business continuity plans of institutions, the implementation of the *Modelo de Avaliação de Risco* - MAR, in particular as regards the description and financial analysis, and the identification of risks and controls broken down by functional area.

In view of the potential impact of the financial turbulence period on the liquidity levels and on the financial soundness of the institutions, Banco de Portugal adjusted its supervisory activity, and stepped up its off-site monitoring, inspection actions and regular meetings with the management bodies.

Increased monitoring of the institutions' liquidity was based on the new liquidity reporting rules defined by Banco de Portugal in the summer of 2007, which complemented the existing liquidity chart. More detailed data were received thereafter on a monthly and in some cases on a two-weekly basis, including information on the sources and financing requirements. The analysis of this new reporting was followed by regular meetings with the managers, in order to discuss the assumptions behind the forecast developments, given the actual market conditions. Subsequently, in view of the persisting financial crisis, main banks also reported to Banco de Portugal daily data on their liquidity positions.

On 1 January 2008 the whole system became subject to the new prudential capital adequacy framework (Basel II), adopting by default the Standardised Approach and the Basic Indicator Approach for calculating own fund requirements to cover credit and operational risks respectively (thereby extinguishing the transitory derogation laid down in Article 33 (1) of Decree-Law No 104/2007 of 3 April).

Works were pursued regarding the validation of authorisation requests for the prudential utilisation of: the Internal Ratings Based Approach to cover credit risk (three institutions); the Standardised Approach to cover operational risk (four institutions); and the Internal Models Approach to cover market risks (two institutions). These works have been continued this year.

In turn, in its quality as host supervisory authority, Banco de Portugal received the documentation on the applications relating to the Internal Ratings Based Approach (credit risk), the Advanced Internal Ratings Based Approach (operational risk) and the Internal Models Approach (market risk) from three, four and one cross-border banks respectively, involving coordination with the respective home-country supervisors.

Within the scope of the implementation of Law No 60-A/2008 of 20 October applications were assessed for the State personal guarantee submitted by several institutions.

As in previous years, the developments in, and the capital adequacy of financial conglomerates were monitored, as well as their shareholders' structure, in cooperation with the Portuguese Insurance Institute, under the aegis of the National Council of Financial Supervisors.

As concerns the inspection activity, within the scope of the activity planning for 2008, thirty-one inspections were carried out covering the most relevant institutions in terms of size, ranking in the financial system, complexity of the operations or specific problems.

Among the inspections conducted in 2008, twenty were made to banks, six to other types of credit institutions (mutual agricultural credit banks, credit financial institutions and branches of credit institutions), four to financial companies and groups of financial companies and one to a holding company.

Inspections, in general, focused on specific aspects, such as: the validation of models for calculating own fund requirements to cover credit risk, market risk and operational risk; solvency; large exposures; internal control systems and risk management structures; credit portfolios, monitoring procedures and credit recovery policies; implementation of the MAR; operations with entities having their head-office in offshore centres; money laundering prevention and customer identification procedures; wealth management and investment funds management.

Inspections to institutions involve contacts with the respective management, namely in meetings held at the beginning of the process to communicate the objectives of the on-site checks to be conducted and, at the end, to examine preliminary conclusions. The report summarising the main conclusions of the inspection is sent to the institutions for comments and possible adoption of corrective measures, whose implementation is subsequently monitored.

Instructions addressed to the institutions in the course of the supervisory activity are mainly related to prudential aspects, such as higher own funds, provisioning, limits for risk concentration, internal control, prevention of money laundering and terrorist financing.

In 2008 the regular meetings with the main banking groups for the assessment of their overall situation and analysis of development prospects were intensified and extended to other groups, as were the regular contacts with the auditing boards and external auditors of the institutions.

### 8.1.2.3. Regulations

Within the prudential field, the main regulatory changes introduced in 2008 are related to the financial market crisis situation, the implementation of the new capital adequacy framework and the need to enforce new requirements in terms of the internal control system of the institutions:

#### i) Regulatory measures and recommendations related to the financial market crisis situations

Considering the extraordinary nature of the losses incurred by institutions arising from the high volatility and liquidity shortage of some financial assets, and taking into account the supervisory regulations and practices in other EU Member States which could contribute to absorbing the negative prudential impact of these losses, Banco de Portugal adopted the following anti-cyclical measures:

- Neutralisation of unrealised gains and losses (excluding impairment losses) in debt instruments classified as available for sale assets, for the purpose of calculating own funds. This measure was implemented with the publication of Notice No 6/2008 of 17 October, which amended Notice No 12/92;
- Extension for 3 years of the deadline for deferring the recognition in own funds of the impact of IFRS first time application associated with post-employment benefits. This measure was implemented with the publication of Notice No 7/2008 of 17 October, which amended Notice No 12/2001;
- Elimination of the prudential filter associated with outstanding deferred taxes, allowing for its full integration in the calculation of own funds. This measure was implemented with the publication of Notice No 9/2008 of 3 November, which amended Notice No 12/92;

- Deferred prudential recognition of actuarial losses for 2008. This measure was implemented with the publication of Notice No 11/2008 of 14 January 2009, which amended Notice No 12/92. It permitted the deduction of such losses from original own funds to be deferred for a period of 4 years, up to the end of 2012. In this vein, institutions may add to the limit established in Article 10 (2) of Notice No 12/2001 of 23 November (accounting «corridor») the value corresponding to total actuarial losses incurred in 2008, net of expected income from pension fund assets for the same year, according to the decreasing percentages laid down in the revised Notice.

Following the guidelines defined at the international level regarding data transparency and asset valuation, Banco de Portugal issued Circular-Letters Nos 46/08/DSBDR of 15 July and 97/08/DSBDR of 3 December, stressing the need that institutions, taking into account the principle of proportionality, meet the recommendations of the Financial Stability Forum (FSF) laid down in the “Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience” of 11 April, as well as the recommendations issued by the CEBS laid down in the “Report on banks’ transparency on activities and products affected by the recent market turmoil” and in the “Report on issues regarding the valuation of complex and illiquid financial instruments”, both of 18 June. These recommendations are particularly relevant when taking into account that insufficient information disclosed by financial institutions, namely on the nature and magnitude of risks associated with crisis-affected balance-sheet and off-balance-sheet exposures, could have hampered the confidence of market players during the turbulence period, contributing to its persistence.

For the purpose of evaluating compliance with these recommendations, institutions shall prepare a specific chapter or annex, as regards their accounts as at 31 December 2008, exclusively dedicated to the aspects mentioned in the above CEBS’s and FSF’s recommendations.

In line with this transparency principle, the Bank also issued Circular-Letter No 105/2008/DSB, establishing that institutions, within the scope of their annual or interim accounts, shall accurately and clearly publish the reclassifications of financial assets under the recent changes introduced in the IAS 39 and IFRS 7 rules.

Considering: the need of institutions to have available, on a permanent basis, own capital adequate to the nature and magnitude of the risks incurred, in a context of higher volatility of the risks associated with their activity; the Financial Stabilisation Programme approved by the Parliament, aiming to contribute, with recourse to public investment, to raising the financial capitalisation levels of credit institutions; and the measures adopted in this field by other EU Member States, Banco de Portugal issued a recommendation advising institutions to raise their original capital adequacy ratios (Tier 1 ratio) to a value equal to or exceeding 8%, by 30 de September 2009.

With a view to the reinforced monitoring of institutions, and in addition to the already mentioned measures in terms of liquidity reporting, Banco de Portugal decided to raise, on a transitional basis, the frequency of data reporting on compliance, on an individual and consolidated basis, with the capital adequacy requirements, in order to ensure a more timely monitoring of the institutions’ solvency ratios. This additional information is also necessary for the preparation by Banco de Portugal of individual monitoring reports on the institutions benefiting from the measures laid down in Law No 60-A/2008 of 20 October or Law No 63-A/2008 of 24 November.

#### ii) Implementation of the new capital adequacy framework (Basel II)

The regulatory aspects of the capital adequacy framework include the publication of Notice of Banco de Portugal No 8/2008 of 30 October and Instructions of Banco de Portugal No 4/2008 of 17 March and No 7/2008 of 15 May.

The above Notice updates the regulatory framework regarding the own funds and the solvency ratios of institutions subject to supervision by Banco de Portugal, reviewing some provisions of Notices of

Banco de Portugal No 12/92 (own funds), No 5/2007 (credit risk), No 6/2007 (large exposures), No 7/2007 (securitisation), No 8/2007 (market risks) and No 9/2007 (operational risk).

Instruction No 4/2008 of 17 March lays down the procedures to be adopted by institutions when applying for internal models approaches, to be used in the calculation of own fund requirements to cover market risks. Instruction No 7/2008 of 15 May establishes the current framework of notification and regular reporting on securitisations.

In the course of 2008 Banco de Portugal also issued a number of Circular-Letters to clarify certain aspects of Basle II-related prudential regulation, in particular:

- Circular-Letter No 30/2008/DSB of 17 April, which clarifies the provisions laid down in Article No 15 (5) (implementation of the IRB approach) of Decree-Law No 104/2007 of 3 April;
- Circular-Letter No 45/2008/DSB of 9 July, which clarifies the scope of Article 10 (3) of Decree-Law No 103/2007 of 3 April, in terms of the treatment of operational risk for the investment firms mentioned in Article 10 (2);
- Circular-Letter No 70/2008/DSB of 16 October, which clarifies the prudential treatment applicable to past due items and loans for building and/or property developments, within the scope of the Standardised approach (credit risk);
- Circular-Letter No 86/2008/DSB of 18 November, which updates the regulatory framework governing own funds and the solvency ratio, as a result of the revocation of Decree-Law No 229-I/88 of 4 July and Notices of Banco de Portugal No 1/93, No 7/96 and No 10/2001;
- Circular-Letter No 110/2008/DSB of 30 December, which provides additional clarifications regarding the provisions of Instruction of Banco de Portugal No 18/2007 of 15 May (stress tests).

With regard to the recognition of External Credit Assessment Institutions (ECAIs), Banco de Portugal is presently involved in the process of recognition of two entities, and already recognised Fitch Ratings, Moody's Investors Service's and Standard & Poor's Ratings Services (the respective mapping of their credit assessments, as laid down in the "Capital Requirements Directive", is defined in Instruction of Banco de Portugal No 10/2007 of 15 May).

In the third quarter of 2008 Banco de Portugal launched an extended consultation to the banking system on concentration risk, in the context of Instruction of Banco de Portugal No 17/2007 of 15 May, requiring information on the policies, procedures and systems for the identification, measurement and management of concentration risk, as well as an indication of the internal concentration limits considered. In view of data received, it is expected that additional recommendations will be issued in the short run, within the scope of the works conducted by the Committee of European Banking Supervisors, regarding Pillar 2 (assessment of the institutions' internal capital vis-à-vis the risks arising from their activity).

### iii) Internal control requirements

In 2008 Banco de Portugal updated the internal control requirements applicable to the institutions subject to its supervision, considering that the existence of an appropriate and efficient internal control system is instrumental for institutions to ensure actual compliance with their legal obligations and duties, as well as appropriate management of the risks inherent to their activities (Notice No 5/2008 of 1 July).

This Notice was published within the scope of a regulatory convergence process in the context of the "Better Regulation in the financial sector" project, commissioned by the National Council of Financial Supervisors, and was preceded by a wide-ranging public consultation, from January to February 2008. The comments received show a broadly based agreement as to the objective underlying the proposals submitted for consultation and to the conceptual approach.

Based on this new regulatory framework, Banco de Portugal systematised the basic principles guiding the implementation of an internal control system, in line with the internationally recognised and accepted concepts defined in the “Internal Control – Integrated Framework” published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), the recommendations issued by the Basle Banking Supervision Committee in the “Framework for Internal Control Systems in Banking Organizations” and the guidelines related to “Internal Governance”, published by the CEBS.

Compared with previous regulations, Notice No 5/2008 adopts a more prescriptive approach, specifying the obligations defined in Article 14 of the Legal Framework of Credit Institutions and Financial Companies, by establishing the minimum requirements to be complied with by the internal control system of every institution, and the managers’ responsibilities in this field.

This approach, which is consistent with the principles and requirements on organisation and internal control laid down in the Securities Code, allowed for the full standardisation of the internal control reports required by Banco de Portugal and the CMVM, enabling institutions to prepare a single report, without prejudice to possible contents that might be related to the specific competences of each one of these supervisory authorities.

#### 8.1.2.4. Other activities

Other consultancy and research activities were developed in 2008, namely:

- i) Implementation of the MAR, an instrument supporting the supervisory procedures described in Article 116-A of the “Legal Framework of Credit Institutions and Financial Companies”, which lays down objective and systematised criteria and procedures to evaluate the magnitude of the risks underlying the activities developed by each institution and financial group, as well as the quality and soundness of the internal control system and, also, the adequacy of the solvency and liquidity positions and the respective management procedures.

This integrated risk-assessment system was developed in 2007, in conformity with the guidelines of the Basle Committee and CEBS on the implementation of the so-called “Pillar 2” of the new capital adequacy framework, and is expected to be a facilitating and structuring element in the dialogue between Banco de Portugal and the institutions, namely for the purpose of reviewing and evaluating the Internal Capital Adequacy Assessment Process.

In addition to systematising the risk review and assessment process, the implementation of the MAR will also foster greater transparency and consistency of the results obtained in this process, facilitating, in particular, the identification of the institutions, or areas within the same institution, requiring more intensive monitoring and more frequent supervisory initiatives;

- ii) Two-weekly analysis of the liquidity position prepared by the institutions within the scope of the situation of market turmoil;
- iii) Analysis of the banking system exposure to institutions and groups facing financial difficulties, particularly North-American financial institutions;
- iv) Monitoring developments in mutual funds and money market funds.

Other regular activities are also worthy of note, such as:

- Quarterly evaluation of the overall situation of the Portuguese banking system and main financial groups, with particular focus on the quality of the assets, efficiency, profitability and solvency;
- Regular analysis of the banking system exposure to certain geographical areas;
- Analysis of prudential and accounting issues;

- Analysis of research focusing on the main institutions and financial groups;
- Management of data and information systems: i) BPnet system – Maintaining and updating the contents of the services made available on the BPnet website and defining the necessary procedures for the implementation of its exclusive use in data transmission; ii) Updating and creating applications for the collection of data regarding regulations issued;
- Institutional cooperation with the Ministry of Finance and Public Administration and the Ministry of Justice, including the preparation of drafts legal acts and participation in working groups; in this context, stress is laid on the preparation of the draft revision of the Legal Framework of Mutual Agricultural Credit, forwarded to the Secretary of State for Treasury and Finance.

Turning to the prevention of money laundering and terrorist financing, a Standing Technical Group was created in 2008, led by Banco de Portugal, with the participation of main financial institutions, the Portuguese Banking Association and the Financial Information Unit of *Polícia Judiciária* (the Portuguese Criminal Police). The creation of this forum for a structured dialogue is expected to contribute to refining the prevention and control mechanisms of supervised entities, as well as the regulatory and supervisory mechanisms of Banco de Portugal and, hence, to increasing the efficiency of the preventive system. In addition, it will make it possible to respond to enhanced requirements in terms of provision of information to supervised institutions, in line with Article 42 of Law No 25/2008 of 5 June, which transposes into national legislation Directives 2005/60/EC and 2006/70/EC on the prevention of the use of the financial system, certain activities and professions for the purpose of money laundering and terrorist financing.

Also worth mentioning is the publication of Decree-Law No 125/2008 of 21 July, which establishes measures for the implementation of Regulation (EC) No 1781/2006 on information on the payer accompanying transfers of funds, and the dissemination to institutions of the common understanding defined by the three Committees of European Supervisory Authorities as regards the approach to be followed by the institutions in case of incomplete information.

### 8.1.3. Market conduct supervision

Banco de Portugal, in the exercise of its functions within market conduct supervision, enshrined in the review, in 2008, of the Legal Framework of Credit Institutions and Financial Companies, intervenes not only in the supply of products and services by credit institutions and financial companies (in particular, housing loans, credit to customers and savings products), aiming at increasing and improving the information provided to bank customers, but also on the demand side, contributing to their information and financial literacy. The strategy defined for compliance with such objectives includes five different, but inter-complementary, components:

- (i) strict compliance with the principles and rules of transparency and accuracy of information provided by credit institutions and financial companies to their customers;
- (ii) analysis, refinement and development of the regulatory framework regulating the conduct of credit institutions and financial companies;
- (iii) supervision of the behaviour of credit institutions and financial companies;
- (iv) mandatory correction of non-compliance situations or irregular performance of credit institutions, by means of specific recommendations and decisions, or by implementing breach-of-regulations proceedings with possible fines;
- (v) promoting the quality of demand for financial products and services, by developing initiatives contributing to the financial literacy of the customers.

### 8.1.3.1. Regulation

As regards the implementation of the strategy defined for its tasks in the field of market conduct supervision, Banco de Portugal developed, in 2008, a number of initiatives, aiming at regulating the retail financial markets under its supervision. On the supply side, these were aimed at increasing and improving the transparency and accuracy of information provided by the institutions to their customers on several occasions (in advertising campaigns or during the pre-contractual stage, when contracting and in the course of the contract); on the demand side, they were aimed at improving its quality by increasing information to, and the literacy level of, their customers.

#### Advertising

When initiating the implementation of the above-mentioned strategy, particular attention was paid to advertising, considering the importance of transparency in the earlier stages of disclosure of information to the public. Misleading advertising may constitute a violation of the customers' interests and of sound competition among institutions, warranting public intervention in this activity. Therefore, the Legal Framework of Credit Institutions and Financial Companies lays down specific rules applicable to the advertising of banking products and services. In addition to the legislation in force on advertising (Article 77-C (1)), institutions shall comply with the rules laid down in such Legal Framework regarding references to deposit guarantee or investor compensation (Article 77-C (2)) and to advertising related to credit contracts (Article 77-C (3)), as well as rules issued by Banco de Portugal by means of a Notice (Article 77-C (4)).

In early 2008 the Bank started its regular supervision of advertising by institutions, requiring compliance with information duties. At the same time, Notice No 10/2008 has been prepared and submitted to public consultation from July to September, and finally published on 22 December. This Notice, which summarises information and transparency requirements when advertising products and services subject to supervision by Banco de Portugal, was the result of the analysis of international experience, the contributions of institutions and other interested parties within the scope of bilateral consultations and public consultation, as well as the supervisory experience of Banco de Portugal in 2008. It embodies a supervision model which relies on an ex post action, like the dominant model at international level. Hence, it fosters the accountability of the institutions, whereby these are granted higher flexibility, leading to lower opportunity costs when launching campaigns. However, similarly to most international experiences considered, supervising the advertising of more complex financial products, due to associated risks, relies on an ex ante model, embodied in Decree-Law No 211-A/2008 of 3 November, which establishes a regime requiring prior approval for advertising complex financial products.

In compliance with Notice No 10/2008, the evaluation of advertising campaigns includes, firstly, checking compliance with principles (particularly related to transparent and balanced messages), without prejudice to the definition of specific rules for products, which are aimed at guiding the conduct of institutions in terms of provision of information. Finally, the sanctionatory actions adopted by Banco de Portugal depend on considering, on a case-by-case basis, the type of risk of the advertising messages deemed to be irregular.

#### Price lists

The price lists of the institutions were also the object of significant surveillance, either through on-site actions at the counters, or through the analysis of their reporting to Banco de Portugal. As a result of these inspections, it was decided to review Notice No 1/95 of 17 February, which stipulates that all institutions shall display in every counter permanently updated information on the general conditions for their products and services. This document is usually known as "Price List". In effect, the price-list model in force reveals some limitations, since the range of financial products and services provided by the institutions to their customers increased and gained some more complexity, vis-à-vis the date

of issue of that Notice. Therefore it is often insufficient to accommodate all relevant information in a harmonised and easily understandable manner. The current price-list model highlights the interest rate component (which is the object of a case-by-case negotiation with the customer, and depends on the credit risk of the latter, wherefore its nature is merely indicative), even though fees charged nowadays by institutions do have a relevant weight, as components of the total cost of the products and services, and are therefore of the utmost importance for customers. Hence, fees should also be highlighted in the information provided by the institutions to their customers.

Considering the limitations of this regulatory framework, Banco de Portugal started, in 2008, the preparation of a new regulation in this field, with a view to reinforcing information requirements to be complied with by credit institutions informing the public of their fees and interest rates for products and services. The draft regulation was prepared in the second half of 2008 and made available for public consultation in early 2009. In particular, the purpose of this initiative is to stipulate that credit institutions shall indicate in their price lists the maximum values charged as commissions and the indicative value of main charges, to be published on the *Portal do Cliente Bancário* – “Portal” (Bank Customer Website). This publication on the Portal of the price lists of all credit institutions providing services in Portugal was prepared in the course of 2008. It involved the creation of a dedicated electronic channel for reporting to the BPnet system and the exhaustive surveillance by Banco de Portugal of all price lists of credit institutions, checking compliance with the applicable legal and regulatory rules and determining the change and correction of any failure detected.

### **Contractual information**

During 2008 Banco de Portugal closely monitored retail financial markets, with a view to enhancing transparency and the accuracy of the information provided by the institutions to their customers at different negotiation stages of financial products and services. These stages include pre-contractual information, as well as information provided when the contract is signed or during its lifetime. In this context, Banco de Portugal paid close attention to the housing loans market and savings products. As a result, pre-contractual information is expected to be standardised, by defining standard information files.

### **Housing loans**

Housing loans have deserved particular attention by Banco de Portugal in the context of its functions within market conduct supervision, due to their importance in the medium and long run for the household budget, as well as for credit institutions' balance sheets.

As a result of the inspective actions and of the appraisal of the complaints and requests for information on housing loans, it was deemed necessary to review Instruction No 27/2003 of 17 November, and to introduce changes in the regulatory framework applicable to information provided within the scope of this type of credit, by defining new requirements applicable in the different contractual stages. Indeed, after examining the results of the implementation of Instruction No 27/2003 over the last 5 years, the information requirements laid down therein were deemed insufficient to ensure that, during the different contractual stages in relation to housing loans, from the pre-contractual stage to the termination of the contract, bank customers have access to the necessary information underlying their decisions.

Therefore, in the course of 2008, a regulatory legal act was prepared on the information requirements within the scope of negotiating housing loans, incorporating contributions from the institutions and other interested parties as a result of bilateral consultations. With a view to allowing for the appropriate evaluation of the costs and risks inherent in loans and the comparison of different alternative sources of financing, this initiative focused on the definition of information requirements in each of the four stages of the loan contract: (i) simulation; (ii) approval; (iii) signing of the contract; and (iv) during its lifetime. Worthy of mention, when compared to Instruction No 27/2003, is the introduction of the obligation for credit institutions to deliver to their customers a standardised document, the Standard Information

File, during simulation and approval stages, which shall contain the detailed financial conditions of the loan and more complete financial plans.

### **Savings products**

The results of supervision of the market for savings financial products led to the conclusion that the information requirements applicable to the marketing of these products were not enough to keep up with their growing complexity. This led Banco de Portugal to start the preparation of a set of draft regulations on the information to be provided to customers when marketing savings banking products. As a result, the Bank issued Notice No 10/2008 of 22 December on the advertisement of financial products and services, which lays down specific rules on the transparency of information in campaigns related to savings products. In addition, other regulatory initiatives were prepared on information requirements related to the marketing of bank deposits and the strengthening of information requirements when marketing dual and indexed deposits (these are complex financial products for the purpose of the implementation of Decree-Law No 211-A/2008 of 3 November), implying the revision of Notice No 6/2002. In parallel, the need to clarify the regulatory rules applicable to the characteristics of the deposits led to the review of Notice No 5/2000.

In view of the need to strengthen information requirements when negotiating simple bank deposits, as a result of the growing range of deposits and respective accounts, with different combinations regarding movement, remuneration structures, capitalisation regime, restricted access, fees, etc., which are not covered by the existing regulatory acts, Banco de Portugal launched a public consultation from 17 November to 15 December 2008 (Public Consultation No 3/2008) on a draft regulatory act. Its aim is to establish information requirements to be complied with by credit institutions when marketing current accounts and bank deposits, be it fixed-term deposits, deposits redeemable at notice or savings deposits.

This draft lays down, in particular, that prior to opening an account or making a deposit, credit institutions shall compulsorily deliver a Standard Information File describing the main characteristics of the account or deposit. The Standard Information File, in addition to enabling the customer to obtain relevant information on the conditions of the account or deposit (in the case of current accounts, providing information on applicable fees and overdraft conditions, where possible; in the case of demand deposits, highlighting information on the applicable interest rate and on the possibility of earlier withdrawals whether or not subject to a penalty), will facilitate comparisons between the different products available in the market. The draft also stipulates the compulsory signing of a contract for opening an account or for specific deposit. The provisions of the contract shall contain the data included in the Standard Information File, and credit institutions must be able to prove that a copy of the contract has been delivered to the customer. This draft also aims to introduce, for the first time, rules on the minimum information to be included in the account statements and the minimum frequency for their availability to customers.

### **Survey on the financial literacy of the population**

Finally, in line with the internationally adopted principles on financial literacy and with the best practices observed in a range of reference countries in this field, Banco de Portugal started to prepare the launch of a survey on the financial literacy of the Portuguese population. Those countries that devised national strategies of financial literacy, as a first step of such strategy, launched a survey of the population literacy in terms of financial products.

The main objective of this survey is to identify financial areas or products evincing a higher deficit in terms of information, understanding and literacy of the population. In parallel, the survey will make it possible to evaluate important communication issues between institutions and bank customers,

namely as regards the definition of the type of most appropriate language, the financial concepts to be used or clarified, and the type of information to be provided on the different financial products.

### 8.1.3.2. *Portal do Cliente Bancário (Bank Customer Website)*

The *Portal do Cliente Bancário* (“*Portal*”) was one of the first projects developed in compliance with the strategy defined for the Bank’s functions within market conduct supervision. Its dual purpose is to provide information and expertise to bank customers on financial products and services and allow for the indirect surveillance of credit institutions’ practices. The *Portal* is a supervisory instrument with a horizontal impact on retail financial markets, due to its effects on both the demand and supply side of financial products and services. In order to tackle demand for information by bank customers, the dynamics of supply by institutions, and the legal and regulatory changes, this website is in permanent development and updating.

The Bank Customer Website was launched in April 2008 covering a wide range of subjects, in line with the best international practices within financial literacy, and is mentioned in the International Gateway for Financial Education of the OECD. It is structured into 10 large thematic fields – “Bank customers’ rights”, “Institutions” (credit institutions and financial companies), “Deposit Guarantee”, “Banking Products”, “Interest rates”, “Banknotes and coins”, “Credit Registers”, “Prohibition of the use of cheques”, “Deceased account holders” and “Complaints”.

In 2008 it had 197,728 visitors, corresponding to an average of 720 visitors per day from May to December, which compares favourably with similar international experiences. The thematic distribution of visitors in 2008 was relatively balanced: Banking products (20.5%) – in particular housing loans with 13% – Credit Registers (19%), Interest rates (14.6%) and Complaints (10.8%). Credit Registers, Complaints, Prohibition of the use of cheques (9.8%) and Deceased account holders (4.6%), as a whole, account for 44.2% of the total, which highlights the importance of Banco de Portugal’s services addressed to bank customers.

Access to the Portal makes it possible to evaluate not only the needs of bank customers in terms of financial information and literacy in specific areas, but also their conjunctural concerns. For instance, visits to Deposit Guarantee-related information increased in October and November, whereas access to Interest rates rose in the fourth quarter, in particular to the page publishing the Euribor’s monthly average of daily rates and the page describing the method applicable to the revision of the benchmark for the analysis of the time impact of interest rate developments on credit instalments.

It is also an important communication channel, enabling bank customers to directly contact Banco de Portugal submitting their complaints on institutions, requesting information, disseminating requests throughout the banking system for the localisation of financial assets in case of death of the respective holders, and obtaining information on a range of services provided by Banco de Portugal (e.g. the Central Credit Register or the List of Risk Cheque Users). Moreover, it is a valuable oversight instrument, acting as a benchmark for institutions in the information they provide to customers and offering simulation possibilities making it possible to evaluate and compare the alternatives presented by one or several institutions.

The conduct of the tasks related to the Portal requires its permanent update and the development of new contents in order to respond to information requests by bank customers, and to reflect the dynamics of institutions in the supply of products and services and the legal and regulatory changes. As regards the contents made available since its launch, stress should be laid on those related to housing loans and the deposit guarantee, due to their impact on and implications for bank customers. As a result of information requests by customers and in order to reply more promptly to their queries, new contents were introduced on several subjects: the pass-through of changes in Euribor into monthly instalments of housing loans; the renegotiation of housing loans following the publication of Decree-Law

No 171/2008 of 26 August, which also resulted in further adjustments to the *Portal*, in accordance with the new rules; the deposit guarantee, reflecting the legal changes arising from Decree-Law No 211-A/2008 of 3 November. Within the scope of housing loans the Euribor monthly average has also been published since October, enabling customers to control the interest rates of their loans, and introducing new repayment options in the simulations (including underprovision or deferred capital), permitting the customer to evaluate the additional costs and risks compared to a standard loan.

### 8.1.3.3. Inspection

Within the scope of its market conduct supervision tasks, Banco de Portugal carried out a number of monitoring and oversight actions to credit institutions, in order to check the implementation of specific laws and regulations governing the market of the different retail financial products and services made available by credit institutions.

