

# Annual Report

Activities and Financial  
Statements 2017



BANCO DE  
PORTUGAL  
EUROSYSTEM



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Statements 2017



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EUROSYSTEM

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# Mission and values of Banco de Portugal

## Mission

Banco de Portugal is the central bank of the Portuguese Republic. It is part of the European System of Central Banks and the Eurosystem, the Single Supervisory Mechanism and the Single Resolution Mechanism.

Banco de Portugal's mission is to:

- Maintain price stability; and
- Promote financial stability.

## Values

Banco de Portugal's values are:

**Integrity** – Banco de Portugal's staff place society and public interest at the centre of their action and uphold high ethical standards;

**Competence, effectiveness, efficiency** – Banco de Portugal employs highly qualified staff in its business areas. Its governance model, internal organisation and processes use best practices as a benchmark.

**Independence** – Banco de Portugal is independent in functional, institutional, personal and financial terms, which is a prerequisite for compliance with its mission. Independence requires a clear mandate, the

impossibility of seeking or taking instructions from third parties, the protection of the status of members of decision-making bodies and financial independence;

**Transparency and accountability** – In compliance with its tasks in the context of the Eurosystem, Banco de Portugal is accountable to the Portuguese Parliament, the government and society for what it does, and why and how it does it;

**Team spirit** – Banco de Portugal's staff act in accordance with the principles of mutual assistance, knowledge sharing, loyalty and transparency;

**Social and environmental responsibility** – Banco de Portugal acts in a socially and environmentally responsible manner, operating as a social actor and advocate of corporate ethics.

The conduct of Banco de Portugal's staff is in accordance with high ethical standards enshrined in *Regulamento da Comissão de Ética e dos Deveres Gerais de Conduta dos Trabalhadores do Banco de Portugal* (Regulation of the Ethics Committee and the General Duties of Conduct of the Employees of Banco de Portugal).

# Message by the Governor

Ten years on from the start of the international financial crisis, the Portuguese economy is in a growth phase.

Economic growth accelerated in 2017, driven by investment, exports, and a sharp increase in employment, with the unemployment rate falling to pre-crisis levels. Economic agents continued to benefit from favourable financing conditions and the financial system today is more capitalised and therefore better equipped to perform its critical role in the sustainable financing of the Portuguese economy. Public confidence in the financial system was preserved and strengthened.



From the institutional viewpoint, both domestically and across Europe, 2017 was a year of transition, from the efforts to repair the damage of the financial crisis, to the work to complete and strengthen the post-crisis institutional environment, in particular, within the framework of the Banking Union and the Economic and Monetary Union.

By nature, growth phases involve a greater propensity to take on risk, and for that reason, it is important in this new context not to forget the lessons that we learned in the crisis and, above all, to prevent the resurgence of the factors that led up to it.

Like any other sector, the financial sector does not operate in a vacuum, and as a result is not, nor will be, immune to risks. This means that we have to ensure, firstly, that we have robust supervisory regulations, instruments and practices, particularly in the context of the Single Supervisory Mechanism, of which Banco de Portugal is part. And, secondly, it means that we have to adopt policies and instruments that allow us to anticipate, monitor and mitigate the risks to the stability of the financial system as a whole.

Despite the progress achieved in boosting solvency, reducing non-performing loans (NPLs) and improving the external perception of Portuguese banks, which are notable achievements, we have to continue to correct the imbalances, taking advantage of the favourable macroeconomic and financial context.

On one hand, the NPL stock on the Portuguese banks' balance sheets must continue to be reduced from its current high level to sustainable levels, despite the substantial reduction in 2017 – of about €9.3 billion. For this, we have to continue the strategy defined for the sector in Portugal, which is based on the ongoing revision of the applicable legal, judicial and tax framework, permanent monitoring by the supervisor within the Single Supervisory Mechanism, and, most

important of all, the institutions' engagement in managing their NPL portfolios.

At the same time, it is vital to continue to reduce the economic agents' leverage, particularly that of Portuguese companies, which are among the most leveraged in Europe. High leverage, in a context of low potential growth, leaves the Portuguese economy more vulnerable to adverse shocks, namely to a possible rise in interest rates or alterations to market sentiment, with negative consequences for households, companies and the financial sector.

Finally, at European level, the Banking Union must be completed, to give consistency to the national authorities' efforts to safeguard financial stability. A single deposit guarantee scheme and a robust mechanism for resolving distressed banks will help break the link between the sovereign and the banking sector, reducing the risks of cross contagion which appeared during the crisis.

Banco de Portugal will remain vigilant and proactive in the anticipation and mitigation of the financial system's vulnerabilities and risks and in defining the applicable national and international framework. In particular, it will monitor the institutions' adjustment to new regulatory and supervisory requirements, as well as the developments in market access conditions and the impact arising from the expected normalisation of monetary policy, which will involve the gradual withdrawal of monetary stimuli in the Eurosystem.



Carlos da Silva Costa

# Management of Banco de Portugal

Board of Directors\*



- 1 Governor  
Carlos da Silva Costa
- 2 Vice-Governor  
Elisa Maria da Costa Guimarães Ferreira\*\*
- 3 Vice-Governor  
Luís Augusto Máximo dos Santos\*\*
- 4 Director  
Hélder Manuel Sebastião Rosalino
- 5 Director  
Luís Manuel Sanches Leginha de Sousa\*\*
- 6 Director  
Ana Paula de Sousa Freitas Madureira Serra\*\*

\* As at 31 December 2017. Vice-Governors Pedro Miguel de Seabra Duarte Neves and José Joaquim Berberan e Santos Ramalho ceased functions on 7 September and 28 February 2017 respectively.

\*\* Appointed by Resolution of the Council of Ministers No 123/2017 of 24 August 2017, published in the Official Gazette No 174, Series I, of 8 September 2017.





## Board of Auditors\*

### Chairman

João António Morais da Costa Pinto

### Member

António Gonçalves Monteiro

\* As at 31 December 2017. Ana Paula de Sousa Freitas Madureira Serra ceased functions as member on 7 September 2017.



## Advisory Board\*

Carlos da Silva Costa

Elisa Maria da Costa Guimarães Ferreira

Luís Augusto Máximo dos Santos

Vítor Manuel Ribeiro Constâncio

José Alberto Vasconcelos Tavares Moreira

António José Fernandes de Sousa

João António Morais da Costa Pinto

Francisco Anacleto Louçã\*\*

Francisco Luís Murteira Nabo\*\*

João Luís Ramalho de Carvalho Talone\*\*

Luís Filipe Nunes Coimbra Nazaré\*\*

Fernando Faria de Oliveira

Cristina Maria Nunes da Veiga Casalinho

Roberto de Sousa Rocha Amaral

Pedro Miguel Amaro de Bettencourt  
Calado\*\*\*

\* As at 31 December 2017.

Pedro Miguel de Seabra Duarte Neves, José Joaquim Berberan e Santos Ramalho and Rui Manuel Teixeira Gonçalves ceased functions on 7 September, 28 February and 2 November 2017 respectively. Luís Miguel Couceiro Pizarro Beleza performed functions until 22 June 2017.

\*\* Appointed by Resolution of the Council of Ministers No 41/2017 of 23 February 2017, published in the *Official Gazette No 55*, Series I, of 17 March 2017.

\*\*\* Appointed by Resolution of the Presidency of the Regional Government of Madeira No 825/2017 of 2 November 2017, published in the *Official Journal No 190*, Series I, of 3 November 2017.