In particular, inspections were made to the correct and effective implementation of legal provisions associated with:

- Housing loans (Decree-Laws No 51/2007 of 7 March, No 88/2008 of 29 May and No 171/2008 of 26 August and Instruction No 27/2003 of 17 November);
- Price lists (Notice No 1/95 of 17 February);
- Consumer credit (Decree-Law No 359/91 of 21 September);
- Deposits (Decree-Laws No 430/91 of 2 November and No 88/2008 of 29 May);
- Advertising (Decree-Law No 330/90 of 23 October and Notice No 10/2008 of 22 December);
- Minimum banking services (Decree-Law No 27-C/2000 of 10 March); and
- Interest calculation, across all operations (Decree-Laws No 220/94 of 23 August, 240/2006 of 22 December, No 171/2007 of 8 May and No 88/2008 of 29 May).

Inspections also focused on compliance with Articles 73 and 77 of the Legal Framework of Credit Institutions and Financial Companies, namely as regards:

- The rules of conduct and capacity of the institutions to ensure high levels of technical competence, providing their organisation with the human and material resources required to ensure appropriate conditions of quality and efficiency;
- Appropriate and clear information on the items characterising the different bank products and services offered, namely on the remuneration they offer for funds received and charges for services provided and other costs borne by the customers;
- The dissemination of appropriate pre-contractual information, in a durable medium, particularly on consumer credit, credit conditions and total credit costs, especially covering the items characterising the products offered, including the TEAG (APRC – Annual percentage rate of change);
- The clear, objective, comprehensive and accurate wording of the contract.

A range of different supervisory instruments were used in the inspections:

- “Mystery customer” inspections, anonymously carried out at the counters of the institutions, with a view to checking the existence of the price list, namely in terms of its updated information and location at an easily accessible place, and evaluating the transparency and accuracy of the information made available to the customer regarding a number of products, especially housing loans, consumer credit and deposits, as well as the appropriate conduct and technical preparation of the institutions. Such inspections will make it possible to detect

the existence of any information gaps, incorrect information on the value of the TAE (EAR – effective annual rate) or APRC, or practices not complying with the regulations in force. 48 “mystery customer” inspections were carried out in 2008, consisting of visits to counters of 24 different institutions, geographically distributed across the Lisbon, Leiria and Santarém districts.

- “Accredited inspections” were performed at central services and counters of institutions by duly identified inspectors of Banco de Portugal, with a view to evaluating the conditions of the contracts, in particular their transparency and legality, compliance by the institutions with the contractual clauses and the law in force, namely that: the calculation of the interest rate had been updated; the fees for advance repayment did not exceed the authorised ceiling; no fees were charged other than those envisaged in the contract or price list, etc. 10 on-site inspections were carried out in 2008 at 9 institutions in different areas of the country in the Lisbon, Santarém, Coimbra and Oporto districts.
- “Off-site” inspections include monitoring the websites of credit institutions and/or financial companies and tests to the respective simulators; reports sent to Banco de Portugal, namely on price lists and accounts related to minimum banking services; advertising campaigns of financial products and services carried out in different media (audiovisual, radio, Internet, placards and mailing).

These inspections make it possible to detect numerous flaws in simulators, due to incorrect EAR or APRC provided to the customer, and in price lists, either due to information gaps or to irregular practices detected.

In the course of 2008 inspections were carried out to 37 websites of 24 institutions, in particular to their simulators. 186 price lists reported to Banco de Portugal by 94 institutions have been monitored. 10 reports and accounts of minimum banking services were also verified and evaluated.

Inspections were made to banks, mutual agricultural credit banks, savings banks, credit financial institutions and branches of credit institutions.

In order to remedy non-compliances detected during the inspections, Banco de Portugal, under the terms of Article 116 (1) c) of the Legal Framework of Credit Institutions and Financial Companies, issued a number of specific recommendations and decisions, whose implementation is continuously monitored and controlled by means of new inspections.

The specific recommendations and decisions focused on price lists, housing loans, consumer credit and other lending, deposit accounts and savings products, and advertising, checking for total compliance with information transparency and the legal rules and norms in force. The specific decisions issued by Banco de Portugal were duly complied with within the established deadlines, and institutions implemented the respective contents and reported to Banco de Portugal the rectified procedures and changes introduced.

#### **8.1.3.4. Complaints**

Banco de Portugal, as supervisory authority of the financial system, assesses the claims submitted to it by bank customers related to credit institutions and financial companies, both through the Complaints Book, and within the scope of the specific legislation governing the financial system (e.g. Legal Framework of Credit Institutions and Financial Companies). Complaints on the operation of credit institutions and financial companies analysed by Banco de Portugal are sent to it via two channels: (i) entry in the Complaints Book, made available by entities to their customers in all counters; and (ii) directly by bank customers.

The lodging of complaints through the Complaints Book was regulated by Decree-Law No 156/2005 of 15 September, which entered into force on 1 January 2006, and made it mandatory for every credit institution to keep a Complaints Book. Its legal framework was amended by Decree-Law No 371/2007 of 6 November, which entered into force on 5 January 2008 and extended its scope of application to financial companies.

In 2008 11,195 complaints on matters pertaining to the scope of competence of the Banking Supervision Department were submitted by customers to Banco de Portugal relating to financial operations in the credit and savings markets, namely regarding housing loans, consumer credit, bank accounts and other operations. The table below shows quarterly developments in the number of complaints received, evincing a rising trend, which had already been seen in previous years.

Complaints lodged in 2008		Compared to 2007 there was an increase of approximately 53% in the number of complaints lodged by bank customers.
Quarter	Number	
Q1	2,390	Of the total complaints received, 6,709 derived from the Complaints Book and the remainder were directly sent by bank customers to Banco de Portugal.
Q2	2,877	
Q3	2,838	Of the 11,195 complaints lodged in 2008 concerning operations in the credit and savings markets, 3,363 were related to consumer credit, 3,346 to bank accounts and 3,134 to housing loans
Q4	3,090	
Total	11,195	

#### 8.1.4. Breaches of regulations and investigations

Banco de Portugal is competent to open and conduct proceedings and to apply sanctions within the scope of breaches-of-regulations proceedings relating to the offences laid down in the Legal Framework of Credit Institutions and Financial Companies and in other legislation which expressly confer that competence on this supervisory authority.

In 2008 22 breach-of-regulations proceedings were initiated, concerning several types of infractions to the legal framework, for whose compliance Banco de Portugal is responsible.

OVERALL INDICATORS	
Proceedings carried forward from 2007	43
Proceedings initiated in 2008	22
Proceedings settled in 2008	13
Proceedings under way as at 31 December 2008	52

The tables below show systematised information on the exercise of this component of the supervisory function, in 2008.

PROCEEDINGS INITIATED			
<b>Enabling Legal ACT</b>	Decree-Law No 298/92 of 31.12	Legal Framework of Credit Institutions and Financial Companies	13 Proceedings
	Law No 11/2004 of 27 March Law No 25/2008 of 05 June	Money Laundering	4 Proceedings
	Decree-Law No 156/2005 of 15.09	Complaints Book	5 Proceedings
<b>Infractions</b>	<ul style="list-style-type: none"> <li>• Non-authorized financial activity</li> <li>• Fraudulent accounting</li> <li>• False information supplied to Banco de Portugal</li> <li>• Non-authorized statutory changes</li> <li>• Non-compliance with money laundering prevention rules</li> <li>• Non-compliance with prudential rules</li> <li>• Non-compliance with registration rules</li> <li>• Non-compliance with reporting requirements to Banco de Portugal</li> <li>• Non-compliance with rules on credit to board members</li> <li>• Non-compliance with rules on the legal framework of mutual agricultural credit</li> <li>• Non-compliance with rules on the Complaints Book</li> <li>• Non-compliance with other mandatory rules governing the activity of the institutions</li> </ul>		
<b>Defendants</b>	<ul style="list-style-type: none"> <li>• 12 credit institutions</li> <li>• 2 financial companies</li> <li>• 1 holding company</li> <li>• 3 other entities</li> </ul>		

PROCEEDINGS SETTLED	
<b>Infractions</b>	<ul style="list-style-type: none"> <li>• Non-authorized financial activity</li> <li>• False or incomplete information supplied to Banco de Portugal</li> <li>• Non-compliance with money laundering prevention rules</li> <li>• Non-compliance with reporting requirements to Banco de Portugal</li> <li>• Non-availability of the Complaints Book</li> <li>• Non-compliance with rules within the scope of housing loans</li> </ul>
<b>Defendants</b>	<ul style="list-style-type: none"> <li>• 11 credit institutions</li> <li>• 3 financial companies</li> <li>• 2 other entities</li> </ul>
<b>Appeals</b>	In 2008 the sanctions decided by Banco de Portugal in 3 breach-of-regulations proceedings were appealed (and are still under appraisal by the <i>Tribunal de Pequena Instância</i> (small claims court) of Lisbon).

Within the scope of the investigations regarding compliance with the legislative and regulatory framework applicable to the taking up and pursuit of business by credit institutions and financial companies, special mention should be made to those pertaining to the pursuit of financial activities by non-authorized entities. In this field, in 2008, Banco de Portugal started 18 investigations and carried out on-site actions in two non-supervised entities, due to a possible non-authorized pursuit of financial activity, namely loans and fund transfers.

### 8.1.5. Cooperation with other authorities and international activity

The growing integration of the financial markets and the development of the international activity of institutions require more institutional cooperation with other authorities involved in the supervision and regulation of the financial sector, at both the national and international levels.

Within the scope of cooperation between national supervisory authorities, particularly relevant is the activity developed by *Conselho Nacional de Supervisores Financeiros* – CNSF (National Council of Financial Supervisors), which is composed of Banco de Portugal, *Comissão do Mercado de Valores Mobiliários* and *Instituto de Seguros de Portugal*.

In accordance with the responsibilities entrusted to the CNSF, several issues of common interest for the supervisory authorities were discussed, namely:

- developments in the financial systems and markets, with particular focus on the analysis of the crisis situation in the financial markets and of the measures adopted by the different national and international authorities, with a view to their stabilisation;
- “Better regulation in the financial sector” project: public consultations on i) the suitability, experience and accumulation of posts of board members (whose conclusions were taken into account in the review of the Legal Framework of Credit Institutions and Financial Companies by Decree-Law No 126/2008 of 21 July); ii) internal control systems; iii) revision of minimum capital requirements of the different types of investment firms;
- monitoring of draft European Community directives of cross-sector nature and/or their transposition into Portuguese law, in particular the draft Directives on mergers and acquisitions and on unfair business practices;
- prevention of money laundering and terrorist financing: cooperation in terms of the revision process of regulatory instruments, in the wake of the publication of Law No 25/2008 of 5 June, and preparation of an Executive Order on equivalent non-EU countries;
- sanctionary regimes in the financial sector;
- implementation of the *Conselho Nacional de Supervisão de Auditoria* – CNSA.

Also worthy of note at the national level is the activity of the *Comité Nacional para a Estabilidade Financeira* – CNEF (National Financial Stability Committee), created in 2007, which is composed of the three supervisory authorities of the financial sector and the Ministry of Finance and Public Administration.

The purpose of the CNEF is to promote cooperation mechanisms to strengthen financial stability at the national level. Hence, a number of issues were discussed, namely: i) financial system developments, ii) Portuguese legal and regulatory framework and cooperation mechanisms to address financial crises; and iii) common methodology to evaluate the systemic implications of a financial crisis.

Banco de Portugal also integrates the *Conselho Nacional de Supervisão de Auditoria*, created at the end of 2008, whose main task is to organise a public oversight system of all statutory auditors and audit firms and, simultaneously, ensure efficient cooperation and coordination in the audit supervision field. The other members are *Comissão do Mercado de Valores Mobiliários*, *Instituto de Seguros de Portugal*, *Ordem dos Revisores Oficiais de Contas* and *Inspecção-Geral de Finanças*. Banco de Portugal chairs this entity in its first business year.

At the international level, regular cooperation was further pursued with the banking supervisory authorities of other EU Member States and non-EU countries. In addition to the regular exchange of information and reciprocal consultations, it is also worth mentioning, in 2008, the cooperation with other authorities on the implementation of the new capital adequacy framework, in particular as regards the validation of the internal models for prudential purposes.

Banco de Portugal, as home supervisory authority (responsible for supervision on a consolidated basis), hosted a meeting of the supervisory college of a national banking group involved in “cross-border” activities, and participated, in its quality as host-country authority, in supervisory colleges of a number of banking groups.

Likewise, it is worth mentioning the multilateral cooperation and monitoring of developments in terms of the international standards and legislative instruments, namely at the European Union level, with the participation in several international committees, groups and fora, in particular within the scope of the Committee of European Banking Supervisors (CEBS), the ECB’ Banking Supervision Committee (BSC) and the European Commission.

Among the different subjects under discussion at the CEBS and the BSC, reference should be made, on the one hand, to those related to convergence in the implementation of prudential regulations (liquidity, large exposures, own funds, model validation, reporting convergence, etc.) and, on the other hand, to subjects of particular interest to supervisory authorities. These include: macroprudential analysis, structural developments in European banking systems and financial stability, the convergence of supervisory practices, and the strengthening of cooperation between authorities, as regards both supervision on a permanent basis (creation of Operational Networks of supervisors for the main cross-border activity groups) and crisis management.

Turning to the works developed by the European Commission and the European Union Council, stress is laid in the participation of Banco de Portugal in the preparation and negotiation of draft changes to Directives No 2006/48/CE and 2006/49/CE of 14 June (usually known as “CRD” – Capital Requirements Directive). Four main issues were under discussion: i) Large exposures; ii) Own funds (eligibility of hybrid instruments for original own funds); iii) Crisis management; iv) “Technical changes”, including quantitative criteria for the recognition of significant credit risk transfer in securitisation operations.

Moreover, a proposal is under analysis for the elimination of a number of national discretionary options in the CRD, with a view to promoting a level playing field and reducing the administrative burden. In turn, it should be noted that, in view of the recent developments in the Basle Committee (BCBS), in terms of incremental risk (trading book) and securitisation operations, other regulatory changes are expected to be introduced in such issues.

#### **8.1.6. Deposit Guarantee Fund**

At the end of 2008, 54 credit institutions authorised to take deposits were members of the Deposit Guarantee Fund, including 44 banks, 5 savings banks and 5 mutual agricultural credit banks not participating in the *Sistema Integrado do Crédito Agrícola Mútuo* – SICAM (Integrated System of Mutual Agricultural Credit). In 2008, three new credit institutions joined the Fund, of which one is branch of a bank having its head office in Switzerland and the other two are banks authorised by Banco de Portugal. The branch of a bank having its head office in a EU Member State and benefiting from the so-called topping up scheme ceased to be member of the Fund.

No situation of non-availability of deposits occurred in credit institutions participating in the Fund in 2008.

Annual contributions from member credit institutions amounted to €37 million, of which €33 million were settled in cash and the remaining €4 million were replaced by the assumption of irrevocable payment commitments in favour of the Fund, collateralised by Portuguese government debt securities.

As at 31 December 2008 the financial resources of the Fund amounted to €1,357 million, accounting for 5.8% growth (€74 million) from the previous year. Out of total financial resources, €923 million are managed by the Fund and the remaining €434 million correspond to irrevocable payment commitments made by credit institutions.

The net result for the year 2008 amounted to €37 million, accounted for by both the yield on investments made by the Fund and gains from the sale and valuation of securities. Compared to 2007, the net result for 2008 shows 33% growth, due to the increase in both euro area interest rates throughout the year and the portfolio investment volume, fuelled by annual contributions received by the Fund at the beginning of the second quarter of the year. The Fund's investment portfolio continues to favour investments in short-term government debt securities issued by euro area countries.

As at 31 December 2007, the ratio of own funds to deposits covered by the guarantee stood at 0.99%, i.e. slightly higher than at the end of the previous year. This ratio is estimated to have been maintained or to have declined slightly up to the end of 2008, due to higher growth of deposits covered by the guarantee, in particular during the last quarter of the year, when compared with the increase in the Fund's resources. Also, the ratio of resources to guaranteed deposits up to €100,000 per depositor is estimated to have decreased, due to the rise in the guarantee limit from €25,000 to €100,000, in force since 12 October 2008.

The base contribution rate for 2008 was set at 0.03%, while the weighted effective contribution rate, calculated according to the capital adequacy ratio of participating credit institutions, ranged between 0.024% and 0.036% of the annual average balance of deposits that correspond to the reserve base. The limit on irrevocable payment commitments that can be used for the partial replacement of the annual contribution was set at 10% of the amount of contributions calculated.

With regard to legislation, some measures have been approved to raise the guarantee limit of the Deposit Guarantee Fund and to shorten the repayment deadlines in the case of unavailability of deposits. Therefore, according to Decree-Law No 211-A/2008 of 3 November, published in the Supplement to the Official Gazette, Series I, of the same date, the limit of the guarantee was raised from €25,000 to €100,000, to be in force up to 31 December 2011. A share of the repayment of up to €10,000 shall be paid within seven days, as from the date when the deposits became unavailable and the remainder within the maximum period of one month. Within the regulatory field, Banco de Portugal published in its Official Bulletin Instructions Nos. 14/2008 and 15/2008, setting the base contribution rate and the limit on irrevocable payment commitments for 2009 respectively. The base contribution rate and the limit on irrevocable payment commitments that may replace the partial payment of the contributions were maintained at 0.03% and 10% respectively.

### 8.1.7. Mutual Agricultural Credit Guarantee Fund

The *Fundo de Garantia do Crédito Agrícola Mútuo* – FGCAM (Mutual Agricultural Credit Guarantee Fund) was established by Decree-Law No 182/87 of 21 April. Its main tasks are: to guarantee the repayment of deposits opened with *Caixa Central de Crédito Agrícola Mútuo* (central mutual agricultural credit bank) and with *Caixas de Crédito Agrícola Mútuo* (the mutual agricultural credit banks) that are members of the *Sistema Integrado do Crédito Agrícola Mútuo* – SICAM (Integrated System of Mutual Agricultural Credit) – which pay annual contributions to FGCAM, in compliance with the provisions laid down in Notice No 14/2003 of Banco de Portugal of 12 January 2004; and to promote and undertake the actions deemed necessary to ensure the solvency and liquidity of the member banks.

As at 31 December 2008, 99 agricultural credit institutions participated in FGCAM, 3 less than one year earlier (due to mergers). These institutions contributed with €14.7 million to the Fund in 2008. On that date, FGCAM's own funds amounted to €263.8 million, accounting for a €20.8 million increase compared to December 2007. Investments for the guarantee of deposits, taken in accordance with and for the purpose of Article 11 of Decree-Law No 345/98 of 9 November, attained €91 million, €26 million more than at the end of 2007, and accounted for 34% of FGCAM's gross assets and around

1% of the volume of deposits eligible for the guarantee scheme (estimated at €9,102 million as at 31 December 2008). The balance of free investments, which can be used in financial aid to SICAM, stood at €30.6 million at the end of the year, and total investments of the FGCAM accounted for around 1.34% of the estimated volume of deposits eligible for the guarantee scheme.

Within the framework of its business purpose, FGCAM has granted loans and subsidies both to the central mutual agricultural credit bank and mutual agricultural credit banks and subsidies to *Federação Nacional das Caixas de Crédito Agrícola Mútuo* - FENACAM (National Federation of Mutual Agricultural Credit Banks). In 2008 FGCAM granted SICAM loans to the amount of €239.7 million, of which €99.5 million have been repaid. At the end of the year, assistance contracts were in force comprising loans granted by FGCAM, net of partial repayments, to the amount of €140.2 million, i.e. €18.7 million down from the figure recorded on 31 December 2007.

In 2008, following the policy prevailing in previous years, FGCAM continued to monitor and financially aid SICAM. In that scope one financial assistance contract was signed, amounting to €11 million, and subordinated loans were repaid, to the amount of €18.7 million.

2008 was also marked by legislative changes which raised the limit of the deposit guarantee from €25,000 to €100,000, and shortened the repayment deadlines in the case of unavailability of deposits (Decree-Law No 211-A/2008 of 3 November) as follows: i) a share of up to €10,000 of all deposits covered shall be repaid within 7 days; ii) the remainder (up to the guarantee limit) within a maximum period of one year. This change implied the introduction of impact tests by FGCAM, as well as analyses and sundry data related to the deposit guarantee scheme.

## 8.2. Currency issuance

### 8.2.1. Banknotes

#### Production of euro banknotes

Each Eurosystem national central bank is assigned, on an annual basis, the responsibility for the procurement of an allocated share of the total volume of euro banknotes – only one, two or three denominations – to meet its own needs and those of other NCBs. The limitation of the number of denominations printed at each production site contributes to economies of scale, to the printing of uniform quality banknotes and allows for a rationalisation of banknote production.

In 2008 total banknote production in the Eurosystem amounted to 6,445 million banknotes, accounting for a 2.3% increase from production in 2007, which had stood at 6,300 million banknotes.

According to this decentralised euro banknote production scheme, in 2008 Banco de Portugal was responsible for ensuring the production of 193.6 million €5 banknotes. Similarly to previous years, the corresponding order was commissioned to Valora S.A., a company set up and currently fully held by Banco de Portugal.

Of the total production under the responsibility of Banco de Portugal, 115.9 million banknotes were reallocated to other NCBs according to a delivery schedule set out by the ECB. The remaining 77.7 million banknotes were used to meet Banco de Portugal's own needs.

Over this period, Banco de Portugal received a total of 245.5 million banknotes from other central banks, corresponding to only two denominations: €20 (109.7 million) and €10 (135.8 million).

#### Circulation in the euro area

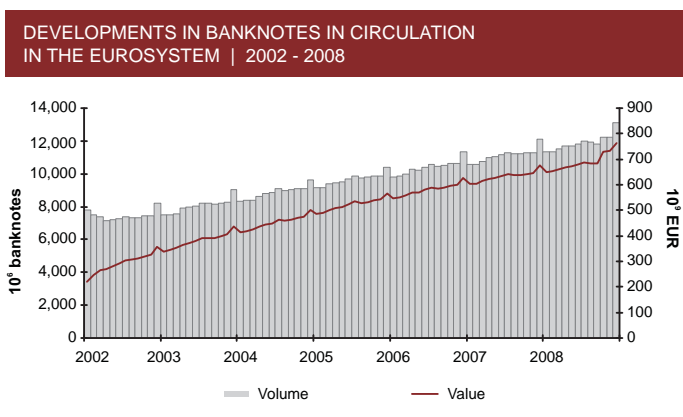
Nowadays, around 330 million European Union citizens use the euro as their currency. In addition to being the official currency of the countries that comprise the so-called euro area,

the euro has been playing an increasingly more important international role as a worldwide used currency.

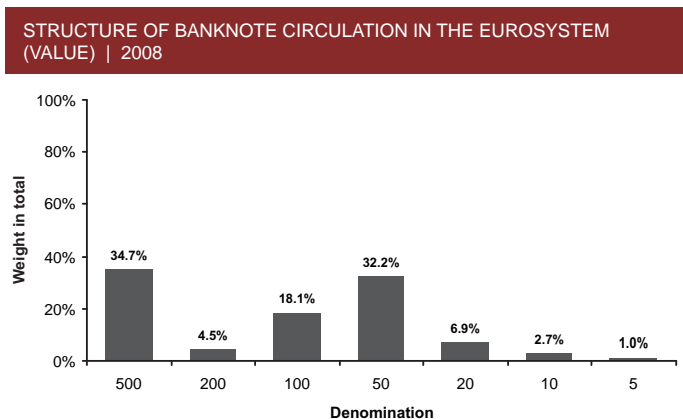
Approximately 20% of all cash, in value terms, put into circulation by euro area NCBs is estimated to be used outside this economic area. In that regard, it should be noted that the euro is already widely used in third countries and euro area neighbouring regions, such as South-Eastern Europe.

In late 2008, 13,116 million euro banknotes were in circulation, totalling €762,775 million. The growth pace of the euro circulation, which has been stabilising in the most recent years, has experienced a strong boost in the last few months of 2008, motivated by great demand for high-denomination banknotes, as a result of the worsening of the international financial crisis.

As a consequence, in 2008 the value of euro banknotes in circulation issued by the Eurosystem grew by around 12.7% overall, compared with 7.7% in 2007.



Source: ECB



Source: ECB

At end-2008 the three denominations with the greatest weight in circulation in terms of value were €500 (34.7%), €50 (32.2%) and €100 (18.1%), reinforcing their weight in the circulation structure vis-à-vis the previous years. The remaining denominations showed rather lower weights, i.e. between 1.0% (€5) and 6.9% (€20).

The analysis of circulation at Eurosystem level, which is valid in aggregate terms, cannot be transposed into the national level. In fact, the free movement of people, goods and capital in the euro area also naturally implies inflows and outflows of cash, in a continuous migration flow among countries, which cannot be controlled nor measured. The computation of the real level of euro banknotes in circulation in each euro area Member State is thus clearly jeopardised and any analysis seeking to be based on the indicator of banknotes put into circulation per each NCB is inappropriate.

The item “Banknotes in circulation” in the balance sheet of Banco de Portugal posted €17,254 million at the end of 2008, i.e. 12.4% more than in late 2007. This figure accounts for the share of banknotes in circulation in the euro area, which theoretically is allocated to Portugal, and at the end of 2008, as in 2007, it corresponded to 2.3% of the total. Theoretical values allocated to each Eurosystem participant are obtained by allocating the total value of euro banknotes in circulation according

to the “banknote allocation key”. Of this total, 8% is part of the ECB’s reserve, and the remaining 92% is allocated to the different NCBs, according to the key for subscription to the ECB’s capital.

**Withdrawals and deposits at Banco de Portugal**

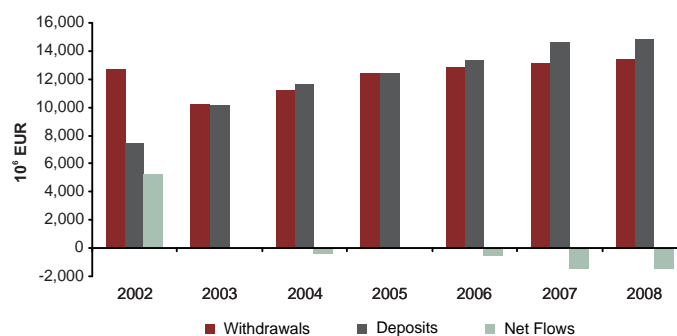
Between 2002 and 2008 withdrawals and deposits of banknotes by credit institutions at Banco de Portugal recorded increasingly growing levels, excluding withdrawals in the period immediately following the euro cash changeover (2002). However, the growth pace in value terms has been decelerating, to stand at only 1.5% for withdrawals and 1.3% for deposits in 2008.

In 2008 as in previous years the value of deposits exceeded that of withdrawals, which can be largely accounted for by the fact that Portugal is traditionally a country of destination – especially via tourism – of banknotes issued by central banks of other countries. These banknotes, when in surplus in the economy, are deposited at Banco de Portugal, and are not subsequently withdrawn in an equal share.

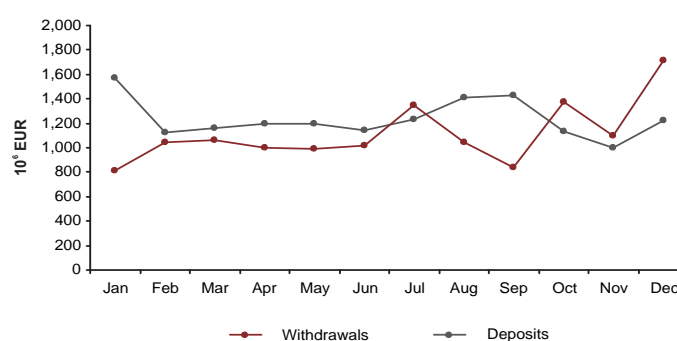
Although withdrawals and deposits at Banco de Portugal have been following the usual seasonal patterns, with peaks occurring between Christmas and New Year and early in the summer, the last quarter of 2008 saw some disturbances, directly related to the international financial crisis. The latter resulted in a high demand for banknotes in October and November, mainly focusing on high denominations.

In 2008 banking system withdrawals at Banco de Portugal amounted to approximately €13,350 million, corresponding to 786.15 million banknotes. Compared to 2007 there was an overall increase, in value terms, of approximately 1.5%, chiefly accounted for an increased demand for higher denomination banknotes (€500 and €200), which grew by 27.2% and 167.8% respectively.

DEVELOPMENTS IN BANKNOTE WITHDRAWALS AND DEPOSITS AT BANCO DE PORTUGAL | 2002 - 2008



DEVELOPMENTS IN BANKNOTE WITHDRAWALS AND DEPOSITS AT BANCO DE PORTUGAL | 2008



DEVELOPMENTS IN BANKNOTE WITHDRAWALS AT BANCO DE PORTUGAL | 2007 - 2008

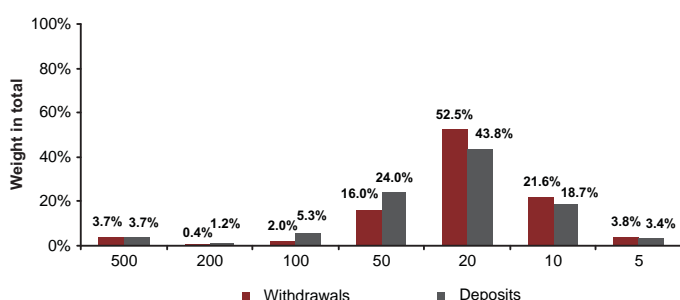
 U:10<sup>6</sup> banknotes, 10<sup>6</sup> EUR

Denomination (€)	2007			2008			Δ 2007 - 2008
	Volume	Value	Weight (value) %	Volume	Value	Weight (value) %	% (value)
500	0.78	389	3.0	0.99	494	3.7	27.2
200	0.10	21	0.2	0.28	56	0.4	167.8
100	2.64	264	2.0	2.62	262	2.0	-0.7
50	41.86	2,093	15.9	42.76	2,138	16.0	2.1
20	354.93	7,099	54.0	350.59	7,012	52.5	-1.2
10	274.50	2,745	20.9	288.69	2,887	21.6	5.2
5	108.75	544	4.1	100.22	501	3.8	-7.8
<b>Total</b>	<b>783.56</b>	<b>13,154</b>	<b>100.0</b>	<b>786.15</b>	<b>13,350</b>	<b>100.0</b>	<b>1.5</b>

During that period, credit institutions deposited €14,814 million at Banco de Portugal, corresponding to 781.99 million banknotes. Compared with 2007 and similarly to withdrawals, deposits recorded a slight overall increase in value terms of around 1.3%, also supported by a rise in high denominations, especially €500 and €200 banknotes.

DEVELOPMENTS IN BANKNOTE DEPOSITS AT BANCO DE PORTUGAL  
| 2007 - 2008U:10<sup>6</sup> banknotes, 10<sup>6</sup> EUR

Denomination (€)	2007			2008			Δ 2007 - 2008
	Volume	Value	Weight (value) %	Volume	Value	Weight (value) %	% (value)
500	0.91	457	3.1	1.10	549	3.7	20.0
200	0.75	149	1.0	0.90	180	1.2	20.7
100	7.39	739	5.1	7.80	780	5.3	5.6
50	68.89	3,445	23.6	71.04	3,552	24.0	3.1
20	332.07	6,641	45.4	324.19	6,484	43.8	-2.4
10	264.74	2,647	18.1	276.86	2,769	18.7	4.6
5	109.22	546	3.7	100.10	500	3.4	-8.4
<b>Total</b>	<b>783.97</b>	<b>14,625</b>	<b>100.0</b>	<b>781.99</b>	<b>14,814</b>	<b>100.0</b>	<b>1.3</b>

STRUCTURE OF BANKNOTE WITHDRAWALS AND DEPOSITS AT BANCO  
DE PORTUGAL (VALUE) | 2008

Notwithstanding the increase in high denominations, €50, €20 and €10 banknotes continued to predominate in the structure of withdrawals and deposits, accounting as a whole and in value terms for 90.2% of total withdrawals and 86.4% of total deposits.

Banco de Portugal's withdrawal structure naturally determines the structure of withdrawals at ATMs. Excluding the €50 banknote, which only accounts for 1% of total banknotes withdrawn, the two mostly used denominations in ATMs (€20 and €10) accounted for around 88% of withdrawals in 2008, i.e. 3 percentage points more than in 2007. By contrast, €5 banknote withdrawals also fell by around 3 percentage points.

Overall, withdrawals at ATMs grew by approximately 3.9% from the previous year, in terms of banknotes made available.

## BANKNOTE WITHDRAWALS AT ATMs | 2007 - 2008

U:10<sup>9</sup> banknotes

Denomination (€)	2007		2008		Δ 2007 - 2008	
	Volume	Weight (%)	Volume	Weight (%)	Volume	Weight (p.p.)
500	0	0	0	0	0	0
200	0	0	0	0	0	0
100	0	0	0	0	0	0
50	24	1	22	1	-2	0
20	848	50	893	51	44	1
10	591	35	653	37	62	2
5	227	13	189	11	-38	-3
<b>Total</b>	<b>1,691</b>	<b>100</b>	<b>1,757</b>	<b>100</b>	<b>67</b>	<b>0</b>

Source: SIBS

### Sorting of banknotes at Banco de Portugal

All banknotes deposited or received at Banco de Portugal are sorted, or checked by means of precision devices in the case of mutilated or suspect counterfeit banknotes. The goal is to ensure the genuineness and quality of banknotes to be recycled, eliminating those that do not comply with the criteria established by the Eurosystem.

In 2008 around 784 million euro banknotes were processed in Banco de Portugal's sorting systems, i.e. 2% more than in 2007.

BANKNOTES PROCESSED IN BP SORTING SYSTEMS   2007 - 2008			U:10 <sup>6</sup> banknotes
Denomination (€)	2007	2008	Δ 2007 - 2008
500	0.90	1.13	26%
200	0.73	0.92	26%
100	7.20	7.87	9%
50	67.63	71.41	6%
20	336.32	321.54	-4%
10	262.22	270.66	3%
5	95.90	110.28	15%
<b>Total</b>	<b>770.90</b>	<b>783.81</b>	<b>2%</b>

Of all banknotes processed, 475 million were classified as fit for recycling, and the remaining 309 million banknotes were deducted and destroyed due to lack of quality.

Overall, the annual unfit rate<sup>1</sup> of processed banknotes stood at 39%, increasing by almost 5 percentage points from 2007.

DEVELOPMENTS IN THE UNFIT RATE   2007 - 2008			U: %
Denomination (€)	2007	2008	Δ 2007 - 2008 (p.p.)
500	13	16	4
200	19	19	0
100	27	27	0
50	36	40	3
20	30	32	2
10	33	36	3
5	57	71	14
<b>Overall rate</b>	<b>35</b>	<b>39</b>	<b>5</b>

Given that the quality of banknotes in circulation in the euro area is an ongoing concern of the Eurosystem, in 2004 the ECB launched an annual procedure to analyse the quality of circulation, based on the collection of unprocessed samples of €5 to €50 banknotes from all euro area countries.

(1) Ratio of the total annual of processed banknotes deemed unfit for recycling to the annual total of processed banknotes.

Results for 2008 show a relative stabilisation in the Eurosystem's unfit rate, compared with the levels recorded since 2006.

UNFIT RATE (SAMPLE)   2004 - 2008						U: %
Denomination (€)	Context	2004	2005	2006	2007	2008
50	Eurosystem	21	26	12	13	13
	Portugal	32	39	14	18	17
20	Eurosystem	19	32	16	10	14
	Portugal	23	26	6	7	11
10	Eurosystem	34	36	16	16	17
	Portugal	18	23	5	4	4
5	Eurosystem	52	41	35	31	37
	Portugal	34	37	27	32	36

Source: ECB

As observed in the previous year, results obtained from the Portuguese sample only significantly diverge from the Eurosystem average as far as the €10 banknote is concerned. In this case, it is to Portugal's advantage, since the quality seen in banknotes collected (only 4% unfit banknotes) is higher than that of the Eurosystem average (17% unfit banknotes).

In general terms, the quality of banknotes in circulation in euro area countries as a whole has improved throughout the periods under review (2004 to 2008), as a consequence of a more effective action from NCBs, materialised in an ongoing renewal of banknotes in circulation.

The relatively good quality of banknotes in circulation in the Eurosystem was also proven through the conclusions of a public survey conducted in 2008, which covered the then 15 euro area Member States. Based on their own perceptions, around 95% of respondents were pleased or remained neutral with regard to the quality of banknotes used on a daily basis. Around 20% mentioned the lower quality of the €5 banknote, which to a certain extent corresponds to the technical analysis results.

### Detection of counterfeits

In 2008, 11,683 counterfeit euro banknotes were withdrawn from circulation in Portugal. This amount, although translating an increase of around 27% from 2007, stands close to the 2005 level (10,063 counterfeits), and is even lower than in 2004 (14,454 counterfeits).

Figures for 2008, on the other hand, are substantially lower than recorded in the last year of the escudo (2001), when 17,533 counterfeit escudo banknotes were seized.

## COUNTERFEIT BANKNOTES SEIZED IN PORTUGAL | 2007 - 2008

U: banknotes

Denomination (€)	2007	2008	Δ 2007 - 2008 (%)
500	72	23	-68
200	900	530	-41
100	684	808	18
50	3,455	4,030	17
20	2,931	4,630	58
10	821	1,508	84
5	321	154	-52
<b>Total</b>	<b>9,184</b>	<b>11,683</b>	<b>27</b>

Source: CMS (Counterfeit Monitoring System).

On the other hand, it is important to note that total counterfeit banknotes detected in Portugal in 2008 accounted for less than 2% of the total seized in the euro area.

The €20 banknote was once again the denomination with the highest number of counterfeits detected in Portugal (40% of the total) in 2008, followed by the €50 banknote (34% of the total). As a whole, these two denominations accounted for around three quarters of total counterfeit banknotes seized.

In the euro area, the €20 and €50 banknotes were also the denominations with the highest number of counterfeits, accounting for 39% and 35% of total counterfeits detected respectively.

In Portugal, detected counterfeit banknotes may be identified without the use of auxiliary equipment, i.e. by only resorting to a careful analysis of the security features for the public, using the “feel/look/tilt” test, as described in official Eurosystem publications, at the European Central Bank’s and Banco de Portugal’s websites, and also in the December 2008 issue of the “*Boletim Notas e Moedas*” (“bulletin on banknotes and coins”) of Banco de Portugal.

Finally, Banco de Portugal, through the National Counterfeit Centre (cncontrafaccoes@bportugal.pt), has been significantly fostering information and training on euro banknotes, targeted at both professionals and the general public.

### Withdrawal from circulation of escudo banknotes

In 2008 around 260,000 escudo banknotes of all plates not yet expired were exchanged at Banco de Portugal, to a total value of €5.44 million.

The 20-year period established by Portuguese law for the exchange of plate 10 of the 500\$ banknote ended in January 2008.

At the end of 2008, 39.53 million escudo banknotes had not yet been withdrawn from circulation, corresponding to €196.31 million.

BANKNOTES DENOMINATED IN ESCUDOS | 2008

U:10<sup>6</sup> banknotes, 10<sup>6</sup> EUR

## Withdrawn from circulation in 2008

Denomination	Volume			Value		
	Withdrawn from circulation up to 31 Dec. 2001	In circulation as at 31 Dec. 2001	Total	Withdrawn from circulation up to 31 Dec. 2001	In circulation as at 31 Dec. 2001	Total
10 000\$	0.01	0.02	0.02	0.28	0.94	1.22
5 000\$	0.02	0.06	0.08	0.45	1.58	2.03
2 000\$	0.00	0.02	0.03	0.04	0.23	0.28
1 000\$	0.02	0.04	0.06	0.11	0.20	0.31
<sup>(1)</sup> 500\$	0.02	0.02	0.04	0.04	0.06	0.09
100\$	0.03		0.03	1.51		1.51
<b>Total</b>	<b>0.10</b>	<b>0.17</b>	<b>0.26</b>	<b>2.44</b>	<b>3.01</b>	<b>5.44</b>

## Still to be withdrawn from circulation as at 31 December 2008

Denomination	Volume			Value		
	Withdrawn from circulation up to 31 Dec. 2001	In circulation as at 31 Dec. 2001	Total	Withdrawn from circulation up to 31 Dec. 2001	In circulation as at 31 Dec. 2001	Total
10 000\$	0.22	0.41	0.63	10.80	20.60	31.40
5 000\$	1.12	1.62	2.74	27.95	40.29	68.24
2 000\$	0.56	1.85	2.41	5.60	18.43	24.02
1 000\$	4.26	3.98	8.24	21.26	19.83	41.09
500\$	4.90	4.53	9.44	12.22	11.31	23.53
100\$	16.08	0.00	16.08	8.02	0.00	8.02
<b>Total</b>	<b>27.15</b>	<b>12.39</b>	<b>39.53</b>	<b>85.85</b>	<b>110.46</b>	<b>196.31</b>

(1) Banknotes from plate 10 ceased to be exchanged as of 31 January 2008.

### Communication and training on banknotes and coins

Within the scope of the integrated communication and training policy on euro banknotes and their counterfeits, the following initiatives were undertaken by Banco de Portugal in 2008:

- Issue of a periodical publication on cash, entitled "*Boletim Notas e Moedas*" (bulletin on banknotes and coins), mainly addressed at credit institutions and other professional cash handlers. In 2008 a new editorial approach was adopted for this publication, which is now oriented not only towards a professional public, but also to other population segments. For this reason, it can be obtained from the website of Banco de Portugal.
- Development of new contents on euro banknotes and coins to be released on Banco de Portugal's website and on the Bank Customer Website, investing on types of communication that are oriented towards different publics.
- Setting-up of new training contents oriented towards publics other than professional cash handlers, from the student population to the general public, with the consequent training initiatives for these targets.
- Distribution to different targets (credit institutions, schools, public services and other institutions) of material containing information on euro banknotes provided by Banco de Portugal and the European Central Bank. This material includes technical information on

banknote features and the “feel/look/tilt” test, used to recognise the security features of euro banknotes.

- e) Regular release of qualified technical information on counterfeit euro banknotes and coins – *Avisos de Contrafação* (Counterfeit Notices) –, aimed at a target public composed of professional cash handlers at credit institutions, cash-in-transit companies and other entities accredited to Banco de Portugal.
- f) Organisation of a technical seminar on “Euro coins”, addressed at credit institutions and professional cash handlers, which mainly aimed at disseminating technical information on euro coins and the legal framework governing recycling activities.

In 2008, in the pursuance of its training policy on genuine and counterfeit euro banknotes and coins, Banco de Portugal carried out a very wide range of training actions for the staff of credit institutions and cash-in-transit companies. 292 face-to-face training courses were carried out by Banco de Portugal, involving a total of 3,270 trainees.

With regard to training, 2008 also saw the implementation of a course on “Euro banknotes” in an e-learning format, in a number of credit institutions and through the platform of the Banking Training Institute. Consequently, this type of training was initiated in large numbers.

### **Common framework for euro banknote recycling**

With the publication of Decree-Law No 195/2007 of 15 May, the euro banknote recycling activity carried out by credit institutions and other professional cash handlers, namely cash-in-transit companies, is now subject to a contract to be signed with Banco de Portugal. 2008 was marked by the extension of such contracts to the whole universe of entities: 129 credit institutions and 4 cash-in-transit companies.

Contrary to cash-in-transit companies, which seem to have fulfilled all the requirements applicable to their activity, most credit institutions' contracts reflect their strategies of gradual implementation of the new recycling regime, with the adoption of migration plans by the end of 2010. In these plans, credit institutions have established schedules for the entry into operation of recycling equipment, changes in procedures followed by the respective branches in line with the new rules and the training plan of their staff, aimed at the respective qualification for recycling.

In 2008, within the scope of the regulatory process regarding the new banknote recycling framework, Banco de Portugal published four circular letters and one instruction:

- Circular Letter No 3/2008/DET of 4 January 2008 – Provided information on the contract signed with the cash-in-transit company LOOMIS, S.A. within the scope of euro banknote recycling;
- Circular Letter No 6/2008/DET of 18 January 2008 – Provided information on the contract signed with the cash-in-transit company GRUPO 8 – Vigilância e Prevenção Electrónica, Lda. within the scope of euro banknote recycling;
- Circular Letter No 27/2008/DET of 17 March 2008 – Provided information on the contract signed with the cash-in-transit company Prosegur – Companhia de Segurança, Lda. within the scope of euro banknote recycling;
- Circular Letter No 47/2008/DET of 24 June 2008 – Informed the banking system on the availability of e-learning training on “Euro banknotes” through the platform of the Banking Training Institute (WebBANCA).
- Instruction No 9/2008 – Established the terms and conditions for monitoring the implementation of migration plans forecast for the transition period, namely as regards the type of information,

frequency and deadlines in which data on euro banknote recycling must be reported to Banco de Portugal.

Once the contract stage had been completed and regulatory production virtually concluded, Banco de Portugal reinforced its inspection powers, having carried out 39 inspections over the year. These included prior checking before the signing of the contract, monitoring the implementation of the migration plan and also, in those cases where migration had already been completed, verifying that the operation was in order.

2008 was also marked by the reinforcement of training to entities developing recycling activities. In this regard, and given the need to train thousands of professionals in the field of euro banknotes, Banco de Portugal chose an innovative strategy, by resorting not only to face-to-face training, which has already been ensured for some years, but also to the launch of a course in an e-learning format, having trained over 700 professionals in 2008. This course was directly installed at a number of credit institutions and also at the Banking Training Institute, being therefore accessible to institutions that did not have their own e-learning platform.

Finally, as regards data reporting, in 2008 the solution made available by Banco de Portugal via BPnet entered into operation, and credit institutions and cash-in-transit companies started reporting data.

In short, in 2008 the process of implementing the common framework for banknote recycling in Portugal progressed very positively and in line with established goals.

#### **Roadmap for more convergence of NCB cash services**

In 2007 the Governing Council adopted a set of measures (the so-called “Roadmap”) which aimed to achieve, in the medium term, greater convergence of the cash services offered by euro area NCBs.

This convergence will allow the various stakeholders involved in cash management, namely credit institutions and cash-in-transit companies – particularly those that carry out cross-border activities – to reap the benefits of a single currency, through the creation of a single euro distribution area. This will contribute to a more effective and rational management of cash cycle activities.

The Eurosystem’s objective is to create a converging but sufficiently flexible cash management system, which takes into consideration the national realities of each country, namely market operator characteristics and cash-related national infrastructures, by creating transitory periods for the implementation of measures to be adopted whenever necessary.

Priority measures laid down in the Roadmap were the following:

- a) Grant of free access by all credit institutions to cash services provided by any central bank (remote access);
- b) Unrestricted acceptance of coin deposits at central bank counters;
- c) Extension of opening hours and/or adoption of similar measures;
- d) Installation of electronic interfaces for the communication of deposit/withdrawal orders;
- e) Free-of-charge acceptance of non-faced and non-oriented banknotes;
- f) Creation of common packaging standards for cash deposits and withdrawals.

The first three measures were implemented in 2007, and in 2008 works related to the implementation of the remaining measures were launched.

The installation of electronic interfaces for the communication of deposit/withdrawal orders assumes that a common use interface is developed for electronic communication between NCBs and their customers. The development of the technical solution and local level implementation is the responsibility of the respective NCBs. In this context, in late 2008 Banco de Portugal launched works leading to the development of an application that will be made available to credit institutions and cash-in-transit companies in a secure Web platform, and that will allow for the electronic transmission of data on deposits of banknotes and coins.

The implementation of the measure aiming at the acceptance of non-faced and non-oriented banknotes in deposit at the treasuries of Banco de Portugal is part of a technological strategy to renew banknote sorting equipment operating at Banco de Portugal, which started in 2007 and will last until 2011. The forecast technological renewal, in addition to making it possible to accommodate the requirements imposed by the Roadmap, will raise the banknote sorting capacity of Banco de Portugal by around 25%.

With regard to the creation of common packaging standards, four packaging solutions were developed. NCBs should make at least one of the solutions available to their customers, within the scope of cross-border operations, keeping the standards in use at national level. Specifications must be finalised by 2009.

In addition to monitoring and complying with Eurosystem requirements for adopting the measures included in the Roadmap, Banco de Portugal intends, on its own initiative, to promote changes in other areas in response to the needs of the Portuguese banking system.

### **Project regarding the creation of a second series of euro banknotes**

The ECB and the euro area NCBs continue to be strongly committed to the preparation of a second series of euro banknotes, a project which is at an advanced stage of development.

In 2008 the project's main activities focused on the design of the new banknotes and the development and integration of security features. Works leading to the production of origination materials were also started, resulting from the transformation of the banknote design into a printing tool, so as to ensure mass production.

The new banknotes will continue to be based on the "ages and styles of Europe" theme of the current series, although the design elements and security features of the second series banknotes will incorporate significant innovations, which will make it easier to tell apart the two series.

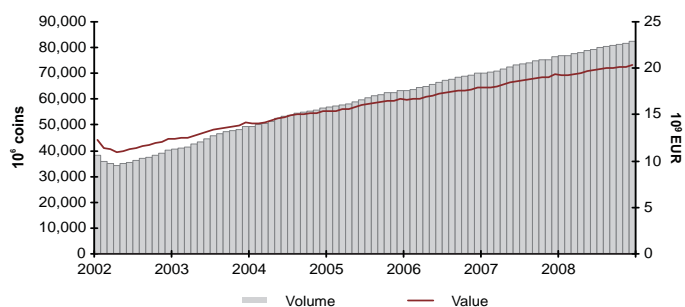
There were also consultations with major stakeholders involved in cash cycle management, namely credit institutions and cash-in-transit companies, to coordinate strategies as to how the new banknotes will be put into circulation.

The new series of euro banknotes will be gradually launched over a period of several years, with the first denomination expected to be issued early in the next decade. However, the exact launch date is not yet determined.

Euro area NCBs will redeem euro banknotes from the first series for an unlimited period.

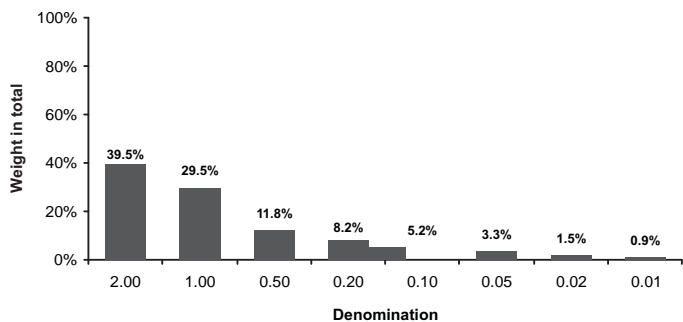
Banco de Portugal continued to actively participate in the development of this project, by taking part in various technical working groups at the Eurosystem level.

**DEVELOPMENTS IN COINS IN CIRCULATION IN THE EUROSISTEM | 2002 - 2008**



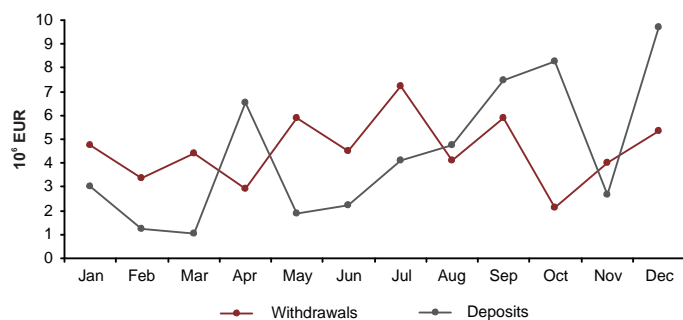
Source: ECB

**STRUCTURE OF COIN CIRCULATION IN THE EUROSISTEM (VALUE) | 2008**



Source: ECB

**DEVELOPMENTS IN COIN WITHDRAWALS AND DEPOSITS AT BANCO DE PORTUGAL | 2008**



**8.2.2. Metal coins**

**Circulation in the euro area**

At the end of 2008 metal coins in circulation in the euro area amounted to €20,404 million, corresponding to 82,314 million coins.

In terms of both volume and value, the circulation of metal coins has been always following an upward trend, albeit tending to record a slower growth pace. In 2008 the circulation of metal coins grew compared to 2007, by 5.7% in terms of value and 7.9% in terms of volume.

In terms of breakdown by denomination, the structure of metal coins in circulation in the euro area at the end of 2008 was the following:

Similarly to banknotes, it is not possible to determine the value of metal coins in circulation in Portugal.

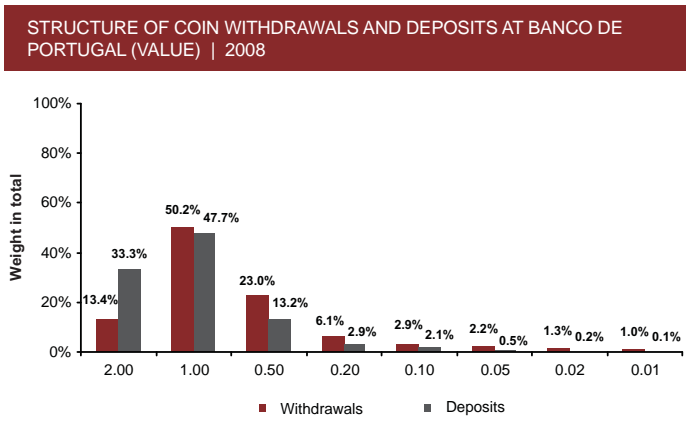
Banco de Portugal, in the performance of the tasks conferred on it by law, puts coins into circulation on behalf of the State, i.e. their legal issuer, while assuming the role as agent responsible for smoothing out excess cash in circulation by accepting deposits of coins at its treasuries.

**Withdrawals and deposits at Banco de Portugal**

A In the course of 2008 withdrawals at Banco de Portugal amounted to €55 million, corresponding to 201.23 million coins, i.e. a 25.2% increase from 2007 in terms of value. In parallel, deposits reached €53 million, which is equivalent to 80.23 million coins, i.e. 65.1% growth in terms of value compared with 2007.

Breaking down the structure of withdrawals and deposits by denomination, €1, €2 and €0.50 coins accounted as a whole for 86.5% and 94.3% respectively of total withdrawals and deposits at Banco de Portugal.

Of total deposits, Banco de Portugal processed 66.3 million euro coins, of which 102,552 were considered unfit for circulation, corresponding to a rejection rate of only 0.15%.



### Counterfeit metal coins

Similarly to banknotes, coins were also designed and produced to incorporate features preventing them from being fraudulently reproduced. The “comparison analysis” methodology makes it possible to track down most counterfeit coins by controlling the main security features: relief, edge and magnetic properties.

Similarly to previous years, the €2 coin had the highest number of counterfeits, both in Portugal and the Eurosystem, due to its higher face value. Of all counterfeit denominations taken together (€2, €1 and €0.50), 793 counterfeit coins were seized in Portugal, i.e. 43% more than in 2007. In turn, in the euro area as a whole 195,900 counterfeits were detected, i.e. 7% less than in the previous year.

### Collector coins

Collector coins issued in Portugal since the euro cash changeover are presented in the following table, which includes, in addition to their description (face value, name and alloy), the year of issue, the authorised issue limit and status at the end of 2008 regarding coins issued and scheduled to be issued.

Source: Banco de Portugal

Collector coins issued in Portugal   By denomination: €						U: 10 <sup>3</sup> coins	
	Denomination	Alloy	Year of issue (Dec. Law)	Issue limit	Issued	To be issued	
	<b>TOTAL</b>			<b>16,188</b>	<b>11,900</b>	<b>4,288</b>	
EUR 10	20 <sup>th</sup> anniversary of the accession of Portugal to the European Communities	Silver Silver Proof	2005	250 20	91 8	159 12	
	Olympic Games - Athens 2004	Silver Silver Proof	2004	350 15	200 14	150 1	
	Football World Championship – Germany 2006	Silver Silver Proof	2005	250 25	107 14	143 11	
	Iberian-American countries at the Olympic Games	Silver Silver Proof	2007	100 18	70 6	30 12	
	Navigation	Silver Silver Proof	2003	350 20	310 16	40 4	
	Oporto cathedral	Silver Silver Proof	2005	300 20	122 7	178 13	
	Olympic Sailing World Championship	Silver Silver Proof	2007	150 8	70 4	80 3	
	EUR 8	European Union Enlargement 2004	Silver Silver Proof	2004	300 35	200 32	100 3
		Football show – defence	Silver Gold Proof Silver BU <sup>(1)</sup> Silver Proof	2003	1 500 10 30 15	950 2 11 11	550 8 19 4
Football values – sportsmanship		Silver Gold Proof Silver BU <sup>(1)</sup> Silver Proof	2003	1 500 10 30 15	1 500 5 21 15	0 5 9 0	
Football values – celebration		Silver Gold proof Silver BU <sup>(1)</sup> Silver Proof	2003	1 500 10 30 15	1 500 5 21 15	0 5 9 0	
Football values – passion		Silver Gold Proof Silver BU <sup>(1)</sup> Silver Proof	2003	1 500 10 30 15	1 500 6 21 15	0 4 9 0	
Football values – the goal		Silver Gold proof Silver BU <sup>(1)</sup> Silver Proof	2003	1 500 10 30 15	950 2 11 11	550 8 19 4	
60th anniversary of the end of World War II		Silver Silver Proof	2005	300 35	132 28	168 7	
Prince Henry the Navigator		Silver Silver Proof	2006	100 35	85 20	15 15	
150th anniversary of the first railroad connection between Lisbon and Carregado		Silver Silver Proof	2006	100 10	82 3	18 7	
Bartolomeu de Gusmão's Passarola (airship)		Silver Silver Proof	2007	100 25	70 15	30 10	
Football show - the shot		Silver Gold Proof Silver BU <sup>(1)</sup> Silver Proof	2003	1 500 10 30 15	950 2 11 11	550 8 19 4	
EUR 5		Alcobaça Monastery	Silver Silver Proof	2006	100 10	82 4	18 6
		Historical centre of Angra do Heroísmo	Silver Silver Proof	2005	300 15	123 4	177 11
		Batalha Monastery	Silver Silver Proof	2005	300 15	122 4	178 11
		Convent of Christ	Silver Silver Proof	2004	300 10	255 6	45 4
		100th anniversary of the world scouting movement	Silver Silver Proof	2007	150 10	80 6	70 4
		Historical centre of Évora	Silver Silver Proof	2004	300 10	255 7	45 3
		Madeira's Laurissilva forest	Silver Silver Proof	2007	100 8	75 4	25 4
		European Year of Equal Opportunities for All	Silver Silver Proof	2007	100 8	70 4	30 4
		800th anniversary of the birth of Pedro Hispano	Silver Gold proof Silver Proof	2005	300 8 15	122 2 5	179 5 10
		150th anniversary of the first Portuguese stamp	Silver Gold Proof Silver BU <sup>(1)</sup> Silver Proof	2003	300 10 20 20	300 3 16 14	0 7 4 6
	Cultural Landscape of Sintra	Silver Silver Proof	2006	100 10	82 5	18 5	
	EUR 2.50	Vineyards of Alto Douro	Cupronickel Silver Proof	2008	150 5	90 1	60 4
		Fado	Cupronickel Silver Proof	2008	150 20	100 10	50 10
		Beijing Olympic Games	Cupronickel Silver Proof	2008	488 13	488 8	0 5
Historical centre of Oporto		Cupronickel Silver Proof	2008	150 5	95 2	55 3	
EUR 1.50	Against indifference	Cupronickel MS <sup>(2)</sup> Silver Proof	2008	50 300 5	50 104 4	0 196 1	
	King Afonso Henriques (12th century)	Gold MS <sup>(2)</sup>	2006	30	22	8	
EUR 0.25	King Dinis (14th century)	Gold MS <sup>(2)</sup>	2006	30	10	20	
	Saint Anthony (13th century)	Gold MS <sup>(2)</sup>	2006	30	17	13	

(1) 'BU' means 'Brilliant Uncirculated', a type of finish.