## Heads of department, regional delegations and district agencies\*

General Secretariat (SEC) José Gabriel Cortez Rodrigues Queiró  
Office of the Governor (GAB) Marta Sofia Fonseca Carvalho David Abreu  
Audit Department (DAU) José António Cordeiro Gomes  
Legal Enforcement Department (DAS) João António Severino Raposo  
Communication and Museum Department (DCM) Bruno Rafael Fernandes Proença  
Accounting Department (DCC) José Pedro Pinheiro Silva Ferreira  
Issue and Treasury Department (DET) Pedro Jorge Oliveira de Sousa Marques  
Financial Stability Department (DES) Ana Cristina de Sousa Leal  
Statistics Department (DDE) António Manuel Marques Garcia  
Economics and Research Department (DEE) Maria Isabel Sanches Horta Correia Rio de Carvalho  
Human Resources Department (DRH) Pedro Miguel de Araújo Raposo  
Risk Management Department (DGR) Gabriel Filipe Mateus Andrade  
Markets and Reserve Management Department (DMR) Helena Maria de Almeida Martins Adegas  
International Relations Department (DRI) Sílvia Maria Dias Luz  
Resolution Department (DRE) João Filipe Soares da Silva Freitas  
Administration Services Department (DSA) Diogo Alberto Bravo de Macedo  
Legal Services Department (DJU) Pedro Miguel da Silva Cerqueira Machado  
Payment Systems Department (DPG) Jorge Manuel Egrejas Francisco  
Information Systems and Technology Department (DSI) António Jacinto Serôdio Nunes Marques  
Banking Conduct Supervision Department (DSC) Maria Lúcia Albuquerque de Almeida Leitão  
Banking Prudential Supervision Department (DSP) Luís Fernando Rosa da Costa Ferreira

### Porto Branch

Ana Olívia de Morais Pinto Pereira

### Regional Delegations

Regional Delegation of the Azores Paulo Ruben Alvernaz Rodrigues  
Regional Delegation of Madeira Rui António da Silva Santa Rajado

### District Agencies

Braga Domingos Marques de Oliveira  
Castelo Branco José António Claro Gaudêncio  
Coimbra Maria João Botelho Raposo de Sousa  
Évora Catarina Sofia Amaral Silva Guerra  
Faro Maria Teresa Gomes Sameiro Macedo  
Viseu Gentil Pedrinho Amado

\* As at 31 December 2017.

# Specialised Committees\*

Specialised Committee for Financial Supervision and Stability (CESEF)  
Chairman Carlos da Silva Costa

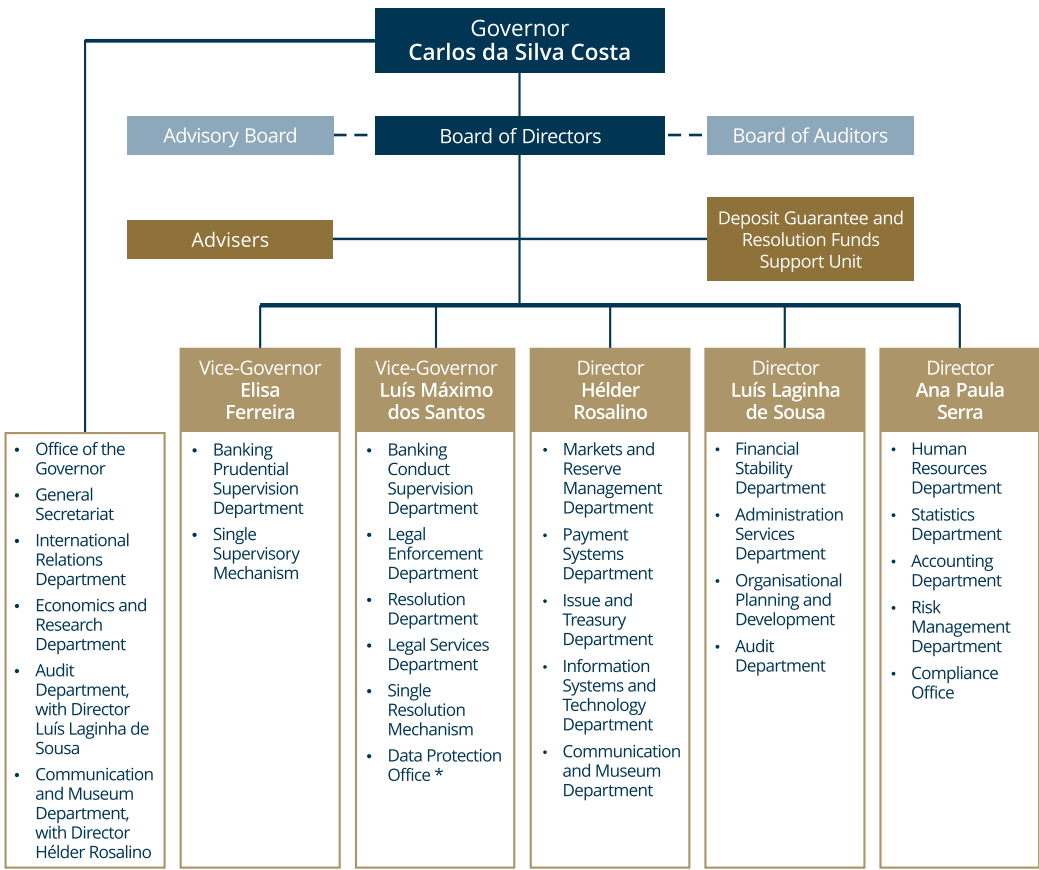
Committee for Risk and Internal Control (CR)  
Chairman Carlos da Silva Costa