(2) 'MS' means 'Mint State', a type of finish.

### 8.3. Payment systems

In 2008 the most relevant events in the field of payment systems were: the preparation of the final migration to TARGET2, the decision to continue the TARGET2-Securities project, and the further development of the SEPA Project (Single Euro Payments Area).

The migration of the national banking community to TARGET2 started on 18 February 2008 and ended on 2 March 2009. During this transitional period, Banco de Portugal acted as the link between SPGT2 (the former Portuguese real-time gross settlement system) and TARGET2. Portuguese banks were, in general, indirect participants.

Before the final migration at the beginning of March 2009 and to ensure a smooth transition, it was essential to prepare the various tasks to be carried out by participants, namely Banco de Portugal, credit institutions, SIBS (Interbank Services Company) and ancillary systems.

In addition to the specific tasks related to TARGET2, Banco de Portugal made the necessary regulatory and operational changes to the Interbank Clearing System (SICOI), so as to incorporate the risk management mechanisms that previously were an integral part of SPGT.

The SEPA project continued to progress according to plan through the development of phases aimed at attaining its key objective: "to enable electronic cross-border payments to be made as effectively and safely as domestic payments and at an equivalent price".

There has been considerable adherence by national institutions to the SEPA credit transfers (launched on 28 January 2008). At the end of the first year, SEPA transfers accounted for around 1.5% of total credit transfers in Portugal, which is still negligible, although above the EU average.

In order to increase migration to this new payment instrument, the European Commission and the Eurosystem have implemented a set of measures aimed at encouraging the public administration to adopt this new instrument.

It should also be noted that national entity registrations are sent to the European Payments Council via the national adherence structure: the National Adherence Support Organisation – Portugal (NASO-PT).

Regarding the implementation of the other SEPA payment instruments, work continued towards the launch of the pan-European direct debit scheme through the publication of the Rulebook and the development of an authorisation and e-mandate solution.

At the national banking community level, interbank meetings were held to inform and provide clarifications, and a new version of the National Migration Plan has been concluded.

The Eurosystem and the European Commission have continued to take a high interest in the SEPA project, and published progress and monitoring reports, so that SEPA would be implemented within a context open to competition, with further technical and operational harmonisation, more innovation, maintenance of the quality of the service provided and no price increase.

In relation to the TARGET2-Securities project, in the first quarter of 2008 a public consultation was held on the user requirements of this new system and on the methodology used to analyse its impact on the economy. After having analysed the results of this consultation, the Governing Council of the ECB decided on 17 July to continue the project and assign its development to four euro area national central banks (4CB).

Since then, several working groups have been set up to develop business requirements and harmonise both practices and procedures. In parallel, discussions continued on the project governance model, the pricing policy, and the contractual issues between the central securities depositories and the Eurosystem.

At the operational level, data indicate a positive change in the functioning of SPGT2/TARGET2 and SICOI (Interbank Clearing System) (see details in sub-sections III.3.1 and III.3.2) in relation to 2007, namely: transactions settled via SPGT2/TARGET2 increased 4.5% in volume and 14.1% in value; transactions processed via SICOI increased 4.7% in volume and 2.9% in value.

### 8.3.1. Gross settlement systems: SPGT/TARGET

Portugal joined TARGET2 on 18 February 2008 in the second migration group of the European banking community. This date marked the start of the national migration to TARGET2. During this transitional period nearly all Portuguese institutions chose to be represented by Banco de Portugal, a direct participant in TARGET2. Banco de Portugal thus acted as a channel for cross-border payments of these institutions, similarly to the former TARGET system via Interlinking.

Thus, participating institutions and ancillary systems (namely, SICOI, Interbolsa and MIBEL) were able to introduce the changes necessary for their direct connection to the TARGET2 Single Shared Platform (SSP), but at the same time most of TARGET's technical infrastructures remained in operation, including the SPGT/SIBS network, the front-end Aplicação de Tesouraria (treasury application), and the settlement in Banco de Portugal's platform – now called SPGT2.

2008 was marked by substantial preparatory work to this end by the several participants in domestic payment systems, which included developments and tests on applications and procedures adjusted to the new reality.

Banco de Portugal was actively involved in the coordination of works on the TARGET2 connection by monitoring and cooperating in tests, as well as other preparatory work and activities supporting the migration of institutions participating in SPGT2 and SLOD (Settlement System for Other Depositors).

Banco de Portugal also developed a set of applications to support TARGET2: a billing application, as well as a current account application – called “*Aplicativo de Gestão Integrada de Liquidações - AGIL* (application for the integrated management of settlements)” – for central bank customers (entities which do not fulfil the legal requirements to participate in TARGET2) and for institutions outside TARGET2 with very specific operations with the central bank.

A new harmonisation/consolidation framework for the Eurosystem, aimed at improving the quality of the series on TARGET2 statistics, is scheduled to be implemented at the beginning of 2009.

According to the SPGT2 data shown in the table below, transaction growth slowed down, with a positive overall change of 4.5% in the volume of transactions in comparison with 12.2% in 2007, as a result of increased domestic traffic (+9.1%), while cross-border transactions decreased by 2.8%.

Amounts settled increased considerably (+14.1%) compared to the previous year (-5.3%), also due to the significant increase in domestic settlements (+30.2%).

TRANSACTIONS SETTLED VIA SPGT2 <sup>1</sup>								Value: EUR million	
	2007		2008		Change				
	Volume	Value	Volume	Value	Volume	%	Value	%	
<b>Total transactions settled</b>	1,501,561	4,907,284	1,569,484	5,597,022	67,923	4.5	689,738	14.1	
• Domestic transactions	924,240	1,743,253	1,008,428	2,269,793	84,188	9.1	526,540	30.2	
• Cross-border transactions	577,321	3,164,031	561,056	3,327,229	-16,265	-2.8	163,198	5.2	
- Sent	215,021	1,581,818	202,134	1,669,996	-12,887	-6.0	88,178	5.6	
- Received	362,300	1,582,213	358,922	1,657,233	-3,378	-0.9	75,020	4.7	
<b>Daily averages</b>									
<b>(Total transactions)</b>	5,888	19,244	6,131	21,863	243	4.1	2,619	13.6	
• Domestic transactions	3,624	6,836	3,939	8,866	315	8.7	2,030	29.7	
• Cross-border transactions	2,264	12,408	2,192	12,997	-72	-3.2	589	4.7	
- Sent	843	6,203	790	6,523	-53	-6.3	320	5.2	
- Received	1,421	6,205	1,402	6,474	-19	-1.3	269	4.3	

(1) The settlement system for other depositors (SLOD) processed 88,629 transactions to an approximate value of EUR 44.8 billion, accounting for a growth rate of 13.4% in the volume of transactions and of -12.8% in value traded.

The increase in the quantity of domestic settlements was mainly due to considerable growth in traffic among institutions participating in the SPGT2, in particular customer transactions and gross settlement transactions from Interbolsa.

The launch of SEPA credit transfer settlements via SICOI (1st and 2nd daily cycles) on 28 January 2008 also contributed to this increase, albeit to a lesser extent.

Transfers among SPGT2 participants were the main contributor to the increase in the amount of domestic settlements, followed by transactions carried out in the Market Electronic Transfer System (SITEME) – liquidity-providing/liquidity-absorbing operations and exchange of money market funds between institutions – and, to a lesser extent, by Treasury operations.

On 8 December 2008, the settlement of STEP2<sup>2</sup> in TARGET2 and SPGT2 went live, including the direct settlement in the SSP of the balances of this system of the Euro Banking Association (EBA) for 5 national institutions. To this effect, these institutions temporarily used settlement accounts with Banco de Portugal in the SSP (until 2 March 2009).

The activities of the Eurosystem groups that were most relevant to TARGET2 (Payment and Settlement Systems Committee, Working Group on TARGET2 and Task Force on TARGET2 Migration Issues) mainly focused on preparing the system's gradual start and implementing two new releases, which went live in May and November, respectively.

Regarding the service level in TARGET2, no major disturbances occurred in the new system in 2008 apart from an incident of some importance, on 30 June, when problems in the SSP applications made it impossible to process several payments until the end of the session. Since then improvements were made and introduced in the contingency procedures in order to avoid similar situations in the future. Some one-off occurrences also led to the temporary interruption of the system and, in some cases, the closing time was postponed by one hour (on 4 March and 29 December).

It should be noted that on a number of days in 2008 more than 500,000 daily payments were processed in the SSP of TARGET2 (for example, on 30 June).

Besides there were also some one-off incidents in national RTGS systems, outside the SSP and during migration phases.

The first audit to TARGET2 was carried out in the last quarter of the year. With this objective in mind, a set of requirements was defined for the platform and each NCB was given the responsibility to audit its own connection to the system, in addition to auditing the SSP. This audit focused on risk management, compliance with agreed levels of service, procedures during normal and contingency situations, and the operation of national and ECB help desks.

In 2008, a working group was also set up at Eurosystem level to investigate the feasibility of developing a single and harmonised interface (Eurosystem Single Interface - ESI) for TARGET2, Collateral Central Bank Management (CCBM2) and TARGET2-Securities. A public consultation was thus launched on 1 September 2008 asking potential users to indicate the level of priority they assigned to different aspects related to communication channels, functions and need of the ESI.

### 8.3.2. Interbank Clearing System (SICOI)

In 2008 operations cleared in the Interbank Clearing System (SICOI) rose by around 4.7% in volume and around 2.9% in value (see table below). These growth rates were lower than in the previous year (6.2% in terms of volume and value), due on the one hand to lower growth in the

(2) Retail clearing system of the EBA.

use of electronic payment instruments (direct debits, credit transfers and Multibanco (nationwide ATM and EFTPOS network)), and on the other to a sharp decrease in the use of paper-based payment instruments (cheques and bills of exchange).

TRANSACTIONS PROCESSED VIA SICOI								Value: EUR millions Volume: million	
	2007		2008		Change				
	Volume	Value	Volume	Value	Volume	%	Value	%	
<b>Total cleared</b>	<b>1,671.7</b>	<b>344,625</b>	<b>1,750.6</b>	<b>354,560</b>	<b>78.9</b>	<b>4.7</b>	<b>9,935</b>	<b>2.9</b>	
Cheques	141.2	174,327	126.5	162,032	-14.7	-10.4	-12,295	-7.1	
Of which returned:	0.9	2,637	1.0	2,988	0.1	9.8	351	13.3	
Bills of exchange	0.4	2,248	0.3	2,076	-0.1	-15.2	-171	-7.6	
TEI	62.9	87,562	70.4	100,923	7.6	12.1	13,361	15.3	
Direct debit	86.7	12,138	97.4	14,522	10.7	12.4	2,384	19.6	
Multibanco	1,380.5	68,351	1,455.9	75,007	75.4	5.5	6,656	9.7	

The cheque sub-system decreased further in 2008 in both volume (14.7 million cheques) and value (approximately €12.3 billion). Developments in rates of change were the following: -10.4% in volume compared to -8.8% in 2007, and -7.1% in value compared to -1.4% in 2007. Nonetheless, cheques continued to be the most important payment instrument in terms of value, accounting for around 45.8% of total amounts cleared via SICOI.

Returned cheques in the Clearing System reached 955 thousand in volume (0.76% of cleared cheques – which was slightly above the percentage recorded in 2007), and €2,988 million in value, accounting for approximately 1.8% of cleared values. In contrast to developments in cheques presented for collection, returned cheques showed growth rates of 9.8% in terms of volume and 13.3% in terms of value. The main reason for returned cheques continued to be the “lack of or insufficient funds”, i.e. approximately 75% of the returns volume, but only 52% in value terms.

In turn, the bills of exchange sub-system maintained its downward trend both in terms of volume (-15.2% in 2008 compared to -13.6% in 2007), and value (-7.6% in 2008 compared to -1.6% in 2007), whereas cleared volumes and values were increasingly more residual.

The growth rates of the Interbank Electronic Transfer (Portuguese acronym: TEI) sub-system were lower vis-à-vis the previous year by 15.3% in value and 12.1% in volume (in 2007 growth rates had stood at around 19% in value and 15% in volume).

The Direct Debit System recorded once again the highest growth rates in 2008, although they were lower than in 2007, in both volume (12.4%) and value (19.6%), thereby contributing to reinforce the tendency towards the utilisation of electronic payment instruments.

Finally, Multibanco also recorded significant growth rates in 2008, similar to those seen in the previous year. In fact, in 2008 transactions via Multibanco accounted for approximately 83.2% of total cleared transactions and for around 21% in value terms.

The smooth operation of SICOI, made up of the above mentioned sub-systems, requires its functionalities to be constantly monitored and updated. These monitoring and development tasks are carried out by working groups operating within the framework of the Interbank Commission for Payment Systems (Portuguese acronym: CISP)<sup>3</sup>, an advisory body of Banco de Portugal on payment systems.

(3) Interbank working groups: cheques and bills of exchange; credit transfers; direct debits; bank cards.

In terms of card schemes, the group monitored the development of solutions for the standardisation of the different segments dealing with transactions and the migration to EMV-compliant cards arising from the implementation of the SEPA project. A manual of good practices is also being developed.

A considerable part of the activities carried out by the working group on direct debits focused on the implementation of the pan-European project (SEPA Direct Debit Scheme), which is scheduled to be launched in November 2009.

The working group on credit transfers devoted a considerable share of its work to monitoring the operation of SEPA transfers – started on 28 January 2008 – and to resolving the problems experienced on its launch and on the migration of operations from the national Interbank Electronic Transfer system to the SEPA format.

In order to ensure a wide dissemination and understanding of different issues on payment systems, of interest to the Portuguese banking community, several meetings were held, to which all institutions were invited.

### 8.3.3. Regulation and control of means of payment

With regard to regulations and control of means of payment, mention should be made to interventions in the following areas in 2008: (i) participation in legislative initiatives on payment systems; (ii) preparation of rules within the scope of Banco de Portugal (Instructions); (iii) signing of contracts with entities participating in the payment system; (iv) preparation of booklets on payment systems; (v) management of the list of risk cheque users, and (vi) assessment of complaints by bank customers on matters related to means of payment. In this respect, mention should be made to:

- Decree-Law No 125/2008 of 21 July, laying down the rules on penalties applicable to infringements as referred to in Regulation (EC) No 1781/2006 of the European Parliament and of the Council on information on the payer accompanying transfers of funds.
- Preparation of a draft decree-law aimed at transposing Directive 2007/64/EC of the European Parliament and of the Council on payment services in the internal market, whose public consultation was launched in February 2009.
- Publication of Instruction of Banco de Portugal No 36/2007 (BOBP No 1 of 15 January 2008) amending the SICOI Regulation, adapting this regulation, in particular as regards the close of clearing sessions, to the processing of SEPA Credit Transfers.
- Introduction of changes in the legal system governing the cheque and its technical specifications (Instruction of Banco de Portugal No 26/2003 as amended by Instruction of Banco de Portugal No 11/2008 published in BOBP No 8 of 18 August). From the user's perspective, the two most relevant changes are: the pre-printing of the euro symbol (€) on the front of cheques is now optional; and the new cheques may be non-endorsable if the wording "not to the order of" is printed on them.
- Introduction of changes in Instruction of Banco de Portugal No 25/2003 – for compliance with the SICOI Regulation – to meet the harmonised conditions regulating the operation of TARGET2.
- Revision of rules on the opening and operation of current accounts with Banco de Portugal, including a new module for the management of settlements called *Aplicativo de Gestão Integrada de Liquidações* – AGIL (application for the integrated management of settlements) allowing entities not participating directly in TARGET2 to open and operate accounts with Banco de Portugal in order to comply with the reserve requirements, and to carry out cash and correspondent banking operations.

- Preparation of legal instruments regulating payments by national credit institutions to LCH. Clearnet and NYSE Euronext, during the migration period to TARGET2, with the drawing up of the “declarations/terms of liability” of these institutions and preparation of the terms of the agreements concluded between Banco de Portugal and LCH.Clearnet, and NYSE Euronext.
- Preparation of the “declaration” to be signed by national credit institutions participating in the EBA’s STEP2 system formalising the acceptance of the settlement of EBA’s balances, resulting from operations using SEPA Credit Transfers, by debiting these participants’ accounts with Banco de Portugal in the payment module of the SSP of TARGET2, and, to the same end, drawing up of the contract to be signed with EBA, the entity operating the STEP2 SCT system.
- Drawing up of contracts for the connection of the ancillary systems Interbolsa and Mercado Ibérico de Electricidade (Iberian Electricity Market - MIBEL) to TARGET2-PT, in accordance with the specifications foreseen in the Harmonised Conditions for Participation in TARGET2.
- Publication of booklet number 9 of Banco de Portugal entitled “*Abertura e Movimentação de Contas de Depósito*” (opening and operation of bank accounts).
- Within the framework of the European Commission, participation in the work that led to the redrafting of Regulation 2560/2001 of the European Parliament and of the Council of 19 December 2001 on cross-border payments in euro, and of Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit of and prudential supervision of the business of electronic money institutions. The work on the interpretation and harmonisation of the issues regulated by the Directive 2007/64/EC of the European Parliament and of the Council should also be mentioned.

As regards the tasks entrusted to the Bank under the legal framework governing the cheque without provision (Decree-Law No 454/91 of 28 December) and in the context of the protection of this payment instrument, 58,692 entities were listed as risk cheque users, 2,904 more than in 2007.

On 31 December 2008, the list of risk cheque users included the names and denominations of 85,740 entities, reflecting an increase of 234 entities from 2007 (85,506).

In the use of the powers conferred on the Bank regarding restrictions on the use of cheques, a total of 20,097 proceedings were started in 2008, resulting in the removal of the names of 11,941 entities from the list of risk cheque users, and in the annulment of the names of 5,189 entities from the same list.

The regional network of Banco de Portugal was responsible for approximately one third of these cases – 5,343 removals and 788 annulments. The public information desks of Banco de Portugal that provide information to the public on restrictions on the use of cheques were visited by a total of 37,183 users in 2008, namely 15,889 visitors to the head office and 21,294 to the regional network.

Banco de Portugal, in addition to receiving the complaints submitted by bank customers, has continued to ensure the processing of complaints that fall within the scope of Decree-Law No 156/2005 of 15 September, namely as regards bank cards, cheques, direct debits, credit transfers and payment infrastructures.

4,250 complaints were submitted, compared with 2,830 in 2007, accounting for an increase of nearly 50%.

These complaints were related to: bank cards (1,830), cheques (1,398), direct debits (160), credit transfers (440), payment infra-structures (342) and other (80), the latter for reasons not directly related to payment instruments or payment systems.

In 2008, 4,174 complaints were finalised, compared with 3,202 in the previous year, and 458 complaints, were pending at the end of the year, vis-à-vis 256 at the end of 2007.

## 8.4. Monetary policy operations and management of the European Central Bank's foreign reserves

### 8.4.1. Single monetary policy implementation

In 2008 the operational framework for the implementation of the Eurosystem's monetary policy was flexible and comprehensive, efficiently addressing renewed financial market instability. Access by a broad range of institutions to central bank money, acceptance of a wide range of assets eligible for monetary policy operations, recourse to a marginal lending facility that does not carry a significant negative connotation, the minimum reserve system and large amounts provided through open market operations (with various maturities and which may be conducted through somewhat quicker procedures), together with other conjunctural measures, made it possible to successfully accommodate strong pressures on the euro area banking system. In its interventions over the year, the ECB always aimed to comply with the principle of separation between liquidity management and monetary policy stance.

In the first half of 2008, amid strong economic growth and ongoing upward risks to medium-term price stability in the euro area, together with the abatement of financial market tensions, the ECB showed a tightening bias in the Eurosystem monetary policy. In July 2008 the monetary authority raised the key Eurosystem interest rates by 25 basis points (b.p.), setting the interest rate on the main refinancing operations (MROs) at 4.25%. Following this increase, the Eurosystem monetary policy stance was neutral, although the ECB continued to show some concern regarding the fact that the inflation rate was above the level consistent with medium-term price stability.

Amid strongly deteriorating global macroeconomic environment, due to the rapid transmission of the financial crisis to the real economy after Lehman Brothers' bankruptcy in mid-September 2008, financial market turbulence intensified swiftly, which led to further disruptions in the functioning of the money market. In this context, the Eurosystem adopted additional measures aimed at ensuring that solvent credit institutions would continue to have access to liquidity, in order to carry on their business activity. To this end, the ECB increased liquidity provided through MROs by allotting amounts significantly above the benchmark amount, and widened the range of eligible counterparties for liquidity fine-tuning operations, in order to include all counterparties eligible to participate in standard tenders. On 8 October the ECB announced that the MROs would be conducted through fixed rate tenders with full allotment and that the width of the interest rate corridor set by the marginal lending facility and the deposit facility would be reduced from 200 to 100 b.p., maintaining a symmetric corridor in relation to the interest rate on the MROs. On the same date, the ECB, together with other central banks of major world economies, reduced its key interest rates by 50 b.p. The interest rate on the MROs was set at 3.75% and interest rates on the deposit facility and the marginal lending facility at 3.25% and 4.25% respectively.

Subsequently, on 15 October the ECB conveyed to the market that, from that date onwards and similarly to MROs, all longer-term refinancing operations (LTROs) would be conducted through fixed rate tenders with full allotment. At the same time, the ECB also decided to increase the frequency of such operations, by conducting twice a month three-month LTROs and once a month a six-month LTRO and a LTRO with a maturity equal to the length of the reserve maintenance period. This increase in the longer-term liquidity provision to the banking system was complemented by the expansion of the list of assets eligible to be used as collateral in Eurosystem credit operations.

The ECB also increased the reciprocal currency arrangement (swap line) with the US Federal Reserve System, with the aim of increasing US dollar funding to Eurosystem counterparties, through the full allotment of bid amounts with various maturities, repurchase operations collateralised by assets eligible to be used in Eurosystem monetary policy operations or EUR/USD foreign exchange swaps. Moreover, the ECB started to provide Swiss franc liquidity through foreign exchange swaps, under a swap arrangement established with the Swiss National Bank.

The inflationary spiral in the first half of 2008 gave rise to a disinflationary period resulting, on the one hand, from the strong reversal of the upward trend in commodity prices (particularly oil and food) and, on the other hand, from the intensification of the financial crisis, which posed higher downside risks to economic growth. In this context, at the Governing Council meetings in November and December, the ECB lowered further its key interest rates by 50 and 75 b.p. respectively, setting the interest rate on the MROs at 2.50% at the end of the year. In January 2009 the ECB lowered further the interest rate on the MROs by 50 b.p. and restored the width of the standing facilities corridor to 200 b.p., setting its main key rate at 2%, which is a historical low, and interest rates on the deposit facility and the marginal lending facility at 1% and 3% respectively.

#### 8.4.1.1. Liquidity management

In a context of intensifying financial market turbulence, activities related to Eurosystem liquidity management and euro money market monitoring in 2008 continued to play a central role in single monetary policy implementation. In the field of liquidity management, the forecast of autonomous factors, which include factors governing the supply of reserves that are not under the direct control of central bank liquidity management, continued to be crucial, given that the conduct of open market operations and its efficiency depend on the correct assessment of overall liquidity needs of the euro area banking system. The permanent monitoring of euro money market conditions and a stronger communication policy towards market participants made it possible to respond in a timely and efficient manner to tensions in the euro area as a whole and in individual countries. In this context, Banco de Portugal continued to closely monitor the participation of resident counterparties in the money market through daily contacts. Banco de Portugal also organised several meetings with banks within the scope of the Contact Group.

#### Eurosystem

With regard to liquidity management, average daily liquidity needs of the euro area banking system in 2008 amounted to €487 billion, 10% higher than in 2007. This increase reflected the cumulated effects of simultaneous growth in reserve requirements and autonomous factors.

Average daily reserve requirements increased by 12% to €211 billion, with growth decelerating from the previous year. Average daily deposits held by institutions, for the purpose of fulfilling reserve requirements, reached €213 billion, i.e. €23 billion higher than in 2007.

The behaviour of autonomous factors continued to strongly shape developments in liquidity needs of the euro area banking system. Autonomous factors<sup>4</sup> contributed on average €275 billion to the interbank liquidity deficit of the Eurosystem, €23 billion more than in the previous year. The increasing trend of liquidity needs stemming from autonomous factors was largely due to growth of banknotes in circulation, which absorbed on average €56 billion more, setting the year-on-year growth rate at 9%. In fact, although growth slowed throughout most of the year, strong demand for currency following the intensification of the financial crisis in mid-September led the year-on-year rate of change in the average balance to close to 12% in the last quarter. Therefore, in annual terms, the growth rate of banknotes in circulation stood virtually unchanged from 2007.

The quality of autonomous factor forecasts remained high for most of the year. For this reason, allotments in the interbank market through regular refinancing operations, particularly MROs, were broadly adequate to meet the liquidity needs of the euro area banking system. In the first three quarters of 2008 the deviation of autonomous factors from the forecast published on the

(4) Total autonomous factors adjusted for the share of each NCB in the ECB's capital. In 2008 this adjustment corresponded to €4.4 billion. Autonomous factors include the liquidity effect stemming from the foreign exchange swaps conducted through the swap lines between the ECB and other central banks.

allotment day of the MROs recorded an average absolute error of €1 billion, remaining virtually unchanged from 2007. However, heightened tensions in financial markets in the last quarter of the year led, in general, to some deterioration in the quality of autonomous factor forecasts in 2008 compared to the previous year, given that the average absolute error in annual terms stood at €3.8 billion at the end of the year.

## Portugal

Portugal the liquidity deficit that has characterised the banking system since 2006 widened in 2008, increasing from €1.9 billion in 2007 to €3.7 billion in 2008 in average daily terms. This was mainly due to an acceleration in growth of the balance sheet item associated with the Capital Share Mechanism (CSM) (asset position offset against the item banknotes in circulation), whose average balance increased by 27% to €13.7 billion.

Autonomous factors underlying the release of funds to the banking system up to 2007 were responsible for the absorption, in daily average terms, of €0.5 billion in 2008. This mainly resulted from the greater absorption of funds due to growth of banknotes in circulation and the sundry item “other autonomous factors”, which was only partly offset by the greater release of funds stemming from the increase in euro-denominated or foreign currency assets.

Since the euro cash changeover, the Banco de Portugal balance sheet item “banknotes in circulation” has edged upwards, mainly due to strong growth in the component associated with adjustments stemming from the CSM. In 2008 the average daily balance of “banknotes in circulation” increased by €1.2 billion, standing at €15.3 billion, of which €13.7 billion refer to the CSM, with an increase of €2.9 billion. This led to a decline in the average daily balance of banknotes in circulation to €1.7 billion, i.e. around half of that seen in 2007.

With regard to the remaining autonomous factor items in Portugal, the average balance of the sundry item “other autonomous factors” increased by 20%, to €7.4 billion, which also contributed to the greater absorption of funds. Turning to the release of funds to the banking system, the average balance of euro-denominated assets increased to €13.4 billion and foreign currency assets rose to €8.7 billion, with a cumulated impact on liquidity of around €1.1 billion.

The average balance of net intra-Eurosystem liabilities (items associated with the settlement of operations through TARGET) maintained its creditor position and, in contrast to the previous year, increased by €4.3 billion to €13.9 billion.

The average daily value of deposits held by resident institutions with Banco de Portugal to comply with minimum reserve requirements amounted to €4.2 billion, 11% higher than in 2007.

### 8.4.1.2. Open market operations

In 2008 the conduct of monetary policy operations was strongly conditioned by the financial market turbulence, which by limiting money market efficiency in terms of liquidity distribution among institutions, led to their greater recourse to Eurosystem operations.

## Eurosystem

In 2008 the average daily balance of euro-denominated open market operations increased by 21%, to €533 billion, mainly due to higher allotments in LTROs. In fact, while the average daily balance of MROs stood at €202 billion (-23% from 2007), the average daily balance of LTROs increased by €152 billion to €335 billion, which contributed to the substantial increase in the average Eurosystem refinancing maturity. In aggregate terms, Eurosystem financing to counterparties stood almost permanently above liquidity needs, although it was regularly adjusted on the last day of reserve maintenance periods.

The ECB maintained a liquidity frontloading policy for MROs, enabling counterparties to fulfil their reserve requirements earlier in the maintenance period. Before the change in the method of allotment in October, the average allotment amount in MROs amounted to €175 billion, with allotments ranging from €128 billion to €250 billion. As from the MRO settled on 15 October, the allotment amount in MROs reached €291 billion on average, ranging from €210 billion to €340 billion. The number of counterparties was, on average, 354 up to the tender conducted on 7 October and 747 for the subsequent operations.

In the course of the year, the ECB increased the frequency of the three-month LTROs to a total of 20 (12 regular and 8 supplementary) operations. Up to September, both the indicative and allotment amount in three-month operations was €50 billion, excluding those conducted on 20 February and 12 March, which amounted to €60 billion. The average bid amount for these operations was €103 billion and the average number of counterparties reached 160. The first fixed rate three-month operation with full allotment was conducted on 29 October. The interest rate was set at 3.75%, the same as the interest rate on the MROs prevailing on that date, and €103 billion were allotted. The number of institutions which participated in this tender was 223. On average, the allotment amount in the fixed rate three-month LTROs with full allotment amounted to €64 billion and the average number of participants was 159.

In April, the ECB introduced the six-month LTROs, with a view to supporting the functioning of the money market, in a context of liquidity shortages in longer-term segments. Initially, two such operations were announced, one in April and the other in June, with an indicative amount of €25 billion each. Amid intensifying tensions in financial markets in mid-September, it was decided that the first six-month LTRO would be renewed in October, but with a higher indicative amount (€50 billion). Subsequently, the ECB decided to conduct, on a monthly basis, a fixed rate six-month LTRO with full allotment. Institutions seem to have been considerably less interested in this type of operation due to changes in the method of allotment for the MROs. In fact, 181 counterparties participated in the October operation – the highest number for the year – and afterwards the number of bidders declined significantly, to a minimum of 96 counterparties in December. Average bid amount stood at €74 billion, and the average allotment amount was €36 billion.

In September, the ECB announced a LTRO with a maturity of 38 days, conducted as a variable rate tender without any indicative amount. In this operation the ECB allotted €120 billion. Bid amount amounted to €142 billion and the number of bidders was 210. In October, the ECB announced the systematic renewal of this type of operation, with a maturity equal to the length of the maintenance period and a method of allotment similar to that for MROs and other LTROs. Afterwards, the average number of participants was 97 institutions, which, on average, had recourse to €78 billion.

In 2008 the ECB continued to conduct liquidity-providing and liquidity-absorbing fine-tuning operations on an ad hoc basis to manage liquidity conditions in the market and to steer very short-term interest rates. In total, 25 fine-tuning operations were conducted (1 more than in 2007), of which 17 were liquidity-absorbing operations and 8 were liquidity-providing operations. Out of the 25 operations, 11 liquidity-absorbing operations and 1 liquidity-providing operation were conducted on the last day of the reserve maintenance period. In addition, 2 liquidity-absorbing operations were conducted at the beginning of the year, in order to sterilise excess liquidity arising from operations conducted in December 2007; 2 liquidity-providing operations were conducted prior to TARGET2 Easter holidays and on the last day of the first quarter; and several liquidity-providing (5) and liquidity-absorbing (4) operations were conducted in September and October, following heightened money market tensions. Most fine-tuning operations were overnight; however, two liquidity-providing operations with longer maturity, 5 and 6 days, were conducted on 20 March and 9 October respectively.

Excluding the last two liquidity-absorbing operations conducted at the end of the reserve maintenance periods ended in November and December, all other liquidity-absorbing operations were conducted

through the collection of deposits, with a fixed rate equal to the rate on the MROs. However, in the November and December operations, the ECB conducted a variable rate tender with a maximum bid rate equal to the rate on the MROs. Amounts allotted by counterparties in liquidity-absorbing operations ranged from €14 billion to €200 billion. The number of counterparties that participated in these operations ranged from 7 to 117, and was higher in the operations conducted after September, as well as in the two operations conducted at the beginning of the year. In annual terms, the average number of participants per operation increased from 31 to 50 institutions.

All liquidity-providing operations, with the exception of the last one on 9 October, were conducted as a variable rate tender, without any indicative amount and with a minimum bid rate equal to the rate on the MROs. In these operations, allotment amounts ranged from €9 billion to €70 billion, with an average number of participants of 48 institutions, 5 more than in 2007. In the operation of 9 October, the ECB allocated the full amount of funds requested by institutions at a fixed rate equal to the rate on the MROs.

The ECB continued to conduct liquidity-providing operations in US dollars to Eurosystem counterparties under the US dollar Term Auction Facility established with the US Federal Reserve at the end of 2007. This type of operation was temporarily suspended in late January, and was resumed at the end of March. Amid the intensifying financial crisis, the ECB enhanced the provision of liquidity and diversified operation maturities, conducting tenders with maturities ranging from overnight to three months. Moreover, this type of operation started to be conducted with full allotment. In October the ECB introduced the provision of US dollar liquidity through EUR/USD foreign exchange swaps, in parallel with operations under the US dollar Term Auction Facility and with similar maturities, types of rate (fixed swap points) and with full allotment. However, the counterparties' interest in foreign exchange swap operations was little compared to repurchase operations, which led the ECB to announce its suspension from late January 2009 onwards. In daily average terms, the outstanding amount of operations conducted in 2008 under the US dollar Term Auction Facility stood at USD 86 billion and foreign exchange swap operations at around USD 3 billion.

Under an arrangement established in October with the Swiss National Bank, the ECB also started to conduct Swiss franc liquidity-providing operations in the form of EUR/CHF foreign exchange swaps. Operations were conducted with a one-week and three-month maturities, to the indicative amount of €20 billion and €5 billion respectively. The average daily outstanding amount of operations since their establishment has amounted to €14 billion.

## Portugal

The greater participation of counterparties resident in Portugal in Eurosystem refinancing operations led to a significant increase in the average daily balance of refinancing to €3,888 million, i.e. nearly six times higher than in 2007. The structure of balance per maturity shows, similarly to the Eurosystem, an increase in the average maturity of refinancing, which was particularly marked in the first three quarters of the year. However, in the last quarter of the year, greater preference for recourse to MROs, largely due to the ECB decision to provide unlimited fixed rate liquidity in this type of operation, led to a substantial reduction in the average refinancing maturity, which, in annual terms, increased only slightly from 2007. On 31 December 2008 the balance of resident institutions in Portugal in Eurosystem refinancing operations reached an historical high of €10,210 million.

At least one resident institution in Portugal participated in all MROs conducted in 2008, and the average bid amount increased to €1,150 million, reflecting an average participation of 5 institutions per operation, 3 more than in 2007. Participation increased significantly starting from the date when the ECB changed the method of allotment for MROs. Therefore, between 15 October and the end of the year, the average bid amount totalled €3,479 million and the average number of participants

in each operation stood at 10. Greater participation of resident institutions in MROs was also characterised by the strong increase in the total number of bids submitted to Banco de Portugal, which amounted to 391, i.e. 290 more than in 2007. As a result of the greater tendency for resident institutions to participate in the MROs, the average refinancing balance in this type of operation increased to €1,005 million, i.e. €816 million more than in 2007.

A number of resident institutions also participated in the one-month LTROs after their introduction in September 2008. The average number of participants in the 3 operations conducted in 2008 was 2 institutions, with a total number of bids of 14. The average bid amount was €915 million and average allotment amounted to €908 million.

In the three-month LTROs, including regular and supplementary operations, the average bid amount in each operation by resident institutions stood at €693 million, and the average number of participants was 3. Resident institutions participated in all but two operations with this maturity conducted by the ECB over the year. Therefore, in the scope of these operations, 194 bids were submitted to Banco de Portugal, i.e. 116 more than in the previous year. The average daily balance reached €2,257 million, i.e. €1,732 million than in 2007.

The interest of resident counterparties in the six-month LTROs, which were introduced in April 2008, seems to have edged downwards over time and to be strongly affected by the ECB decision to allot unlimited funds in the fixed rate MROs. In fact, following significant demand for the first three operations, with an average bid amount of €631 million, bid amounts fell to €16 million in the November operation and no resident institution participated in the December operation. In annual terms, the total number of bids to Banco de Portugal in the scope of these operations was 37. The average daily balance stood at €485 million.

In 2008 resident institutions continued to participate in most fine-tuning operations, similarly to 2007 and in contrast to their past behaviour. Although resident institutions did not participate in all operations, their participation was more frequent in liquidity-absorbing fine-tuning operations. In average terms, bid amounts reached €1,067 million for liquidity-absorbing operations and €169 million in liquidity-providing operations. In liquidity-absorbing operations, around 91% of bid amounts were allotted, while in liquidity-providing operations that ratio was much lower. In fact, resident institutions only obtained funds in one liquidity-providing operation. Institutions participating in fine-tuning operations submitted 32 bids to Banco de Portugal, i.e. 14 more than in 2007.

Resident institutions did not participate in US dollar liquidity-providing operations in the form of repurchase operations, which had been initiated in December 2007 under the US dollar Term Auction Facility, up to the operation conducted on 14 October 2008. Since then, and up to the end of the year, at least one resident institution participated regularly, although overall bid amounts for each operation remained low. On average, and taking into account only those operations in which there was demand, bid amounts were slightly below USD 30 million. Up to the end of the year, resident institutions did not participate in US dollar and CHF liquidity-providing foreign exchange swap operations, which were initiated in late October 2008.

#### **8.4.1.3. Standing facilities**

Eurosystem counterparties may use two standing facilities on their own initiative to obtain overnight liquidity against eligible collateral or to place overnight deposits with the Eurosystem.

In 2008 recourse to Eurosystem standing facilities increased significantly from the previous year. Trend growth had been recorded in the last months of 2007, following the onset of the financial market turbulence. However, amid heightened money market tensions and decreasing interbank transactions, demand for liquidity to cover interbank positions increased significantly. In this context,

given the malfunctioning of the interbank market, the ECB decided to enhance its intermediation role within the financial system by satisfying all counterparty bids for all refinancing operations. This situation resulted in overall excess liquidity, which was reflected in the wide use of the deposit facility, given that counterparties holding excess funds preferred to keep them or deposit them with the central bank. Moreover, as a negative secondary effect of the narrowing of the corridor formed by the interest rates on standing facilities, which aimed at stabilising very short-term interest rates, incentives for counterparties to place their excess liquidity positions in the market declined. In turn, efficiency losses in the money market as an intermediation and liquidity distribution channel caused some difficulties for institutions to obtain market financing, leading them to turn to the Eurosystem marginal lending facility.

## Eurosystem

Within the Eurosystem, the average daily amount provided through the marginal lending facility reached €1.2 billion up to mid-October and €6 billion from then onwards and up to the end of the year. In annual terms, the average daily balance was €2.3 billion, around 10 times higher than in 2007. Changes in the average amount absorbed through the deposit facility were significantly higher, amounting to €5.6 billion up to 14 October and €232 billion subsequently. In annual terms, the average daily balance was €49.8 billion, nearly 100 times higher than in 2007.

## Portugal

In the first half of the year, exclusive on-and-off recourse to the deposit facility continued to be observed in Portugal. Between July and mid-September, this recourse became more frequent, but daily amounts were small. From mid-September onwards, large amounts were deposited in several days, peaking at €2 billion on 30 September. On average, up to 14 October the average daily balance of the deposit facility was €22 million, increasing to €209 million from then up to the end of the year. In annual terms, the average daily balance of recourse to the deposit facility by resident institutions in Portugal reached €58 million, i.e. €54 million more than in 2007. This corresponded to a total of 243 bids submitted by institutions to Banco de Portugal, 229 more than in 2007. Moreover, between 8 October and mid-December, recourse to the marginal lending facility was observed on a nearly daily basis, with an average daily value of €15 million. In annual terms, a total of 46 bids were submitted to Banco de Portugal for access to the marginal lending facility. It should be noted that resident institutions in Portugal had not used this type of facility since September 2004.

### 8.4.1.4. Eligible Assets

As at 31 December 2007 the overall nominal value of marketable eligible assets included in the Single List amounted to around €15,670 billion, accounting for an increase of approximately 61.8% compared to one year earlier (€9,687 billion).

Likewise, the number of securities included in the Single List increased significantly, from a total of 25,597 in 2007 to 48,458 in 2008 (+89.3%). Behind this was the Governing Council's decision, in October 2008, to lower the minimum credit threshold for eligible assets to be used in the Eurosystem's credit operations (from "A-" to "BBB-", with the exception of asset-backed securities, for which the "A-" credit threshold remains in force). In turn, strong demand for collateral, due to the intensifying financial crisis, resulted in increasing issuance of securities, which seems to have also contributed to a rise in available securities.

Taking into account the weight of each central securities depository in the aggregate (nominal) value of (marketable) eligible assets registered in the euro area, International Central Securities Depositories (ICSD) Euroclear Belgium and Clearstream Luxembourg held, as a whole, the largest share of holdings (40.4%). The main national central securities depositories in the euro area were

Clearstream Frankfurt, whose weight declined vis-à-vis 2007 (from 25.9% to 17.7%), Euroclear France (which increased from 14.4% to 15.9%) and Monte Titoli (which declined from 14.1% to 9.9%). The relative share of eligible securities registered in Portuguese central securities depositories (Interbolsa and SITEME) stood at 0.8% of the overall value.

Similarly to the Eurosystem as a whole, developments in the overall amount of (marketable) eligible assets proposed by Banco de Portugal increased significantly (+37.1%) from 2007, reflecting greater demand for collateral in response to resident counterparties' needs, as a result of new issues (mainly covered bonds and commercial paper). Debt securities issued by the central government (Treasury bonds and bills) continued to account for the greatest share of collateral (72.4%), although below that seen in previous years. The weight of bonds issued by resident credit institutions increased to 23.5% (from 5.7% a year earlier). At the end of 2008 the share of corporate bonds and instruments issued by the local/regional government in the overall debt instruments included by Banco de Portugal was very small, at 3.5% and 0.76% respectively.

Compared to the Eurosystem, the concentration by type of debt instrument continued to be very high in Portugal, albeit somewhat lower than in the past few years. In fact, in Portugal, bonds continue to account for 64.8% of total instruments. In turn, in the Eurosystem the average value was 45.4%, Medium-Term Notes (MTN) accounted for 28.5% (12.6% in Portugal), Pfandbriefe-style securities for 11.5% (equally to Portugal), securitised debt instruments (asset-backed securities and residential mortgage-backed securities) for 8.5% (0.0% in Portugal) and short-term instruments (Treasury bills and commercial paper) for 6.4% (11.1% in Portugal).

In annual average terms, the use of (marketable and non-marketable) eligible assets in Eurosystem credit operations by resident counterparties reached around €12,848 million, accounting for an increase of more than 260% from 2007. The previous two years (2006 and 2007) were characterised by a decreasing use of assets by resident counterparties (-15.4% and -38.5% respectively). Greater participation by resident counterparties in Eurosystem liquidity-providing operations was accompanied by an increase in the relative weight of recourse to assets registered in foreign central securities depositories, which amounted to around 86% of the total.

After the implementation of the pooling system in January 2007, the aggregate value of collateral pooled for monetary policy operations by resident counterparties edged upwards. This trend was more marked following the onset of financial markets turbulence in August 2007 and was only partly reversed later that year, in December, and, more recently, in February 2008. Afterwards, it grew again and consolidated in the course of the second half of the year. At the end of 2008 the number of individual pools amounted to 20, while in the beginning of the year it had stood at only 8. In terms of value, the total collateral included in the pools exceeded €21.3 billion at the end of 2008 (compared to €4.4 billion in December 2007). With regard to their composition, asset-backed securities were used the most, accounting for 61.9% of the average overall pool constituted in 2008 (19.2% in 2007). The weight of public debt declined and, for the first time after October 2008, credit claims in the form of bank loans were used by resident counterparties. Moreover, the eligibility status of commercial paper issues has changed, as these instruments started to be traded in a regulated market (Euronext Lisbon) in December.

Within the framework of the Correspondent Central Banking Model (CCBM), recourse to securities registered in Portugal by counterparties located in the European Union totalled approximately €10,636 million, accounting for an increase of around 27.5% vis-à-vis the 2007 average.

In contrast to previous years, in 2008 collateral registered with Portuguese central depositories was mostly used by counterparties set up in Germany (36.7%), followed by the United Kingdom (35.7%) (accounting for 52.5% of collateral mobilised on a cross border basis one year earlier), Luxembourg (8.3%), France (5.7%) and Ireland (5.0%). In 2008 counterparties from Cyprus,

Netherlands, Finland and Malta also made regular use of assets registered with Portuguese central depositories.

#### **8.4.1.5. Changes in the Eurosystem collateral framework**

During the year under review, particularly in the second half, the Eurosystem announced a number of changes in its collateral framework, as explained below.

On 4 September 2008 the ECB published a press release announcing the result of the biennial review of the risk control measures applied in Eurosystem credit operations. Subsequently, the following changes were introduced: (i) revision of valuation haircuts applied to marketable assets, particularly unsecured debt instruments issued by credit institutions and asset-backed securities; (ii) extension of the definition of “close links” to asset-backed securities in order to include situations where support is provided through a currency hedge or via liquidity support; (iii) introduction of transparency requirements regarding credit assessments issued by eligible External Credit Assessment Institutions, particularly for asset-backed securities; and (iv) reinforcement of the discretionary powers of the Eurosystem, recalling that it has the possibility to limit or exclude the use of certain assets as collateral for its credit operations, also at the level of individual counterparties. The implementation of these measures motivated the release of a new version of “The implementation of monetary policy in the euro area – General Documentation on Eurosystem monetary policy instruments and procedures” (referred to as General Documentation (November 2008 version)), and the publication, on 16 February 2009, of a new version of Instruction No 1/99 in the Official Bulletin of Banco de Portugal. These changes entered into force on 1 February 2009.

With a view to improving conditions for euro area counterparties to access liquidity, the ECB published a press release on 15 October 2008, announcing measures to temporarily expand the Eurosystem collateral framework. The announced measures were: (i) reduction of the credit threshold to “BBB-“ (with the exception of asset-backed securities, for which the credit quality threshold of “A-“ remains in force); (ii) inclusion in the single list of marketable assets issued by credit institutions, traded on non-regulated markets accepted by the ECB; (iii) acceptance of subordinated debt instruments when they are protected by an acceptable guarantee as specified in the General Documentation; and (iv) acceptance of marketable debt instruments denominated in US dollars, pound sterling and Japanese yen. The inclusion of these assets entails the fulfilment of the remaining eligibility criteria defined in the General Documentation, e.g. issuance in a central securities depository located in the European Economic Area and settlement within the euro area. Measures from (i) to (iii) entered into force on 22 October 2008 and measure (iv) was implemented on 14 November 2008. These measures shall remain in force up to the end of 2009. In order to provide a regulatory framework for these changes, the ECB published Guideline ECB/2008/18 of 21 November, which was transposed by Instruction of Banco de Portugal No 19/2008 of 27 November 2008.

Finally, in addition to these changes in the Eurosystem collateral framework, the Eurosystem informed market participants, via two press releases issued on 17 July 2008, of the launching of two projects (CCBM2, Collateral Central Bank Management and TARGET2-Securities), which will positively affect the operational framework of its credit operations. The CCBM2 project aims at developing a single platform within the Eurosystem to manage collateral mobilised for Eurosystem credit operations. The TARGET2-Securities project will make it possible to pool pan-European securities in a single borderless structure, providing a core, neutral and state-of-the-art settlement process.

#### **8.4.1.6. Minimum reserve system**

In 2008 the average value of monthly minimum reserves in Portugal increased by 10.2% from 2007 (the sharpest since 2002), amounting to €4,146 million. The total reserve base increased by

11.8% and, in line with previous years, the liability structure of resident credit institutions continued to shift towards liabilities subject to the reserve ratio of 0% (liabilities with a maturity of more than 2 years).

The average level of total excess reserves in Portugal in 2008 grew by 10% from 2007, amounting to €21.7 million. As a percentage of minimum reserves, the average level of excess reserves, in Portugal and in the Eurosystem, increased from 0.53% to 0.55% and from 0.48% to 0.51 respectively.

The frontloading behaviour displayed by credit institutions resident in Portugal, within the framework of minimum reserves, observed since the second half of 2007, was enhanced in 2008. Institutions subject to the minimum reserve system increased their average balances (above the minimum requirements) early in the maintenance period, linearly reducing balances throughout the maintenance period, benefiting from the averaging provision. This behaviour was particularly marked from September 2008 onwards, reflecting heightened uncertainty and therefore risk aversion, as well as spillovers in the money market.

Volatility in the daily compliance with the minimum reserve increased slightly in Portugal, in contrast to the decline observed in 2007. At the Eurosystem level, volatility also increased, particularly in the beginning and at the end of the maintenance period, reflecting the increased frontloading behaviour of institutions in compliance with minimum reserve requirements and greater recourse to the deposit of funds with the Eurosystem at the end of the maintenance period. Heightened volatility was particularly observed from September 2008 onwards, due to existing liquidity conditions.

In 2008 there were seven cases of non-compliance with the minimum reserve requirement in Portugal, which were subject to penalties. Compared to 2007, the number of cases of non-compliance remained unchanged, but their magnitude declined. With regard to the Eurosystem,<sup>5</sup> and compared to the previous year, the number of non-compliances increased slightly, while the total amount of penalties increased significantly.

#### 8.4.1.7. Institutions subject to minimum reserves and eligible counterparties

In Portugal, at the end of 2008 a total of 175 credit institutions were subject to the minimum reserve system. Among these, only 74 (42% of the total) complied with the minimum reserves on a direct basis, while the other 101 (in their near entirety, mutual agricultural credit banks - *Caixas de Crédito Agrícola Mútuo*) held minimum reserves through an intermediary.

Around half of the credit institutions that comply directly with minimum reserves in Portugal fulfil the operational criteria regarding the access to the Eurosystem monetary policy operations. With respect to open market operations, standing facilities and the issuance of ECB debt certificates, 46% of the above mentioned entities (34 entities) are authorised to participate in these operations.

The Governing Council of the ECB has decided that, from 6 October 2008 until further notice, all institutions that are eligible to participate in open market operations based on standard tenders and that fulfil additional operational or other selection criteria specified by the respective national central bank will also be eligible to participate in fine-tuning operations.

On 15 October 2008 the ECB announced that the Eurosystem would start providing USD and CHF liquidity through foreign exchange swaps against euros to the Eurosystem counterparties selected to participate in foreign exchange swaps according to Appendix 3 of the General Documentation and which provide their standard settlement instructions (SSIs) in these currencies. In addition, counterparties eligible for USD liquidity-providing operations through repurchase agreements are also deemed eligible for the above-mentioned foreign exchange swap operations.

(5) Preliminary data for the last two maintenance periods of the year.

#### 8.4.1.8. Euro money market

Contrary to initial expectations, the problems in the euro money market which emerged in August 2007 continued into 2008. The reluctance of banks to lend to each other, resulting from losses by financial institutions due to the financial market turbulence triggered by the US sub-prime mortgage market crisis, worsened throughout 2008, as problems spread to other sectors of the economy and financial market segments.

In early 2008 unsecured money market interest rates declined significantly compared to the levels prevailing at the end of 2007. This reflected abating financial market tensions, as well as the measures taken by the ECB to normalise the functioning of the money market. However, amid a positive outlook for the economic activity and the existence of strong short-term upward pressure on price stability, euro money market interest rates started an upward trend. This fact anticipated the adoption by the ECB of a tighter monetary policy, which culminated in an increase in the key ECB interest rates in July 2008.

After a period of relative stability, financial market turbulence heightened and became widespread by mid-September 2008, and the money market slowed to a virtual standstill. This led to a strong rise in unsecured money market interest rates (such as EURIBOR), which reached historic highs in early October in most maturities. At the same time, risk premia increased further, substantiated in the widening of spreads between unsecured and secured money market interest rates (such as interest rates derived from the EONIA swap index or EUREPO) of a comparable maturity, which also reached their highest figures since the start of the financial crisis in August 2007. Likewise, the substantial widening of the spread between the EURIBOR rates and expectations for the key ECB interest rates, in parallel with the virtual absence of money market transactions in maturities above one week, led to the loss of effectiveness of the monetary policy transmission mechanisms. In fact, due to the virtual absence of interbank market transactions, the EURIBOR no longer correctly reflected the market situation or market participants' expectations for the future evolution of the key ECB interest rates, thus limiting the ECB's ability to influence one of the main benchmarks for the cost of bank lending to the economy.

Thus, against a background of a dramatic deterioration of the functioning of financial markets worldwide, measures to strengthen the financial system were intensified both by central banks that significantly reduced interest rates and increased the injection of liquidity into the market, and by governments, through the granting of guarantees on bank debt issuance. These measures helped improve euro money market conditions. In this context, the EURIBOR started a sharp downward trend that persisted until the end of the year. Nonetheless, the confidence of money market participants is taking time to recover, with risk premia remaining at levels above those prevailing before the financial crisis worsened, and amounts traded in different maturities staying at much lower levels than in the period before August 2007.

The volatility of very short-term interest rates remained at historically high levels, against a background of continuing tensions in the money market. The EONIA continued to show significant positive and negative spreads against the interest rate on the MROs, maintaining the pattern that had emerged in August 2007. These spreads were smaller in the first months of 2008. However, from mid-September 2008, amidst the intensification of the financial crisis, the EONIA became highly volatile, registering its largest positive spread (35 b.p. on 7 October) and negative spread (-55 b.p. on 14 October). It is also worth noting that, after the ECB introduced the full allotment of bid amounts in Eurosystem liquidity-providing operations, the EONIA remained consistently below the MROs rate. The EONIA reached an annual peak of 4.601% on 7 October and a low of 2.225% on 24 December. Similarly to the longer money market maturities, the average daily volume of transactions underlying the computation of the EONIA also fell markedly in the last quarter of 2008

compared to amounts traded until that date. In the first three quarters of the year, the daily average volume of transactions reached around €51.5 billion, dropping to €35.4 billion in the last quarter of the year. In annual terms, this helped the daily average volume remain broadly unchanged at around €48 billion compared to the previous year.

The downturn in euro money market activity was significant and particularly marked in the longer maturities. The results of the Euro Money Market Survey conducted by the Eurosystem in July 2008, which covers the second quarter of the year, thus not including information on the most critical period of the crisis, had already shown a decrease of around 5% in aggregate turnover by comparison with the same quarter of the previous year. The overall amount reported was lower than in 2006, particularly in the unsecured market, repo market, and overnight index swap market segments. However, activity increased in some segments, such as forward rate agreements and interest rate swaps.

As in previous years, Banco de Portugal was responsible within the Eurosystem for collecting and processing data from resident counterparties. The data pointed to an increase of around 50% in the total amount traded owing to strong growth in activity in the unsecured and foreign exchange swap market segments.

Regarding transactions in the unsecured interbank money market carried out through SITEME (market electronic transfer system) – which is a platform for the registration and settlement of transactions managed by Banco de Portugal – the total volume traded in its last year of operation increased by 7.5% to €233 billion, i.e. the highest level since 2000. Overnight transactions continued to account for the largest share of this market's overall activity, with 98% of the total amount traded. The overnight rate of SITEME continued to follow suit developments in the EONIA, but remained at consistently lower levels. In 2008 the overnight rate of SITEME stood at levels above the EONIA in only four days. The average spread between the EONIA and the overnight rate of SITEME increased from 2.3 b.p. in 2007 to 8.2 b.p. in 2008. This increase largely resulted from a considerable widening of the spread after the financial market tensions intensified. In fact, in the last quarter of 2008, the average spread stood at 21 b.p., compared to 4 b.p. in the first three quarters.

#### **8.4.1.9. SITEME – Central securities depository**

SITEME's central securities depository (CSD) provides services related to the registration, control, clearing and settlement of monetary securities in the form of Treasury bills, commercial paper, ECB debt certificates and other marketable money market paper. However, since November 2004 the CSD only registers one type of debt securities – Treasury bills, i.e. short-term securities in book-entry form – issued by Instituto de Gestão da Tesouraria e do Crédito Público –IGCP (Portuguese Treasury and Government Debt Agency).

The allotment of Treasury bills is conducted through regular tenders in accordance with a pre-announced calendar. In 2008, IGCP conducted 22 Treasury bill tenders, which gave rise to a total amount of deposits of securities with SITEME of €17.5 billion, €15.3 billion having been placed on the primary market. At the end of 2008, 6 series of Treasury bills were registered in SITEME, with a nominal outstanding amount of €13.2 billion.

Total amounts settled in SITEME (transfers between different account owners) decreased 18% in comparison with the preceding year. This development seems to be associated with the deterioration in market liquidity due to the worsening of the financial crisis throughout the year.

#### **8.4.2. Management of the European Central Bank foreign reserves**

In 2008 the management of the ECB foreign reserves continued to be carried out in a decentralised way under an agency agreement between the ECB and the national central

banks of the Eurosystem, and in compliance with the rules, procedures and guidelines defined by the ECB.

Under the currency specialisation model, and for the third consecutive year, Banco de Portugal was responsible for the active management of a Japanese yen portfolio, which at the end of the year was equivalent to €1,014 million, according to the rules for the allocation of shares in foreign reserves.

During this period, the ECB changed the rules regarding the operation of gold accounts for rationalisation reasons and has now the exclusive right to operate them. This may be reversed if the ECB decides to actively manage this portfolio. This change did not affect the size of the reserve nor its allocation among the members of the Eurosystem.

In addition to the operational reserve management activity, Banco de Portugal continued to participate in the ECB Committees, Working Groups and Task Forces specialising in this area, namely regarding new investment instruments and methodologies to control credit and market risks, enhancing the rules and procedures to be complied with by portfolio managers, and the relationship between the ECB and its agents.

Preparations were made for the entry of one more country, Slovakia, into the euro area. The adoption of the euro as its official currency, according to the Rules and Agreements in force, impacted on the total amount of the ECB foreign currency reserves and on their management, considering that from the beginning of 2009 another active portfolio had to be managed.

## 8.5. Analysis and research

In the course of 2008, the economic analysis and research developed by Banco de Portugal continued to focus on three main objectives: advice to the Governor in the monetary policy decision-making process within the scope of the Eurosystem; analysis and forecast of the Portuguese economy; and analysis and monitoring of financial markets and systems, on both a macro-prudential and a microeconomic perspective.

Regarding the advice to the Governor, reference should be made to the regular monitoring of the euro area economy and its international background, as well as to technical opinions on all relevant matters in monetary policy discussions within the framework of the Eurosystem.

In 2008, Banco de Portugal published an analysis of the Portuguese economy for the year 2007 in its Annual Report, covering supply (including employment and unemployment), demand and external accounts, prices, public finances and the financial situation. During the year, the Bank also published the Financial Stability Report, which comprises an analysis of the macroeconomic and financial risks, as well as the financial situation of the non-financial private sector and the banking system.

In 2008, Banco de Portugal continued to publish the Economic Bulletin (winter, spring, summer and autumn issues). As in previous years, the Economic Bulletin, in addition to articles of a technical nature on several subjects, included articles on the economic situation and policies, namely estimates and forecasts for the Portuguese economy and analyses of the banking system. In particular, the Bank continued to develop and improve its macroeconometric forecasting and modelling tools.

In the course of the year, the Bank's research on the Portuguese economy covered different subjects, such as wealth effects on private consumption, job creation and destruction in Portugal, analysis of the efficiency of corporate hospitals, stabilisation policies, impact of changes in the civil servants' retirement rules, and several works on macroeconomic modelling.

The Monthly Economic Indicators continued to be published in 2008 according to the schedule announced at the end of 2007. This monthly publication presents the major indicators released

during the month, as well as the coincident indicators of economic activity and private consumption computed by Banco de Portugal. The results of the quarterly bank lending survey continued to be published on the Bank's website.

In 2008, the Bank's Working Papers Series continued to be released, with 23 new research articles published in the course of the year. An article on wealth series in Portugal was published in the series of Occasional Papers. Some of the research produced by the economists of the Economics and Research Department was published in international scientific journals, namely: *Journal of Political Economy*, *Económica*, *Labour Economics*, *Journal of Monetary Economics*, *European Economic Review*, *Economics Bulletin*, *Economic Modelling*, *Review of Economics and Dynamics*, *Kredit und Kapital*, *Journal of International Financial Markets*, *Journal of Mathematical Economics*, *Portuguese Economic Journal*, *Research in Labor Economics*, *Oxford Bulletin of Economics and Statistics*, *Journal of Labor Research*, *Managerial and Decision Economics*, *Journal of Banking and Finance*, *Applied Economics*, and *Scottish Journal of Political Economy*.

The economists of Banco de Portugal presented their work at international scientific meetings, such as the Annual Conferences of the European Economic Association, European Association of Labour Economists, Society for Economic Dynamics, European Society for Population Economics, among other conferences and seminars. The Bank's economists continued to be represented in the executive committees of several international scientific organisations, such as the European Economic Association.

Banco de Portugal has continued to ensure the institutional reporting and the representation in the Eurosystem's Committees and Working Groups on economic analysis and monetary policy issues. In particular, Banco de Portugal has participated in the Eurosystem's spring and autumn projection exercises. Furthermore, the Bank has participated in the Economic Policy Committee of the European Commission and in some of its working groups associated with structural issues, of interest to the Portuguese economy.

In 2008, Banco de Portugal continued to cooperate with national bodies, such as the Ministry of Finance and Public Administration and Statistics Portugal, and international organisations, such as the European Commission, the International Monetary Fund, the Organisation for Economic Co-operation and Development, the Eurostat and the Bank for International Settlements.

In 2008, the Bank continued to promote cooperation with Portuguese and foreign researchers, by hosting conferences, seminars and providing staff training. In the course of the year, 62 internal and external seminars and 3 short-term training courses took place at Banco de Portugal. In May 2008 the Bank held the fourth Conference on Portuguese economic development in the European area and in June the fifth Conference on Monetary Economics, organised by economists of the Economics and Research Department and attended by renowned national and foreign economists.

## **8.6. Statistical information**

### **8.6.1. Legal framework**

An updated Law of the National Statistical System (Law No 22/2008 of 13 May) was published in 2008. Among other provisions, this law recognises Banco de Portugal as statistical authority and sets out its tasks within the scope of the National Statistical System, in line with the Organic Law of the Bank. Pursuant to the provisions laid down in Article 13 of the Organic Law, Banco de Portugal shall ensure the collection and compilation of the monetary, financial and balance of payments statistics. These tasks are now formally recognised within the scope of the National Statistical System.

Under the terms of the new Law, the participation of Banco de Portugal in the National Statistical System does not prejudice the guarantee of independence resulting from its participation in the European System of Central Banks (ESCB), in particular as regards the cooperation with the European Central Bank (ECB) at the statistical level.

In fulfilment of the new legal framework, the Statistical Activity Plan of Banco de Portugal for 2009 was presented to the Statistical Council. This plan contains the strategic goals defined for the statistical function of the Bank in the three-year period from 2007 to 2009.

### 8.6.2. Dissemination and accessibility

In 2008 Banco de Portugal enhanced the dissemination of its statistical information and further improved its use.

Within the scope of the **BPstat | Statistics online** system, Banco de Portugal ensured the updating of the statistical information three times a day (i.e. at 9:30 a.m., 11:30 a.m. and 2:30 p.m.), the expansion of the existing metadata and statistical areas, and the introduction of new statistical domains.

In January Banco de Portugal started to disseminate in **BPstat** and in the Statistical Bulletin, statistical series on currency issuance, produced on the basis of data available at the Bank.

In November the monetary and financial statistics on the balance sheet and interest rates of monetary financial institutions started to be made available in **BPstat**, before being published in the Statistical Bulletin.

In 2008 four new statistical areas of the Eurosystem started to be available in **BPstat**: (i) harmonised indices of consumer prices; (ii) gross domestic product and major expenditure components; (iii) payments statistics and (iv) number of monetary financial institutions.

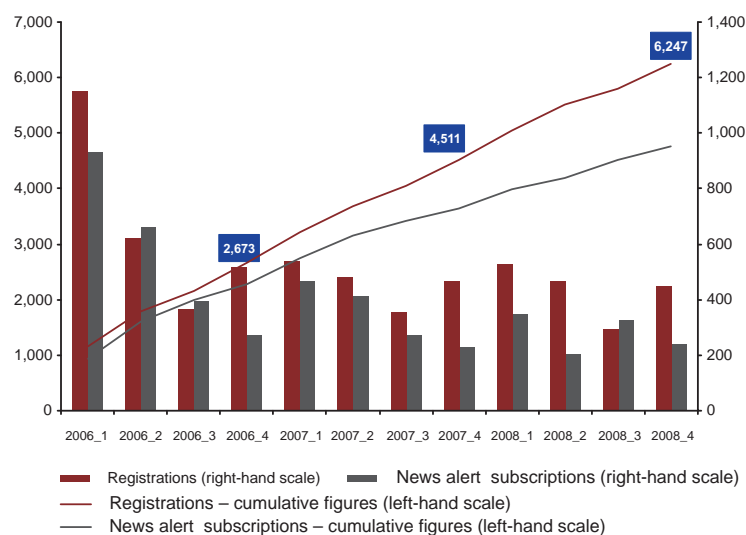
It should also be noted that the first integrated system for the management of the statistical metadata of Banco de Portugal was concluded.

The number of users registered with **BPstat** continued to increase in 2008, with 6,247 registered users on 31 December 2008.

The Statistical Bulletin, published by Banco de Portugal on a monthly basis, comprises nearly 5,000 statistical series grouped in 34 sections, each of them corresponding to a different statistical area. In the course of 2008 two new supplements to the Statistical Bulletin were published, aimed to contribute to a better use of the statistical information made available by Banco de Portugal:

- Supplement 1/2008 on “Simplified Reporting: inclusion of the Simplified Corporate Information in the Statistics of Non-Financial Corporations of the Central Balance-Sheet Database”, stemming from an oral communication by Banco de Portugal presented to the other national central banks and national statistics institutes of the European Union countries, at a meeting of the Committee for Monetary, Financial and Balance of Payments Statistics (CMFB), held in early 2008.

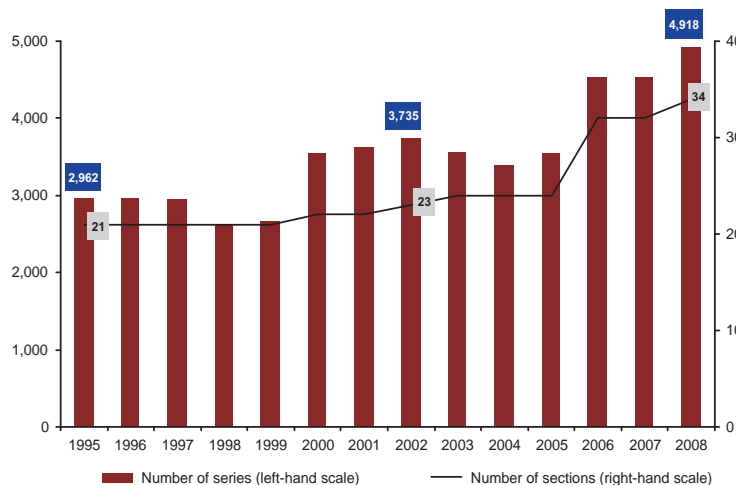
DEVELOPMENTS IN THE NUMBER OF REGISTERED USERS AND OF SUBSCRIPTIONS OF THE NEWS ALERT SYSTEM OF BPSTAT



- Supplement 2/2008 focusing on “Securities Statistics: Integrated System Features and Main Results”, containing a brief description of the *Sistema Integrado de Estatísticas de Títulos – SIET* (Securities Statistics Integrated System), methodological notes on the compilation of securities statistics, and the presentation of the main results for the 1997-2007 period, based on securities issues data.

Banco de Portugal also made some presentations at the Workshop on “Foreign Direct Investment Statistics”, organised by the Statistical Council, aimed at contributing to the identification of the statistical information available on the existence of foreign capital in the Portuguese economy and shedding light on the different ways of understanding this issue. This workshop gathered in the same discussion forum compilers and users of these statistics.

#### DEVELOPMENTS IN THE STATISTICAL BULLETIN



Finally, “Sigma - The Bulletin of European Statistics”, a magazine produced by Eurostat, published an article on the Portuguese experience in the field of the statistical function.

#### 8.6.3. Reporting to international organisations

As regards the reporting of statistical information to international organisations, 2008 was characterised by strict compliance with the reporting deadlines in the various information fields. 908 reports were sent to international organisations (i.e. an increase of 14% from 2007), namely: ECB, European Commission, IMF, OECD and BIS, totalling 865,000 series (i.e. an increase of 40% from 2007).

#### REPORTING OF DATA TO INTERNATIONAL ORGANISATIONS

	2006	%	2007	%	2008	%
Total reporting	673	Annual rate of change: 15%	799	Annual rate of change: 19%	910	Annual rate of change: 14%
deviation* = 0	472	70%	708	89%	737	81%
deviation* < 0	201	30%	89	11%	173	19%
deviation* > 0	0	0%	2	0%	0	0%
Total series	520,905	Annual rate of change: 4%	616,512	Annual rate of change: 18,4%	864,619	Annual rate of change: 40%

\* Deviation from the date foreseen in the reporting schedules.

#### 8.6.4. Institutional cooperation

One major achievement regarding the institutional cooperation was the development of *Sistema de Informação da Classificação Portuguesa das Actividades Económicas – SICAE* (Information System on the Portuguese Classification of Economic Activities). The main contributors to this project were Banco de Portugal, Instituto Nacional de Estatística – INE (Statistics Portugal), the Ministry of Justice, the Ministry of Finance and Public Administration, and the Ministry of Labour and Social Solidarity. The creation of this system was set out in Decree-Law No 247-B/2008 of 30 December 2008, which also provided for the creation and regulation of the “Company/Collective

Person Card”, which will be the relevant identification document of companies and legal persons and which will also include information on the CAE (Portuguese acronym for Classification of Economic Activities) code in the SICAE system. This system contains permanently updated and harmonised data on the Portuguese CAE code of legal persons and other comparable entities and is scheduled to be launched on 6 April 2009. From that date onwards, for the legal persons and other comparable entities, the CAE code in SICAE will be the only economic activity code valid for all legal purposes.

The participation of Banco de Portugal in the activity of the Statistical Council is also worthy of mention as the representatives of Banco de Portugal were the chairpersons of the Standing Section of Statistical Coordination and of four Working Groups: (i) Monetary and Financial Statistics; (ii) International Economic Relations Statistics, (iii) National and Regional Accounts and (iv) Labour Statistics. Another important aspect was the participation of the Bank in the work developed for the creation of a Single Units File of the National Statistical System (Portuguese acronym: FUESEN). This will be a single file supporting the preparation of statistics by all entities belonging to the National Statistical System, exploiting synergies and contributing to better information quality. The IES, the acronym for *Informação Empresarial Simplificada* (Simplified Corporate Information) and SICAE enabled the creation of a new and important working basis for the implementation of FUESEN, as very comprehensive sources with enhanced quality for the purposes of the Single Units File of the National Statistical System are now available.

Within the scope of the cooperation protocol signed in 2008 between Banco de Portugal and *Comissão do Mercado de Valores Mobiliários* (Securities Market Commission), the cooperation mechanisms in the compilation of statistical data have been reinforced. These two entities have agreed to: (i) allow mutual access to and exchange the information periodically received from the reporting institutions for statistical purposes, thereby avoiding any redundancy in the collection of information; and (ii) consult each other on draft regulatory projects that specifically govern the collection of information, when the fields of competence of both entities overlap.

In 2008 Banco de Portugal continued to participate actively in the production of General government statistics. The compilation and dissemination process of these statistics was consolidated, in articulation with INE and the Ministry of Finance, under the Institutional Cooperation Agreement established in 2006.

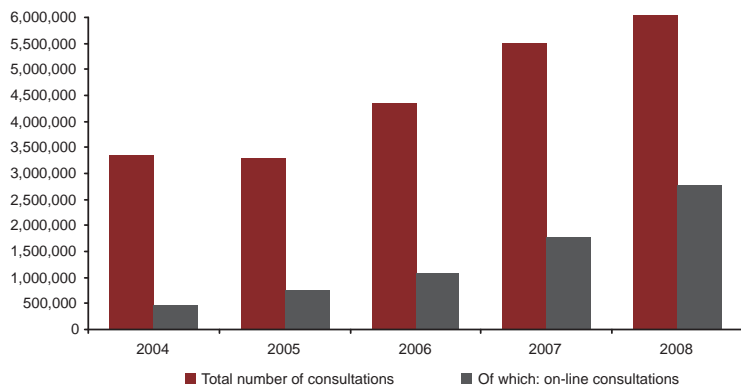
### 8.6.5. Central Credit Register

Banco de Portugal continued to ensure the functioning of the Central Credit Register – CCR (*Central de Responsabilidades de Crédito*) through the processing, control of statistical quality, centralisation and making available information relating approximately to 20 million credit liabilities records that are monthly received from the reporting institutions. CCR has continued to provide an extremely important service for the management of credit risk by the financial system and is of the utmost relevance for various functions performed by Banco de Portugal, namely: statistical exploration, supervision, analysis of financial stability and monetary policy.

The distribution of centralised information to the reporting institutions was made in full compliance with the annual schedule for 2008, which had been disclosed to all institutions at the end of 2007. The coverage of CCR, measured by the degree of participation of the credit institutions operating in Portugal, continued to be 100%, the figure recorded since mid-2004.

The utilisation of CCR by the reporting institutions as an instrument to assess risk in the granting of credit became increasingly important. Nearly 6.9 million consultations were made in 2008, i.e. an increase of 24% compared with 2007. On-line consultations increased by 56% from 2007 and

DEVELOPMENTS IN CONSULTATIONS TO CCR BY REPORTING INSTITUTIONS



accounted for 41% of total consultations. The chart below shows developments in the number of consultations to CCR by reporting institutions in the last five years.

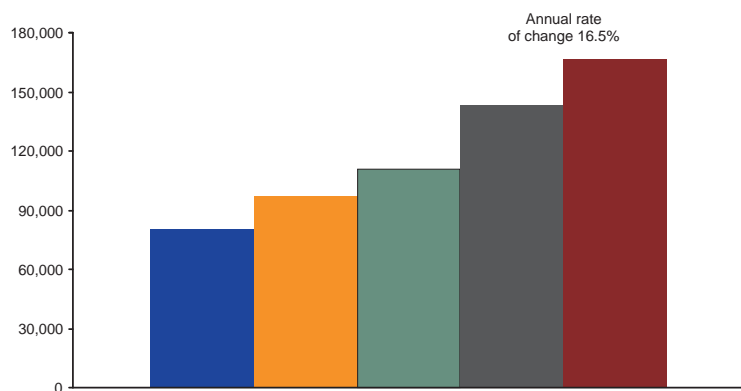
2008 was also marked by the development of a new CCR information system, launched in February 2009. This new system is aimed at introducing various improvements in the regular functioning of CCR, in terms of its main goal, i.e. to allow reporting agents to assess credit risk more accurately, by analysing the overall indebtedness of potential borrowers next to the financial system.

Such improvements are particularly visible in the

new mechanisms for the identification of physical persons (use and validation of the Taxpayer Number as the key identification document), the degree of detail in the description of liabilities and in the quality and availability of the consultation services for reporting institutions. This new system is regulated by Decree-Law No 204/2008 of 14 October and by Instruction of Banco de Portugal No 21/2008, published in the Official Bulletin of January 2009.

In 2008 information continued to be provided to borrowers on the data stored in CCR in their name. The number of direct consultations at the public information desks of Banco de Portugal (head office, Oporto branch, agencies and regional delegations) reached 167,000 at the end of 2008 (average of 669.9 persons per day), with an annual rate of change of 16.5%.

DEVELOPMENTS IN THE NUMBER OF DIRECT CONSULTATIONS AT CCR INFORMATION DESKS OVER THE PAST FIVE YEARS



8.6.6. Statistical information systems

To guarantee an efficient statistical production in 2008 the information systems that support the collection and treatment of statistical information continued to be modernised.

With regard to work related to the redrafting of European regulations on “Monetary and financial statistics”, within the framework of the ESCB, several exercises were conducted with the collaboration of the financial institutions, for the assessment of both the costs and the relevance of the new requirements resulting from this revision process, in order to contain the reporting costs

usually borne by institutions when changes are introduced in data reporting systems.

At the end of 2008 the Governing Council of the ECB approved Regulation ECB/2008/30 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions and Regulation ECB/2008/32 concerning the balance sheet of the monetary financial institutions sector.

In the field of the “Balance of payments and international investment position statistics”, in 2008 work continued to be made for the modernisation of the respective reporting system, with the launch of a new annual international investment survey (QINV), which gathers in a single notation instrument the former annual surveys on foreign direct investment in Portugal (QIDE) and Portuguese direct investment abroad (QIPE). In addition to compiling statistical information on direct investment,

the new survey also includes information on other end-of-period external positions (assets and liabilities), deposits and loans and financial derivatives, supplementing the currently existing information sources in the field of the international investment position statistics. The collection of information – from around 2,300 reporting agents of the financial and non-financial sector – is made through an application available by electronic means on the Banco de Portugal's website. This application includes a set of validation rules and metadata to enhance the quality of reported data and to improve the efficiency of resources.

In the field of the “Securities statistics” work continued to streamline the statistical operation and exploration within the scope of the SIET, namely as regards securities issues statistics and the articulation with the Centralised Securities Database (CSDB) of the ESCB.

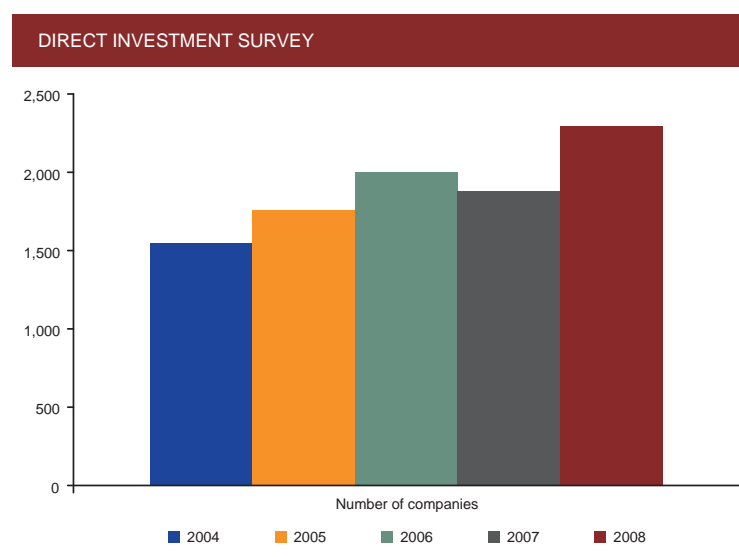
The SIET database currently contains the registration of approximately 45,000 shares, 75,000 debt securities and 5,000 participation units. There are more than 154,000 entities (issuers and investors) registered. Around 200,000 registrations with information on securities portfolios are processed per month.

In 2008 the “Investment funds statistics” project was launched. Its main purpose consists in preparing the information system for the reporting to the ECB of the information requirements set out in Guideline ECB/2007/9. Within the scope of the protocol signed with the Securities Market Commission, this entity will provide Banco de Portugal with the base information required for this purpose.

Under the protocol signed between INE and Banco de Portugal and in the field of the “National financial accounts”, a reconciliation was made between 2006 financial and non-financial accounts whose public disclosure was made in July 2008. In order to comply with the information requirements set out in Guideline ECB/2005/13 concerning euro area quarterly financial accounts, “from-who-to-whom” tables for the instruments Deposits and Loans were for the first time reported to the ECB.

As far as the Central Balance-Sheet Database is concerned, statistics continued to be produced on a timely and smooth manner, on the basis of quarterly and annual data of non-financial corporations stored in the data bases managed by Banco de Portugal. In the particular case of annual data, it was possible to overcome the delays recorded in the previous year and to disclose before the end of the year the results for 2007 of more than 300,000 companies, within the scope of the Central Balance-Sheet Database (Chapter G of the *Statistical Bulletin*; Sector Tables; and international databases: BACH and Corporate Sectoral References). At the end of the year “Corporate and Sector Tables” were sent to approximately 4,000 companies. With regard to quarterly data, in 2008 results were disclosed in the fourth month after the end of the reference quarter.

The statistical indicators produced by the Central Balance-Sheet Database were supported by a very significant work in terms of the quality control of corporate data, in order to ensure the consistency of information in the period under review, the temporal harmonisation of data relating to the same company and the adherence to statistical concepts and to information stored in other data bases managed by Banco de Portugal. The companies that have been individually analysed in the course of 2008 represent more than 75% of the gross value added and total assets published for total non-financial corporations integrating the Central Balance-Sheet Database, both in quarterly and in annual terms.



### 8.6.7. International relations in the field of the statistical function

The institutional representation of Banco de Portugal in several national and international working groups continued to be a priority in the field of the statistical function. In 2008 the Banco de Portugal's reputation at this level was recognised through:

- The election of the representative of Banco de Portugal in the Committee for Monetary, Financial and Balance of Payments Statistics (CMFB) as the Vice-chairperson of this committee, for a two-year term, starting in January 2009.
- The appointment of the representative of Banco de Portugal in the Statistics Committee of the ESCB to chair the Advisory Group on Securities Holdings Statistics, set up within the framework of this committee.

In 2008 and within the scope of the international relations in the field of the statistical function, Banco de Portugal also made presentations at the following events:

- (i) Fourth ECB conference on statistics on "A strategic vision for statistics: Challenges for the next 10 years".
- (ii) Fifth meeting on National Statistical Systems of the central banks of Portuguese-speaking countries, organised by the central bank of Cape Verde.
- (iii) CMFB meeting, focusing on "Simplified Reporting: inclusion of IES in the Statistics on Non-Financial Corporations from the Central Balance-Sheet Database".
- (iv) Seminar organised by the South African Reserve Bank, on "Understanding Flow of Funds – An international perspective".
- (v) Workshop organised by the Irving Fisher Committee on Central Bank Statistics and by the International Monetary Fund on "Challenges to improve global comparison of securities statistics".
- (vi) International Conference on Computational Statistics 2008, organised by the International Association for Statistical Computing.
- (vii) Workshop on Data Management Strategies and Technologies organised by the Board of Governors of the Federal Reserve System.
- (viii) European Conference on Quality in Official Statistics organised by Eurostat and the Italian National Institute of Statistics.
- (ix) Seminar on "Methodologies for Measuring the Impact of Migrant Remittances on Household Income and National Accounts", organised within the framework of the European and Mediterranean statistical cooperation programme MEDSTAT II.

With regard to the international technical cooperation and assistance in the field of the statistical function, Banco de Portugal was responsible for the following initiatives in 2008:

- (i) Organisation, in collaboration with the International Monetary Fund, of a course on Monetary and Financial Statistics for the central banks of Portuguese-speaking countries.
- (ii) Organisation of a session focusing on specific external current account issues, within the framework of the 56th Conference of European Statisticians of the United Nations Economic Commission for Europe.
- (iii) Organisation of a study visit to Banco de Portugal of a delegation from the central bank of Lithuania, within the scope of the financial accounts compilation system.
- (iv) Under the Cooperation protocol signed between Banco de Portugal, the Brazilian Geographical and Statistical Institute and the central bank of Brazil, organisation of a visit by senior officials from these Brazilian institutions to Banco de Portugal, within the scope of the financial accounts compilation system.

- (v) Organisation of a study visit to Banco de Portugal of a delegation from the central bank of Bulgaria, within the scope of the financial accounts and securities issues statistics.
- (vi) Organisation of an internship for a representative of the national bank of Angola in the field of statistical quality and auditing.

#### 8.6.8. Methodological developments

Banco de Portugal continued to take part in the works of international organisations for the development and revision of methodologies for the harmonisation of practices and improvement of the quality and comparability of statistical data.

In particular, the Bank contributed at the methodological level to the updating of the System of National Accounts (SNA93) and of the IMF's Balance of Payments and International Investment Position Manual (BPM5). On the other hand, Banco de Portugal continued to participate in the drafting committee responsible for the updating of the General Government Debt and Deficit Manual.

The revision of the European System of Accounts (ESA) began in mid-2008. This work is coordinated by the Eurostat, and the ECB has actively participated in the chapters relating to the classification of institutional sectors and characterisation of financial transactions. Banco de Portugal together with INE has also collaborated in the Contact Group on the Statistical Measurement of the Assets and Liabilities of Pension Schemes in General Government, set up by CMFB, within the framework of the ESA updating.

Banco de Portugal also participated in the preparation of a test version of the quarterly financial accounts to be reported to the ECB 80 days after the end of the reference period, thereby shortening by approximately one month the current reporting deadline. This initiative met the objective of the ECB of making available, from 2010 onwards, an estimate for the euro area accounts within 90 days. Banco de Portugal also took part in the Task Force on Insurance Corporations and Pension Funds Statistics of the ECB, for the implementation of the regular reporting of the statistics of this financial sub-sector 80 days after the end of the reference period.

#### 8.7. International relations

Exceptional events characterised the international economic and financial environment in 2008. There was a need for closer than usual global-scale monitoring of markets and the financial system by national authorities and international bodies and greater cooperation in the coordination of policies targeted at fighting the downturn that had gradually been developing. At both domestic and international level Banco de Portugal was involved in key events and decisions, thus confirming the weight of its international activities.

In addition to participating in international organisations, the Bank was also involved in consultations and interventions related to the control of impacts and systemic risks of the current juncture, namely within the framework of its responsibilities in the banking and financial sector.

Special reference should be made to the European Council decisions of March 2008 on financial market stability. On a later stage, as the crisis deepened, euro area countries, gathering in a summit in October, prepared a coordinated action plan intending to restore confidence and the smooth functioning of the financial system, as well as to coordinate measures to guard the real economy against financial distress. This plan and the roadmap approved in the ECOFIN Council on the same month – which included the coordination of measures aimed at addressing the deceleration in economic activity and proposals to reinforce the efficiency of financial system supervision, in particular of cross-border groups – were endorsed by the European Council in October.

The commitment to reform the international financial system, supported by European leaders, but also by G7 and G20 and universally subscribed to by IMF members, will proceed in 2009 and continue to be the main topic in the agendas of the international organisations in which Banco de Portugal intervenes.

The conclusions of the G20 Leaders Summit in November 2008 were very important both due to the identification of the causes of the current crisis and the support to some measures that had already been taken, and also because it defined immediate and medium-term measures to be implemented by governments, central banks and other regulatory and supervisory authorities; markets (including financial entities, auditors and rating agencies), and international institutions and organisations, (Bretton Woods institutions and the Financial Stability Forum (FSF)). Common principles to be followed in the financial market reform were agreed on, with a view to enhancing transparency, improve regulation, protect financial market integrity, pursue international cooperation and reform international financial institutions.

2008 marked the tenth anniversary of the establishment of the European Central Bank (ECB) and the European System of Central Banks (ESCB) and the confirmation of conditions for the adoption of the single currency by 11 Member States, among which Portugal. This was a key milestone of Banco de Portugal's action as part of the ESCB and the Eurosystem (the euro area central banking system, composed of the ECB and the NCBs of Member States that have adopted the euro) and of its responsibilities in the decentralised implementation of the decisions of the ECB's decision-making bodies, namely the Governing Council and the General Council. The Governor of Banco de Portugal is a member of both these councils.

The ECB defines the euro area monetary policy, steering it in accordance with the primary objective of maintaining price stability. It must also support general economic policies in the Community and contribute to a smooth conduct of prudential supervision and financial stability, by carrying out advisory functions, at national and Community level, in its fields of competence. It is also represented in various organisations aiming at international cooperation. The ECB's basic tasks also include the conduct of foreign exchange operations and the promotion of the smooth operation of payment systems. In addition, it performs statistical tasks, in cooperation with other national and Community entities.

Overall, 2008 required strict monitoring of economic and financial conditions by the ECB's Governing Council (composed of the President, Vice-President and the other four members of the ECB's Executive Board and the governors of euro area NCBs) and General Council (composed of the ECB's President and Vice-President and the governors of the ESCB's central banks). Conditions were serious, heterogeneous and uncertain.

As for monetary policy, in addition to decisions on the levels of euro area key interest rates (generally adopted in the first of the two monthly meetings of the Governing Council), ECB's actions in 2008 focused on smoothing the functioning of money markets and easing liquidity difficulties. This often required coordinated steps with the US Federal Reserve and other central banks.

Banco de Portugal, as part of the Eurosystem, or with other national authorities, was engaged in the definition and implementation of European policies targeted at restoring market functioning and reinforcing financial stability. This included the arrangements and cooperation of supervisory entities to access and control systemic risk (an EU level Memorandum of Understanding was signed) and the review of the Lamfalussy approach, stressing the importance of a cross-border broadly based perspective in supervisory mandates.

As for crisis management, consistent protective measures for depositors and the concerted action plan adopted by the European Council in October were of particular relevance. These proved important to support solvent institutions by providing liquidity guarantees and access to financing.

Banco de Portugal was also involved in this work to structurally enhance the international financial system and reinforce supervisory and regulatory powers.

Cyprus and Malta adopted the single currency on 1 January 2008. This enlarged the euro area, and the Eurosystem. Also, according to the regular cycle of progress assessment of the convergence of Member States with a derogation, the ECB prepared its convergence report. Both this and the report prepared by the European Commission under a similar mandate were submitted to the Council of the European Union. For complying with economic convergence criteria and given the compatibility of its legislation with the Treaty establishing the European Community and the Statute of the ESCB (hereinafter referred to as the Statute), as of 1 January 2009 Slovakia became the 16th Member State to adopt the euro. All technical procedures and arrangements necessary for participation in the Eurosystem were checked. Following this enlargement, and according to the Statutes, a rotation scheme was established for voting rights within the Governing Council. This scheme will be introduced once the number of governors in this Council exceeds 18.

The launching and pursuing of the various steps of SEPA, the Single European Payments Area, were among the most important items in the Governing Council's 2008 agenda. The Eurosystem is deeply committed to this process, which is coordinated by the European Payments Council, and regards it as a step for the achievement of a fully-fledged single currency. The Eurosystem continued to contribute to guide the various stages of market preparation, including monitoring and reporting – taking the view that interested parties extend beyond banks and payment institutions.

Migration to TARGET2<sup>6</sup> – the Eurosystem's new real-time gross settlement system – was completed and the Governing Council launched TARGET2-Securities (T2S), a single technical platform for securities settlement, and CCBM2, the Collateral Central Bank Management, a common collateral management platform. These two projects are also instrumental for completing the financial integration process and creating a single market.

In 2008 Eurosystem's activities included the preparation of the future production of the second series of euro banknotes, improvements in the regulatory framework of euro area monetary and financial statistics, research on modelling, forecasting and monetary analysis, and opinions following consultations to national or European authorities.

The General Council, which has statutory tasks arising from the existence of non-euro area Member States, met five times in 2008. Agendas included the analysis of major economic and monetary developments in the EU, the functioning of the exchange rate mechanism, ERM II, the approval of the convergence report and the preparation for the IMF spring and autumn meetings. A report on structural developments in the European banking sector and an ESCB report on public finances were released.

The ECB committees and sub-structures, composed of ESCB and/or Eurosystem experts (depending on the mandate, object and statutory provisions), continued to provide technical support, making their contribution to the decision-making process or implementing decisions on the above mentioned matters and within the scope of other ECB tasks.

The International Relations Committee was particularly active as regards ESCB/Eurosystem international intervention. Several subjects were also monitored by specific high-level groups, set up at the ECB, in which the Bank participates.

The diversity and scope of issues monitored by the Eurosystem implied a direct participation of all the Bank's departments, according to their business areas, and in line with the strategic purposes and organisational principles of the Eurosystem Mission Statement.

(6) Portugal was included in the second of three groups that were organised for migration. Migration took place in February 2008, as scheduled.

External participation included attendance to meetings (sometimes teleconferences), preparation of contributions for written procedures and other initiatives and contacts with ESCB peers. Participation requires coordination and preparation of the necessary technical elements.

The ECB assigns great relevance to the transparency of its decisions and guidelines. In addition to press conferences and press releases, namely on monetary policy decisions and other matters, it reports on its activities. In addition, the Annual Report, the Monthly Bulletin, the Convergence Report and the Financial Stability Report, it releases survey results and other information, e.g. on the banking sector, banknotes and payment systems. Banco de Portugal takes part in this activity through editorial and technical groups. In most cases, full or partial Portuguese versions of these reports are released in electronic format.

The economic and financial situation and its main risks were the main topics of the spring meetings of the International Monetary Fund (IMF) and the World Bank (WB), namely the International Monetary and Financial Committee (IMFC), held in Washington in April 2008.

Signs of deterioration of the worldwide economic and financial situation were confirmed. The scenario still reflected fears of possible impacts of food and energy price pressures on inflation, fiscal accounts and the balance of payments. The situation of the most vulnerable groups especially in poor countries was of particular concern. The IMFC concurred with the recommendations of the Financial Stability Forum (FSF) aimed at reinforcing financial market resilience, covering both sector practices and codes and the role and instruments of national and international supervisory authorities. These meetings also highlighted the importance of IMF surveillance, insisting on strategic targets and focused and transparent IMF missions to integrate the main economic and financial vulnerabilities as well as systemic and regional implications.

At the Annual Meeting of the IMF/WB, in Washington, in October, amidst the financial crisis and a critical moment for worldwide financial stability, swift and far-reaching action by governments, central banks and international institutions was necessary. Monetary authorities from various countries took a number of measures, on certain occasions coordinated ones, such as deposit guarantees, liquidity injections and interventions in financial institutions.

The IMF stood by the concerted action plan put forward by G7, intended to support systemically important financial institutions, to restore the flow of credit and re-establish confidence. The Fund also defended the appropriate use of macroeconomic policy tools aimed at preserving the real economy, shielding it from the impacts of the financial crisis, while providing financial resources to address emergency situations.

The Fund created a new instrument, the short-term lending facility, intended to provide financial assistance to emerging economies hit by liquidity crises. At the same time, the conditions for the use of the Exogenous Shocks Facility were modified (conditionality, amounts, flexibility and access). Over the year, a number of stand-by agreements were negotiated with the IMF.

International juncture thus provided additional impetus to discussions on international financial architecture and the role of the IMF including surveillance and financial and technical assistance as in this agenda.

Prior to the Annual Meeting of the IMF/WB, Banco de Portugal hosted the 18th Lisbon Meeting with the delegations of the Portuguese-Speaking African Countries (PALOPs) and Timor-Leste, targeted, inter alia, at the joint preparation of participants in this Annual Meeting.

Reference should also be made to the 2008 reforms of the IMF, namely on voice and participation – approved under Resolution 63-2, which implies, inter alia, an ad hoc quota increase to 54 members, among which Portugal – and investment authority (Resolution 63-3). Both Resolutions were adopted by the Board of Governors and were targeted, respectively, at improving quota and

voice and at expanding investment authority. The latter reflects the adoption of a new income model for the Fund. Proposals to amend the agreement with the IMF require acceptance by a qualified majority of the members, in accordance with established procedures and legal frameworks. This process is still going on, also in Portugal.

At the bilateral level, in July 2008 an IMF Mission visited Portugal as part of the usual Article IV consultations. Several meetings were held at Banco de Portugal, including technical meetings and, according to the issues addressed and the mission's requests, meetings with other national authorities or external entities were held. Consultation procedures followed the recommendations and guidelines decided on by the IMF, with a view to improving the quality and efficiency of surveillance, account having been taken of economic and financial interaction and major vulnerabilities. As usual, staff reports and the Public Information Notice were released and Portuguese versions made available on the Bank's website. Monetary policy is encompassed in the euro area Article IV.

In 2008 the Bank also fulfilled its commitments to the IMF concerning financial relations and statistics.

Likewise, special reference should be made to the regular participation of Banco de Portugal in the activities of the EU Economic and Financial Committee (EFC). Over 2008, in the performance of the tasks required of it under the Treaty, the EFC focused its activities on the monitoring of the economic and financial position of Member States and the Community and the preparation of the works and decisions of the ECOFIN Council, including the respective informal meetings (which are open to NCB Governors). The Governor participated in the informal ECOFIN Council meetings held in Brdo and Nice (4-5 April and 12-13 September respectively).

The implementation of the Stability and Growth Pact (SGP) continued to be a focal point of the EFC's activities, requiring a regular exercise of multilateral supervision and coordination of economic policies. Within this scope, reference should be made to: (i) the assessment (mainly in the first quarter) of Stability/Convergence Programme updates; (ii) the preparation and monitoring of the different steps of the excessive deficit procedure (EDP). This issue was generally addressed in restricted composition, as a consequence of the working methods in force since the Committee was reorganised in 2003. However, this work methodology envisages participation by NCB representatives in debates – in the context of SGP implementation – focusing on the respective countries. Hence, (in February) the Bank took part in discussions on the update of the Portuguese Stability Programme (2007-2011) and the revoking of the decision on the existence of an excessive deficit procedure in Portugal (in May). The main topics in the agendas of meetings in full composition continued to be the monitoring and assessment of the economic situation and prospects and issues related to financial markets and services. These themes gained increased relevance in the context of the turbulence experienced in these markets and its impact on the real economy. Among the topics approached, reference should be made to: the regular assessment of EU financial stability; issues relating to the implementation of roadmaps relating to financial supervision and the response to the financial turbulence; follow-up of the G20 Summit on the reform of the international financial system. Against this background, the EFC continued to closely monitor the works of the Financial Services Committee (set up in February 2003 by ECOFIN), having met more frequently in its Financial Stability Table format (February, April and September). In compliance with the provisions of the Treaty, the EFC also examined the case of capital movements and freedom of payments, approving the respective annual report. The major points in this Committee's agenda were statistical issues, the quality of public finances, the appraisal of successes and challenges after ten years of EMU, and the Commission's and ECB's convergence reports. Slovakia's assessment should be stressed, given this country's adoption of the euro as of 1 January 2009. Furthermore, efforts were pursued to strengthen the

coordination of EU positions at international level and to reinforce the economic and financial dimension in the dialogue with third countries. Particular emphasis continued to be placed on European coordination in the IMF and on preparing the participation of the EU Presidency in several fora, in particular the IMF/World Bank and G20 meetings. EFC's activities in this context were to a large extent prepared by the Sub-Committee on IMF and Related Issues (SCIMF), in which Banco de Portugal also participates. Its agenda, as far as the IMF is concerned, focused on the reform of quotas and voice, the Fund's finances, the lending framework and the reinforcement of the Fund's surveillance and of its role in promoting international financial stability. It is also worth mentioning international financing associated with climate changes (with the presence of experts in this field). Also within the scope of the EFC, the meetings of the Sub-Committee on Government Bonds and Bills Markets and of the Euro-Coin Sub-Committee (in which the Bank is also represented) were held.

With regard to European organisations, the Bank continued to take part in Eurostat committees and working groups, namely in the field of monetary, financial and balance of payments statistics.

In June 2008 the 78th Annual General Meeting of the Bank for International Settlements (BIS) – of which Banco de Portugal is a shareholder – was held at the BIS head office in Basel. A high-level delegation of Banco de Portugal took part in the General Meeting. As in previous years, discussions covered shareholders issues, but also the main developments in the world economy and finances, including macroeconomic management and the role of policies and regulation. Banco de Portugal takes part in the activities of several BIS structures, for example concerning statistics. It also took interest in the works of the Basel Committee on Banking Supervision.

This Committee played a relevant role in analysing the weaknesses leading to the financial crisis and in devising a strategy to overcome them, with practical proposals for discussion in the fields of regulation, supervision and risk management.

The Bank collaborated in the preparation of the 2008 Economic Survey of Portugal, led by the Review Committee of the OECD. In addition, it attended working groups and was part of the national delegations of the Economic Policy Committee and the Financial Markets Committee.

The Bank participated in the plenary session of FATF (Financial Action Task Force on money laundering and terrorist financing) which was held in October in Rio de Janeiro. The biannual update report on Portugal, released by the Bank, was presented during this session, in the wake of the 2006 evaluation exercise.

The Bank's cooperation policy in 2008 was as relevant as in previous years, continuing to be particularly close with the central banks of the PALOPs and the Banking and Payments Authority of Timor-Leste.

In the context of programmes prepared on an annual basis, which were discussed and agreed on among the monetary authorities referred to, cooperation initiatives reflected the consolidation of new areas and projects in the different institutions, namely with regard to financial asset management and money market development, reinforcement of human and organisational structure management, financial system supervision and also legal regulation. Cooperation essentially covered all central banking areas of action, requiring a mobilisation of efforts in virtually every Department of the Bank. Projects launched in previous years were of course continued, taking into account, on the one hand, the complex and evolving nature of projects, and on the other, the growing challenges posed by the financial environment.

Cooperation provided in terms of technical assistance covered areas such as human resources, statistics, legal advice and also the Deposit Guarantee Fund.

The Bank continued to participate both in the Exchange Rate Cooperation Agreement Commission (COMACC), and the corresponding Macroeconomic Monitoring Unit of this Agreement, which was

signed between the Portuguese and Cape Verdean Governments in 1998. On the occasion of its tenth anniversary, an International Conference was held in Praia, in which Banco de Portugal took part. Furthermore, in its capacity as external manager mandated by the Cape Verdean authorities, the Bank continued managing the Cape Verdean Stabilization Trust Fund, established as a back-up to the conversion of the domestic debt of the Cape Verdean State.

Already in late 2008, the authorities of S. Tomé and Príncipe and of Portugal agreed on the setting-up of a bilateral working group, in which Banco de Portugal takes part, entrusted with the mandate of analysing conditions and developing preparatory works targeting at a possible signing of an exchange rate cooperation agreement between Portugal and S. Tomé and Príncipe. In December 2008 this group had its first meeting in S. Tomé, in which several relevant aspects for the signing of the agreement and the procedures to be followed for its completion were discussed. Against this background, the opportunities and challenges underlying an exchange rate agreement were discussed and so was the macroeconomic framework needed to adopt a fixed exchange rate regime.

With regard to training, there was a course on monetary and financial statistics from 20 to 31 October in Lisbon. It was held in Portuguese and was monitored by the IMF's Statistics Department, with the collaboration of the Statistics Department of Banco de Portugal. 12 participants from the Central Banks of the PALOPs and Timor-Leste took part in this course.

As regards training in the PALOPs, an "Awareness raising seminar in the field of payment systems" was held in S. Tomé and Príncipe in May, and there was a "Seminar on the use of the Central Credit Register", with two editions in 2008, in Angola from 26 to 29 October and in Cape Verde from 13 to 14 November.

The 2008 multilateral meeting programme included the "18th Lisbon Meeting with the delegations of the PALOPs and Timor-Leste to the Annual IMF/WB Meeting", which took place on 6 and 7 October, on the topic "The international financial situation and its impact on developing countries". The "4th Meeting of Governors" was held in Bissau, with the core topic "Monetary policy in the context of globalisation: challenges of inflation control". At sectoral level, but also with representatives from all, or almost all, Central Banks of Portuguese-Speaking Countries, stress should be laid on a number of initiatives: the "3rd Meeting on Payment Systems", held in S. Tomé and Príncipe, the "Seminar on the Financial Sector Assessment Program (FSAP)" in Lisbon, the "10th Forum of Information and Communication Systems and Technologies" in Lubango, Angola, the "12th Meeting of Legal Experts" in Luanda, the "11th Human Resources Meeting" in Maputo and finally, the "5th Meeting on National Statistical Systems of the Central Banks of the Portuguese-Speaking Countries", in Cape Verde.

The Bank continued with the programme of cooperation with the central banks of emerging economies and other low-income countries. Most initiatives undertaken continued to be of a multilateral nature, corresponding to participation in meetings and seminars hosted in the framework of the Eurosystem's International Relations Committee (IRC) activities.

In this context, Banco de Portugal took part in the "Eurosystem high-level seminar with the central banks and monetary agencies of the Gulf Cooperation Council (GCC) member states", jointly organised by the ECB and the Deutsche Bundesbank and held in Mainz, Germany, from 11 to 13 March. This seminar focused in particular on economic structures and developments in the GCC and its role in the regional and global economy. In June the ECB hosted the "Preparatory Workshop for the Fifth Seminar of the Eurosystem with Mediterranean Countries" in Frankfurt, the Seminar having taken place in Alexandria, Egypt, in November. The core issues were the analysis of recent economic and financial developments in Mediterranean countries and their monetary policy strategies and exchange rate regimes. Banco de Portugal was represented in

both events. Also in June, Banco de Portugal took part in the “EMEAP-Eurosystem high-level seminar” hosted by the ECB and Banca d’Italia, in Rome. This Seminar focused in particular on the financial crisis – including an assessment of international cooperation efficiency – and cyclical changes and their implication for central banks.

Another Eurosystem initiative in which the Bank took part was the “Preparatory Workshop for the Fourth High-Level Seminar of the Eurosystem and Latin American Central Banks” held in Paris in December, under the theme “The global and regional impact of financial and commodity price developments”.

Still with regard to the Eurosystem’s agenda, the Bank continued to participate in the IRC’s “Task Force on Central Bank Cooperation”, with a mandate to foster the exchange of information on cooperation developed by the Eurosystem with the central banks of EU neighbouring regions.

Also at regional level, but as part of the activities of the Centre for Latin American Monetary Studies (CEMLA), Banco de Portugal hosted with Banco de España the “5th International Cash Management Course of the Central Banks of Latin America, Portugal and Spain”, which has held in Lisbon in end-May.

At the bilateral level, two staff members of the Central Bank of Brazil and the Brazilian Institute of Geography and Statistics visited the Bank, specifically the financial accounts area of the Statistics Department, under a Cooperation Agreement signed between Banco de Portugal and the above institutions.

Banco de Portugal participated in the Seminar hosted by the South African Reserve Bank under the theme “Understanding flow of funds - an international perspective”, which took place in South Africa, from 5 to 8 May, having delivered a lecture on information sources and other aspects regarding the methodology for compiling, disseminating and analysing the Portuguese financial accounts by institutional sector of the economy.

In addition to the already mentioned interventions regarding the release of reports and other documents produced by international organisations, including Portuguese versions, as in previous years and considering the importance of external communication, Banco de Portugal’s main publications have been translated into English.

## **8.8. Financial activities**

### **8.8.1. Management of the Bank’s own investment assets**

In a year marked by enormous tensions in international money and capital markets, Banco de Portugal continued to pay close attention to the credit risk of investments made regarding the management of the Bank’s own investment assets. At the end of 2008, these were valued at €22,428 million, accounting for an increase of around 2.8%, compared with €21,825 million at the end of 2007.

The value of the euro and foreign currency portfolio, valued on a marked-to-market basis, was €10,071 million (against €10,825 million at the end of the previous year).

This adds to the value of the medium-term investment portfolio, which was set up in 2005 and has been managed and valued on a held-to-maturity basis. Its amount, invested at the end of the year, totalled €4,710 million (compared with €4,000 million at the end of the previous year).

At the end of 2008 the gold portfolio had a market value of €7,647 million (compared with €7,001 million in 2007), corresponding to around 382.5 tons (382.6 in 2007). This market value increase resulted from the rise in the international price of gold denominated in US dollars (+3.4%), and from the appreciation of the dollar against the euro (+5,8%).

## 8.9. Exchange authority

In accordance with Articles 20 and 21 of its Organic Law, Banco de Portugal is the foreign exchange authority of the Portuguese Republic. In this capacity, the Bank shall be particularly responsible for the authorisation and control of external payments, whenever required in accordance with the Treaty establishing the European Community, and for the definition of the principles governing gold and foreign exchange operations.

In turn, Decree-Law No 295/2003 of 21 November governs external economic and financial operations and foreign exchange operations and entrusts the Bank, *inter alia*, with the task of special registration of the contracts signed between credit institutions and financial companies and non-financial institutions for the carrying out of manual foreign exchange operations, as well as the investigation, instruction and decision on proceedings relating to breaches of foreign exchange regulations.

In carrying out these tasks, Banco de Portugal opened, throughout the year, five proceedings relating to breaches of foreign exchange regulations, of which two proceedings were filed and three are at the investigation stage. One proceeding started in previous years was concluded with the imposition of a fine.

In addition, two manual foreign exchange contracts were registered and clarification was provided to prospective contracting parties.

## 8.10. Internal organisation and management

### 8.10.1. Human resources

The Human Resources Management and Development Department (DRH) was engaged in several activities and initiatives in 2008, including in particular:

- Structural adjustments in the Markets and Reserve Management Department (DMR), Administrative Services Department (DSA), and Treasury and Issue Department (DET).
- Development of both internal and external recruitment and selection processes, promoting higher qualification levels within the Bank, enhancing its staff potential, and encouraging cooperation with the academia through paid traineeships and the recruitment of new graduates, based on a social responsibility policy across different levels of the institution.
- Participation in the implementation project of the integrated management system ERP<sub>sap</sub>@bp. The contribution of DRH comprised process and content modelling, the implementation of the organisational structure model, in addition to training for users, as well as the validation of several processes focusing on competencies, recruitment and selection, performance appraisal and compensation. The segments containing staff training programmes and staff records went live in this period.
- Creation of various institutional staff training and development programmes, as well as participation in external training aimed at enhancing technical, specialised and behavioural competencies, in order to create the organisational conditions for improving the levels of performance and organisational efficiency.
- Management of the participation of top and middle managers, as well as of other senior staff in joint training actions for EU national central banks (in the field of management, leadership and integration in the ESCB). In this context, the Bank organised a phase of the “Heading for Leadership” programme.

STAFF DEVELOPMENT PATTERN					
Staff	2004	2005	2006	2007	2008
Male	980	951	946	930	926
Female	756	751	761	757	759
<b>Total</b>	<b>1,736</b>	<b>1,702</b>	<b>1,707</b>	<b>1,687</b>	<b>1,685</b>

- Pursuance of bilateral cooperation actions with the central banks of Portuguese-speaking African Countries (PALOP) and other Portuguese-speaking countries through the training of specialist staff, internships at Banco de Portugal, as well as expert advisory actions in human resources management to staff members of Banco de Moçambique (Bank of Mozambique) and Autoridade Bancária e de Pagamentos de Timor-Leste (Banking and Payments Authority of Timor-Leste).

PROFESSIONAL CATEGORIES					
Categories	AE	GROUP A		GROUP B	
	ACTV	G. I	G. II	G. III	G. IV
Heads and Deputy Heads of Department		45			
Managerial staff		60	11	25	5
Senior professional staff <i>(Professional staff)</i>		718			
Professional staff <i>(Specialist staff)</i>		86			
Technical-administrative staff <i>(Administrative staff)</i>		496			
Specialist staff <i>(Support staff)</i>			37		
General staff <i>(Support staff)</i>				163	
Auxiliary staff <i>(Support staff)</i>					39
<b>Total</b>		<b>1,405</b>	<b>48</b>	<b>188</b>	<b>44</b>

### Staffing

In 2008 the number of persons employed by Banco de Portugal decreased slightly from 1,687 to 1,685, i.e., a reduction of 0.1 per cent.

In 2008 the Bank recruited 54 staff. There were 48 retirements (9 disability retirements, 18 normal age retirements and 21 agreed retirements), 7 terminations of labour contract and one death.

The Bank's total workforce comprised 926 men and 759 women. 1,446 were working at the head office, 135 at the Oporto branch and 104 at the regional delegations and agencies.

It should be noted that *Acordos de Empresa* – AE (company-level agreements), comprising a new career framework, were signed between Banco de Portugal and its employees who opted for this type of agreement. In parallel, other employees continued to be covered by ACTV (collective labour agreement for the banking sector). Therefore, the tables below include the two agreements, with ACTV professional categories printed in italics for a more comprehensive analysis of staff developments within the Bank.

CONTRACTUAL GROUPS DEVELOPMENT PATTERN						
Staff		2004	2005	2006	2007	2008
G. A	G. I	1,426	1,404	1,407	1,394	1,405
	G. II	62	57	54	53	48
G. B	G. III	197	191	197	193	188
	G. IV	51	50	49	47	44
<b>Total</b>		<b>1,736</b>	<b>1,702</b>	<b>1,707</b>	<b>1,687</b>	<b>1,685</b>

Thus, among the 1,685 employees, there were 45 Heads and Deputy Heads of Department, 101 managerial staff, 718 senior professional staff, 86 professional staff and 496 technical-administrative staff. The remaining 239 were operational and support staff.

Group I of ACTV, corresponding to Group A of AE, comprises 1,405 employees, representing 83.4 per cent of total staff, followed by Group III with 188 employees, representing 11.2 per cent of total staff.

AGE GROUP DEVELOPMENT PATTERN					
Age group	2004	2005	2006	2007	2008
19/25	24	32	35	22	23
26/30	103	91	107	106	121
31/35	140	131	130	129	129
36/45	408	312	286	261	256
46/55	766	819	793	786	764
56/60	234	239	251	253	257
61/65	60	77	101	126	130
> 65	1	1	4	4	5
<b>Total</b>	<b>1,736</b>	<b>1,702</b>	<b>1,707</b>	<b>1,687</b>	<b>1,685</b>

### Age groups

The breakdown by age groups shows that the group with the highest number of staff was the 46/55 age group (764), followed by the 56/60 age group (257).

There were 273 employees aged below 36, corresponding to 16.2 per cent of total staff. 135 employees were over 61, corresponding to 8 per cent.

On 31 December 2008 the average age level was 46.9 for women, 48.6 for men, and 47.8 for total staff, unchanged from the previous year.

### Years of service

With regard to the years of service, and as shown in the table, the largest group of staff (729) has served the Bank for more than 25 years, followed by the group that has served the bank for 21/25 years, with 385 employees.

There were 442 employees who have served the Bank for up to 15 years, accounting for 26.2 per cent of total staff, whereas 1,243 employees (73.8 per cent) have served the bank for more than 15 years.

The average seniority in the Bank was 21.8 years, unchanged from the previous year.

SENIORITY DEVELOPMENT PATTERN					
Group	2004	2005	2006	2007	2008
Up to 5 years	136	135	145	141	170
6 to 10	174	169	156	114	112
11 to 15	136	138	149	162	160
16 to 20	291	211	146	143	129
21 to 25	526	548	559	540	385
> 25	473	501	552	587	729
<b>Total</b>	<b>1,736</b>	<b>1,702</b>	<b>1,707</b>	<b>1,687</b>	<b>1,685</b>

### Level of education

Taking into consideration the specific functions of the central bank, namely the number of its senior professional staff (718), it can be concluded that, on average, the level of education of the Bank's staff is high.

In 2008, the 796 employees with a university degree (394 women and 402 men) corresponded to 47.2 per cent of total staff, an increase of 4.2 per cent compared to 2007 (764 employees).

LEVEL OF EDUCATION DEVELOPMENT PATTERN					
Level of education	2004	2005	2006	2007	2008
PhD	21	21	23	25	30
Master's degree	75	77	84	96	102
Graduation	637	639	653	643	664
Bachelor's degree	32	30	30	30	30
Upper secondary education	447	431	420	410	409
Lower secondary education	225	214	215	213	199
Primary education	298	289	281	269	250
No grade	1	1	1	1	1
<b>Total</b>	<b>1,736</b>	<b>1,702</b>	<b>1,707</b>	<b>1,687</b>	<b>1,685</b>

### Retirees and pensioners

In 2008, 1,739 staff were in retirement (9 more than in the previous year), exceeding by 3.2 per cent the number of active staff (1,685).

The number of pensioners increased from 491 (in 2007) to 509 (in 2008), accounting for 30.2 per cent of the Bank's active staff.

RETIRES AND PENSIONERS' DEVELOPMENT PATTERN					
Development pattern	2004	2005	2006	2007	2008
Retirees	1,729	1,745	1,738	1,730	1,739
Pensioners	480	478	492	491	509

### Professional training

During the year under review, 1,395 employees took part in internal and external training activities (in Portugal and abroad), totalling 5,009 participations, of which 4,470 were internal and 539 external. Of these, 309 took place in the country and 230 abroad.

812 training actions were held, amounting to 64,397.5 hours (8,740 hours more than in the previous year), which corresponded to 53,238 hours of internal training and 11,159.5 hours of external training.

The average number of training hours per employee increased from 33 hours in 2007 to 38.2 hours in 2008. Over the same period, taking into account the 1,685 staff, the rate of participation was 82.8 per cent (compared with 83.6 per cent in 2007).

PROFESSIONAL TRAINING DEVELOPMENT PATTERN					
Training	2004	2005	2006	2007	2008
Participants	1,262	1,148	1,197	1,411	1,395
Hours	48,132.5	34,640.5	44,493.5	55,657.5	64,397.5

### Pension Fund

The Banco de Portugal Pension Fund, set up in 1988, is composed of an autonomous set of assets exclusively allocated to meeting the liabilities endorsed by the Banco de Portugal concerning the payment of retirement, disability and survivors pensions, as well as the payment of post-retirement charges relating to contributions to the SAMS (social health assistance service for banking sector employees).

It is a closed fund, operating a defined benefit scheme and plays the role of the first pillar of social protection.

The Banco de Portugal's Pension Fund Managing Company is responsible for managing the Pension Fund and for preparing all actuarial valuations required to compute the value of liabilities related to the benefit plan and other commitments financed by the Fund. The Banco de Portugal holds 97.8% of the capital of this company, the staff of which is composed mainly of Banco de Portugal employees on a secondment arrangement.

The actuarial methods as well as the main calculation assumptions used are detailed in the note entitled "Post-employment benefits" in the Financial Statements section of this Annual Report.

The future cash flows related to the Pension Fund's liabilities are discounted using market interest rates. This methodology rests on the assumption that the actual value of liabilities must represent, at each moment, the capital that should be invested to meet future payments. By complying with this principle, it is possible to pursue an investment policy in assets which largely match the maturity structure of the liabilities.

The management of the Fund's assets is also conditioned by the high maturity of the population covered by the Bank's Pension Fund, whose number of beneficiaries (retirees and pensioners) is higher than the number of active staff members (with a ratio of the latter to the former of 0.75 at the end of 2008), and by the resulting ratio of pensions in payment to total liabilities (57.3%).

The Pension Fund's financial investment policy is not aimed at maximising the return from a purely assets perspective. Instead, it aims at optimizing the return of the assets vis-à-vis the liabilities value, prudently limiting market and counterparty risks affecting the assets value and safeguarding an adequate liquidity level to meet pension payments' obligations.

As at 31 December 2008, the assets of the Banco de Portugal Pension Fund amounted to €1,161.3 million. The asset portfolio was diversified among bonds (84.1%), real estate (15.0%) and equities (0.9%).

Total past service liabilities amounted to €1,159.6 million, of which €664.0 million corresponds to liabilities for pensions payable and €495.6 million to past service liabilities of active employees.

In a particularly adverse financial market environment, the Banco de Portugal made an extraordinary contribution of €20 million to the Pension Fund. This contribution helped bring the discount rate used in actuarial valuations more into line with the low risk market interest rates, resulting in a discount rate of 4.8%, while maintaining the Pension Fund's funded ratio above 100 per cent.

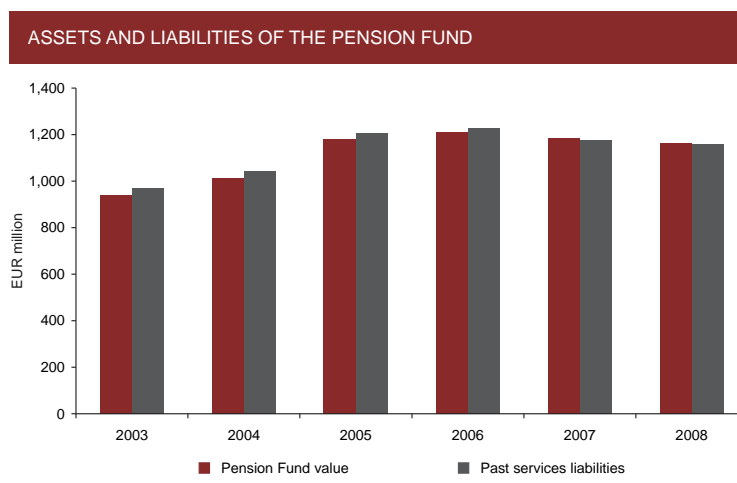
As at 31 December 2008 the Pension Fund recorded an overall funded ratio of 100.1%, ensuring a 100% coverage of liabilities relating to pension payments, as well as a 100.3% coverage of active members' past service liabilities.

Thus, the above-mentioned overall funded ratio stood above the minimum solvency level established in Notice of Banco de Portugal No 12/2001 of 23 November (94.5%).

FINANCIAL STANDING OF THE PENSION FUND AS AT THE END OF THE YEAR					EUR thousands
	2005	2006	2007	2008	Change 2007 - 2008
Pension Fund value	1,181,527	1,208,550	1,183,275	1,161,308	-1.9%
Past service liabilities	1,207,430	1,226,239	1,175,299	1,159,582	-1.3%
Beneficiaries (retired staff/pensioners)	684,972	691,158	665,387	663,943	-0.2%
Participants (employees)	522,458	535,081	509,912	495,639	-2.8%
Funded ratio	97.9%	98.6%	100.7%	100.1%	

The activities carried out by Banco de Portugal's Pension Fund Managing Company were focused on:

- Improving the asset-liability management policy oriented towards hedging the Pension Fund's liabilities;
- Reinforced risk monitoring and control taking into account the financial markets situation;
- Changes to some operating procedures aimed at achieving a higher degree of protection;
- Transfer of the securities portfolio to another depository;
- Completion of the risk assessment project and start of a business continuity plan by the Pension Fund Managing Company.



### 8.10.2. Organisation and information technology

At the level of the European System of Central Banks (ESCB), and according to the initial plan, activities leading to the implementation of TARGET2 / Single Shared Platform (SSP) continued, as well as to its expansion to include the national central banks (NCBs). NCBs belonging to the second and third migration waves started participating on 18 February and 19 May 2008 respectively. In view of the results obtained during the first three migration waves, the contingency wave foreseen for September was not necessary. Banco de Portugal joined the second migration wave, which went smoothly and successfully. With the exception of one institution (ABN AMRO BANK, N.V.), which from that date started directly interacting with TARGET2/SSP, the national financial community maintained its indirect participation in the system via SPGT2, Banco de Portugal's platform. Since this scenario was expected to be discontinued on 2 March 2008, procedures and mechanisms were developed for financial institutions to join the system as direct participants. Also at the level of projects and activities related to the ESCB, the deployment of EXDI (ESCB XML Data Integration) was concluded. Banco de Portugal was part of both the initial task force, set up to define its requirements, and a pilot group to test and implement the system. The new BI (Bilateral Interventions) application also became operational.

At the domestic level, efforts to implement an ERP (Enterprise Resource Planning) solution continued in the areas of finance, logistics and human resources. Modules and functions were made available in stages. Up until the end of 2008, the following modules were implemented: i) in the financial area, central modules, working capital, administrative budget, Cross Application Time Sheet (CATS) and the cost system; ii) at the logistics level, modules on maintenance and purchasing, albeit with some functional restrictions; iii) in the area of human resources, some functions on human resources registration and training. Simultaneously, work continued regarding salaries and compensations, with operational procedures to be carried out at the beginning of 2009 in parallel with the current system, *Sistema de Informação de Administração de Pessoal* (Personnel Management Information System - SIAP).

A consulting firm continued to work on developing and implementing the project for the new Central Credit Register (CCR) following a revision of its scope (after which the project only took the base component into account). Several test cycles were carried out considering the expectations of participating financial institutions and the degree of development of applications both within Banco de Portugal and those institutions. Since problems during the tests prevented the system from starting operating normally at the planned date (November 2008), the start was postponed to February 2009. December and January were excluded at the request of commercial banks. At the same time, an ancillary system

was developed and started being used in the assessment of the eligibility of credit claims as collateral for monetary policy operations. The first credit claims for this purpose were received during October.

In compliance with the objectives set out for phase one of the project, a prototype was launched for the new documents management and electronic archive system of Banco de Portugal. The prototype was mainly built from Livelink functions and was submitted to assessment and tests by a group of more than 50 users with specific needs and profiles covering different prototype areas. Based on the outcome of these tests and their assessment report, it was decided to proceed to phase two, and a strategy was devised to implement those requirements the prototype did not cover. This has made it possible to produce a first version of the gap analysis document which will support work during the consolidation phase. Banco de Portugal has also decided to set up a working group aimed at raising relevant issues on a process to centralise the receipt and register of external mail.

Turning to the web platforms, work continued integrating the Internet into the Bank's Architecture with a view to releasing new versions of the Institutional website, the Bank Customer Website, and the Deposit Guarantee Fund website, in addition to creating a new website for the Mutual Agricultural Credit Guarantee Fund. The graphic design and concept diagrams of these websites were thus developed and approved. In order to ensure appropriate usability and accessibility, ACAPO (Portuguese association for the blind and partially sighted) has been collaborating with the project to assess its compliance. The aforementioned websites are expected to be developed and made available to the public during the first quarter of 2009.

The Bank Customer Website (accessible from the Bank's current website) was made available to the public in April 2008. The website received a great number of visits in its first few days, which then gradually decreased to a regular level.

In addition to the development of electronic forms for the submittal of complaints via the Bank Customer Website, new processes have been introduced for electronic communication between financial institutions and Banco de Portugal. These focused on speeding the analysis of complaints and on a swifter deadline for reply. The project *Gestão Integrada e Consulta On-Line das Reclamações* (Integrated management and on-line consultation of complaints) was launched in the last quarter of 2008 to provide claimants, at a first stage, with an application via the Bank Customer website to check the state and outcome of their complaints.

The Risk Assessment Model (RAM) was further developed. Its initial objectives are expected to be achieved at two different stages: i) in a first stage, providing facilities essential to Risk Assessment; and ii) in a second stage, coverage of other functions, namely a wide range of management reports. At the end of 2008, an initial version of the system was finalised and released, as planned, containing essential components. However, its actual use was postponed for a few weeks in order to include some improvements and additional functions.

Within the scope of its Business Continuity Plan, Banco de Portugal carried out three real disaster simulations in 2008, with distinct technical and functional scopes, covering most of the Bank's business functions and all those requiring up to 48 hours recovery time.

The start of the year saw the launch of the Telefonía IP – *Sistema de Comunicações em Tempo Real* (IP, real-time communications system). This system will gradually replace the Bank's telephone system, which will evolve towards a real-time global communications infrastructure. In 2008 Banco de Portugal launched and finalised a tender procedure for a solution to be implemented in 2009 in two separate phases: the Lisbon buildings during the first half of the year and the remaining buildings at a later stage.

At the end of 2008, in the context of BPnet (Extranet of Banco de Portugal for the Financial System), 56 distinct services were available, relating to 12 business areas of the Bank, and 3,788 users were registered, spread across 363 institutions. In the course of the year over 330,000 consultations to the available services were made by the users. Throughout the whole year the total number of requests for

assistance from users to the system's Helpdesk amounted to 6,420 (corresponding to 1.69 requests/user/year). The solutions for the BPnet communications infrastructure were redesigned at the end of the second quarter. This regarded both direct links (with a significantly higher bandwidth – minimum values with a capacity 16 times that of the previous bandwidth) and temporary links (replacing the technology used in Internet connections).

From the point of view of the development and maintenance of IT systems, 53,737 man hours were dedicated to project development, 14,573 man hours to application maintenance and 2,224 man hours to organisational activities (i.e. not integrated in information system projects – organisational and functional restructuring processes of some of the Bank's departments, rationalisation of printed forms and administrative equipment, technical coordination of the Internal System for Written Communication, etc.). Technical support to users required a total of 12,217 man hours and the administration and management of production and infrastructures totalled 62,030 man hours.

In the field of cooperation with the central banks of the Portuguese-speaking countries, Banco de Portugal, in cooperation with the central banks of Angola, Cape Verde and Mozambique, participated in a working group responsible for carrying out a study to identify and characterise scenarios for the implementation of a portal for the Central Banks of the Portuguese-speaking Community. The findings of this study were presented to the 10th *Fórum de Sistemas e Tecnologias de Informação* (Forum on information technologies and systems) held in Angola with the participation of the central banks of Angola, Brazil, Cape Verde, Mozambique and S. Tomé and Príncipe, the national directorate of the BCEAO (Central Bank of West African States) in Guinea-Bissau and the Banking and Payments Authority of Timor-Leste. In addition to this topic, the forum also discussed the following subjects: "Electronic document management", "Code of Conduct in IS/IT", "Security of information systems and human resources management and training in IS/IT", and the following topics were presented: "The stage of development of the BSA system" and "Evaluation of and trends for ICT in each Central Bank".

### 8.10.3. Legal services

In 2008 the legal activity in the Legal Services of Banco de Portugal was carried out in two main sectors: consultation and legal studies; and litigation and contracts.

In the consultation and legal studies area, over 700 opinions were issued throughout the year, and the number of informal consultations was significant. At the beginning of the year the legal services took part in 12 working groups, two of which within the scope of the European System of Central Banks (ESCB). At the end of the year 14 working groups were active. Nearly all of these working groups had the participation of external entities, namely government bodies and supervisory institutions.

With regard to the legal support related to the Bank's tasks, consultations were made on a large number of issues throughout the year, with special emphasis on those relating to the legal framework of credit institutions and banking supervision, namely rules on market conduct supervision. Other consultations concerned the winding-up of financial institutions, payment systems and services, money laundering and terrorist financing. In addition, the Bank contributed to the new rules on public procurement. Mention should also be made to the monitoring of issues regarding the solvency and liquidity of financial institutions, as well as issues on parliamentary enquiries.

Within the framework of the ESCB, in the course of 2008 Banco de Portugal monitored and examined numerous opinions issued by the European Central Bank on legislative, national and community measures aimed at fighting and shedding the impact of the global financial crisis. Changes were made to the monetary policy operations system as an immediate response to fragility in global financial markets - such as the temporary expansion of the list of assets eligible for Eurosystem credit operations. In addition, new rules were introduced in the "Implementation of the monetary policy in the euro area - General documentation on Eurosystem monetary policy instruments and procedures"

regarding risk control, the acceptance of assets denominated in foreign currencies as eligible collateral under exceptional circumstances (so-called “foreign collateral”), and the treatment of counterparties subject to a freezing of funds with a view to combating terrorism (rules that were also introduced in the legislation on TARGET2). In 2008 mention should also be made to the cooperation with the European Commission on the revision of Directive on settlement finality in payment and securities settlement systems (Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998), and Directive on financial collateral arrangements (Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002). In the second half of the year, work intensified on two major projects, CCBM2 and TARGET2-Securities. Finally, numerous legal acts were prepared and concluded in the context of the adoption of the euro by Slovakia on 1 January 2009.

With respect to the prevention of money laundering and terrorist financing and the activity of The Financial Action Task Force (FATF), mention should be made to the preparation in April and September 2008 of an update report on the Portuguese money laundering and terrorist financing preventive system. The report involved intense coordination with financial supervisory authorities, such as the Portuguese Securities Market Commission, the Portuguese Insurance Institute, and economic supervisory authorities, such as the Office for International Relations of the Ministry of Finance and Public Administration, Direcção-Geral das Alfândegas e Impostos sobre o Consumo (Directorate general on customs and excise), Inspeção-Geral de Jogos (the Portuguese gambling commission), Autoridade de Segurança Alimentar e Económica (the Portuguese food and economic safety authority), Instituto Nacional da Construção e do Imobiliário (the Portuguese institute for construction and real estate), Ordem dos Revisores Oficiais de Contas (the Portuguese institute of certified auditors) and Câmara dos Técnicos de Contas (Institute of Chartered Accountants), as well as representatives from judicial authorities, in particular the Portuguese Directorate-General for Justice, the Directorate General of Registries and Notaries, Ordem dos Notários (the Portuguese notaries association), Ordem dos Advogados (the Portuguese bar association), Câmara dos Solicitadores (the Portuguese institute of solicitors), and Unidade de Informação Financeira da Polícia Judiciária (the Financial Information Unit of the Criminal Police).

In September 2008 Banco de Portugal sent FATF an update report on the Portuguese money laundering and terrorist financing preventive system, following the previous report approved in 2006, consisting of 132 pages in English released on the website of Banco de Portugal.

The update report is made up of three separate sections. The first section describes the legislative, operational and coordination developments from January 2006 to August 2008. The second section is a response to the FATF Plenary recommendations regarding the FATF general and special recommendations with which our system was not, or was only partially, compliant. Finally, the third section covers the presentation and translation into English of the main national legislative measures on the prevention of money laundering and terrorist financing. These were published from January 2006 to August 2008 and tackled most shortcomings detected in the 2006 report.

Banco de Portugal continued to participate in annual FATF plenaries and in working groups established within this organism, namely regarding international relations. Portugal continued to play a prominent part in cooperating with Portuguese-speaking African Countries and regional organisms similar to FATF. Portugal has observer status in these organisms and Portuguese is their official working language.

In relation to the preparation of legal acts, Banco de Portugal also participated in the inter-ministerial group made up of the Ministry of Finance and Public Administration and the Ministry of Justice. This group prepared the issue of Law 25/2008 of 5 June 2008, which is currently in force, transposing into Portuguese law Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

Banco de Portugal also participated in preparatory work for Decree Law No 125/2008 of 21 July 2008 on information on the payer accompanying transfers of funds, implementing Regulation (EC) No 1781/2006 of 15 November 2006.

With regard to international cooperation, mention should also be made to the seminar Financial Sector Assessment Program, organised by Banco de Portugal and aimed at Portuguese-speaking African and Asian Countries.

In the litigation and contracts area, the legal representation of the Bank was made either directly or, in some cases, through the monitoring of cases when the representation was entrusted to external lawyers. In the course of the year, a total of 13 legal proceedings were initiated in which the Bank intervened and 11 were concluded. Among the legal proceedings related to breaches of regulations and to matters of an administrative, civil or labour nature, 69 were pending at the end of the year.

In addition to the preparation, granting and monitoring of housing loans to the Bank's employees, the Legal Services of the Bank reviewed and gave an opinion on numerous contracts signed between the Bank and external entities.

With regard to international cooperation, the Bank participated in the Working Group on Bribery in International Business Transactions, established by the OECD to monitor the implementation of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, to which Portugal is a signatory.

Finally, Banco de Portugal cooperated with the Ministry of Finance and Public Administration, with a view to preparing the definition of Portugal's position in Community and international institutions in matters falling within the competence of the Bank.

#### **8.10.4. Internal audit**

##### **Mission**

The internal audit function is independent from the other services and units of the Bank. Its main task is to assure, in an impartial and preventive manner, the effectiveness, operability, safety and adequacy of the Bank's services, systems, procedures, activities and operations. This function focuses both on systems and procedures that fall within the exclusive competence of the Bank and on those that are common to or shared with the ESCB/Eurosystem. The performance of this function contributes to the fulfilment of the objectives of Banco de Portugal and the ESCB/Eurosystem at various levels, through a systematic and disciplined focus on the assessment and improvement of the effectiveness of risk management, internal control and governance procedures. Although in principle the audit function may be directed to all activity areas of the Bank, in practice its activities follow a programme established for the year. Hence, its main emphasis is on units, activities, procedures and systems that, at any given period, imply higher potential risk. Audits are intended to prevent and anticipate the most relevant risks and problems inherent in the complexity and fast changing environment that characterises the purpose and context of the Bank's activities.

The internal audit function may also undertake special investigations and other research, at the request of the Board of Directors of the Bank or of the Governing Council of the ECB.

##### **Work programme**

In 2008 the main operational internal audit activity consisted in the implementation of an audit programme based on the two following plans approved at the end of 2007 by the governing bodies of Banco de Portugal and ESCB/Eurosystem: (i) an internal audit programme approved by the Board of Directors and (ii) a programme defined at the level of the ESCB/Eurosystem, approved by the

Governing Council of the ECB. The preparation of the two audit programmes was based on formal and structured methodologies for the assessment of the risk of all relevant operations, activities and systems of the Bank and of the ESCB/Eurosystem.

The general objectives of programmed audits consist in giving a reasonable degree of assurance to the members of the Board and to the management that, in the definition and pursuance of the objectives and in the performance of their activities, the services, systems and procedures of the Bank ensured the following objectives in 2008:

- adequate identification, measurement and coverage of existing risks;
- existence and operation of effective and efficient internal control systems;
- reliability and integrity of financial and operational information;
- effectiveness and efficiency of operations;
- adequate security and safeguard of human, financial, technical and material assets;
- compliance with applicable legal, regulatory and contractual rules and obligations.

#### **Work carried out**

In quantitative terms, it should be mentioned that, within the framework of the programmes implemented in 2008, the main internal audit activity included 39 audits, of which (i) 33 domestic audits and (ii) 6 audits to systems that are common to or shared with the ESCB/Eurosystem.

The reports issued at the Banco de Portugal and ESCB level on activities carried out in 2008 provided the management bodies with opinions, information and assessments on the quality and effectiveness of their risk management and internal control systems. Whenever necessary, comments and recommendations were made to ensure the improvement of the internal activities, processes, systems, procedures and controls in place.

As a professional duty, internal audit also monitored in 2008 on a regular basis the actions and measures taken with a view to implementing the recommendations made in previous years, thereby ensuring that the risks of situations subject to a recommendation are adequately assessed and overcome. In this context, the main follow-up activities in 2008 were:

- Annual follow-up of open recommendations issued within the scope of the audits performed by the ESCB in previous years. This work was developed during the second half of 2008 at the initiative of the ESCB's Internal Auditors Committee (IAC);
- Annual follow-up of all recommendations previously issued within the scope of the Bank's internal audit programme, which have not yet been implemented, carried out during the third quarter;
- Other follow-up initiatives, systematically included in audits carried out in 2008 to validate, in an independent manner, the implementation of recommendations previously considered to have been implemented, as well as the quality of measures taken.

Still within the scope of the internal audit function, the Bank developed in 2008 a number of activities to promote or contribute to the further improvement of risk management and internal control procedures, either inside or outside the Bank. In this area, its main activities consisted in:

- Systematic reporting of information to the Board of Auditors of the Bank and undertaking several assessments requested by this Board;
- Supply of technical support and reporting to the external auditors of Banco de Portugal and of the ECB;
- Regular and systematic participation in the meetings and activities of the Internal Auditors Committee (IAC) and in the different sub-working groups that support the audit activity at the ESCB level;

- Participation in several projects, commissions and working groups of the Bank, with special focus on the regular participation in the Committee for IT (*Comissão para os Sistemas e Tecnologias de Informação – CSTI*) and in the Committee for Security Coordination (*Comissão de Coordenação da Segurança – CCS*);
- Issue of technical opinions, provision of advisory services, and supply of technical support to other services of the Bank; more specifically, support was given to CCS for the implementation of a formal and harmonised framework for operational risk management within the Bank as a whole;
- Promotion of an appropriate risk management and internal control culture through the organisation of the 8th *Jornadas de Auditoria e Gestão* (audit and management workshops) on operational risk management in central banks, and the publication of a new issue of DAU's *Cadernos de Auditoria Interna* (internal audit booklets) on overall risk management procedures within the COSO/ERM framework (COSO “Enterprise Risk Management – Integrated Framework”);
- Exchange of experiences and sharing of information with other ESCB central banks;
- Cooperation and sharing of information with central banks of the Portuguese-speaking African countries, particularly by carrying out internships for staff members from the central bank of Angola with a view to promoting the development or improvement of audit best practices and culture.

#### 8.10.5. Documentation, publishing and museum

With regard to Documentation, Publishing and Museum Services, Banco de Portugal continued to cooperate with the central banks of the Portuguese-speaking African countries and in some projects within the framework of the European System of Central Banks. In particular, Banco de Portugal participated in some events included in the Cultural Days of the ECB, in Frankfurt, and co-organised the Annual Conference in the European Association for Banking and Financial History (EABH), which in 2008 focused on “Continental and Global Networks of Credit and Capital in Historical Perspective”. Within this context, Banco de Portugal was also an active participant cooperating with the University of Athens in the summer course for central bank archivists and technicians, sponsored by the Bank of Greece.

The Bank's Museum participated in the activities of the International Committee for Money and Banking Museums (ICOMON), the UNESCO organisation for international museums of numismatics.

The Bank's library services continued to be provided to the public within and outside the Bank, making it possible to consult its collection of documents and electronic publications, either via the Bank's website ([www.bportugal.pt](http://www.bportugal.pt)), or through free access to its reading room.

In 2008, the Bank library catalogued the collection of ancient books (19th century) and restored several works in need of specific expertise. It also continued to consolidate legal acts which the Bank does not directly issue but nevertheless enforces. An electronic version of the Official Bulletin of Banco de Portugal was also released on the Internet via SIBAP - Banco de Portugal Instruction System.

Both library and documentation services developed a communication plan consisting of a set of measures for internal and external users. This plan aims to increase awareness of reading rooms and services. In this field, Banco de Portugal began publishing the *Newsletter do DSADM – Área de Documentação, Edições e Museu* (DSADM's Newsletter - Documentation, publishing and museum), a quarterly publication distributed both within and outside the Bank in electronic format and hard copy. Articles tracing the history of Banco de Portugal buildings deserve special prominence as they focus on the agencies of Braga and Vila Real, as well as the head office. The particular article on the head office building history provides information on the new project to refurbish this building, where the future *Museu do Dinheiro* (the money museum) will also be installed.

With regard to archive matters, the archival description of the document collection in the Bank's Historical Archive proceeded and support continued to be provided to external research in the field of Portuguese banking and financial history. Within the research project on the history of Banco de Portugal, the archives collected biographical data as well as pictures of members of the Bank's management Boards.

The Bank's Museum permanent exhibition focuses on the history of money in the West of the Iberian Peninsula and has received a great number of visitors, both individuals and groups. The Museum organised several guided tours to exhibitions open to the general public during this year in Lisbon, Oporto and Ponta Delgada.

In 2008 the Oporto branch opened an exhibition featuring a collection of medals donated by the sculptor Charters de Almeida entitled *Memória e Intimismo* (memory and intimism). This exhibition features the different steps required to manufacture a medal or an object medal (*medalha-objecto*), from sketch to the final product, thus contributing to a better understanding of how a medal goes from concept to execution, as well as techniques used during the manufacturing procedures. Banco de Portugal issued a brochure to guide the audience through the exhibition containing pictures of exhibits and including a text from the artist. This brochure is available at [www.bportugal.pt](http://www.bportugal.pt).

The Bank also participated in the coordination and preparation of the European Commission's travelling exhibition named "The euro, our currency". This exhibition celebrates the 10 years of the euro and was inaugurated on 5 January 2009.

During this year, Banco de Portugal also signed a contract with *Biblioteca Nacional de Portugal* (national library of Portugal) to deposit in the Bank's museum a coin collection which was for many years part of the department of numismatics of that library. This transfer procedure is expected to be concluded in 2009, wherefore an important set of coins will be exhibited in the future money museum.

Preparatory work is being carried out to house the new museum in the former Church of S. Julião as part of a project to refurbish the head office of Banco de Portugal, within the scope of a municipal project to revitalise the Baixa Chiado area. Due to the size and objectives of this project, the Bank set up a working group consisting of internal experts and a firm of architects. This working group combines different areas, namely museography, architecture, engineering, communication and information technology systems towards creating an interactive and educational money museum intended for the general public.

In terms of publications, Banco de Portugal continued its editorial and (internal and external) information activities. During 2008 the Bank implemented a new solution for internal printing processes.

#### **8.10.6. Buildings and facilities**

In 2008 Banco de Portugal developed a Master Plan for the head office building, with the aim to strengthen the building's safety, namely against fire, floods, cyclones and earthquakes. A licence was formally assured by the relevant authorities of the City of Lisbon for this purpose.

Banco de Portugal also began a public tender to refurbish the Rossio building and finished the first conversion of offices into open spaces in Edifício Portugal. Measures were implemented to increase the reliability of technical installations, namely by conducting an energy audit of Edifício Portugal, covering an area of about 54,000 square metres, and redesigning the main heating, ventilation and air conditioning systems in the Carregado complex.

In the Regional Network, the agency in Braga was refurbished with better customer service, lighting and air conditioning. The exterior of the agency in Viseu was also renovated. The customer service area of the agency in Évora was redesigned and a Master Plan was developed for the Delegation in Funchal.

Turning to security matters, Banco de Portugal continued to remodel security systems and installations so as to their centralised management. Thus, the Bank carried out work to install a security operation centre on the -1 floor of Edifício Portugal. In order to improve some security procedures, supervise external human resources and optimise the use of security systems, some changes were implemented in the organisational structure of the *Serviço de Vigilância e Segurança* (Vigilance and security service), namely by appointing intermediate operational managerial staff (Building Supervisors).

Professional risk evaluations of Edifício Portugal and of the improvements to the Carregado complex were completed in cooperation with the Health Centre and Occupational Health Services. In addition, due to staff complaints, the air quality was analysed and corrected in specific situations.

Efforts were made throughout 2008 to increase cooperation with the police force and fire brigade towards the improvement of the Bank's security system. Banco de Portugal also continued to undertake training and awareness initiatives related to matters of safety and hygiene at work aimed at all Bank employees.

The Bank participated in a regional exercise (PROCIV) sponsored by the National Authority of Civil Protection (Portuguese acronym ANPC) for civil protection in the district of Lisbon carried out by simulating the total evacuation of Edifício Portugal. The outcome of this exercise was quite positive considering the number of entities involved. Mention should be made to the cooperation of Banco de Portugal employees, in particular the Floor Controllers.