Budget Monitoring Committee (CAO)  
Chairman Ana Paula de Sousa Freitas Madureira Serra

Specialised Committee for Information Systems and Technologies Management (CEGIT)  
Chairman Hélder Manuel Sebastião Rosalino

Ethics Committee\*\*  
Chairman Vítor Manuel da Silva Rodrigues Pessoa  
Member José da Cunha Nunes Pereira  
Member Vasco Manuel da Silva Pereira\*\*\*

Organisational chart of Banco de Portugal as at 31 December 2017



(a) The Data Protection Officer (DPO) was appointed on 17 October 2017; the Data Protection Office (GPD) was created on 12 December 2017; functional responsibility assigned to Vice-Governor Luís Máximo dos Santos on 14 February 2018.

\* As at 31 December 2017.

\*\* As at 31 December 2017. Orlando Pinguinha Calço ceased functions as member on 3 October 2017.

\*\*\* Appointed by deliberation of the Board of Directors of Banco de Portugal of 7 November 2017.



## I Activities

- 1 Monetary authority
- 2 Financial stability
- 3 Economic advice and openness to society
- 4 Internal management



# Highlights in 2017

In 2017 Banco de Portugal started the implementation of the Strategic Plan establishing the priorities for the four-year period 2017-2020. These priorities derive from Banco de Portugal's mission to safeguard financial stability and price stability.



## Monetary authority

Banco de Portugal:

- participated in the definition and implementation of the Eurosystem's standard monetary policy and non-standard programmes. The Governing Council of the European Central Bank decided to keep its key interest rates unchanged, to scale back the volume of monthly purchases under the asset purchase programme (APP) and to extend until September 2018 the period for implementation of this programme;
- ensured, on a continuous basis, that liquidity conditions were suitable for the Portuguese financial system and purchased securities, amounting to €15,445 million in net nominal terms, under the APP, increasing the net portfolio of securities held for monetary policy purposes on its balance sheet by 62%, to €40,174 million;
- managed its own investment asset portfolio, amid particularly demanding market conditions, continuing to diversify its sources of income, namely through an investment fund of the Bank for International Settlements and the lending of securities held in its portfolio, against collateral;
- managed, jointly with the central bank of Lithuania, one of the ECB's portfolios denominated in US dollars;
- issued regulations governing the In-house Credit Assessment System (Portuguese acronym: SIAC), a credit-rating tool to evaluate the credit quality of collateral accepted for Eurosystem operations, made available in 2016;
- prepared the process of transposing the revised Directive on payment services in the internal market (PSD2) into Portuguese law, in close collaboration with the Ministry of Finance;
- monitored the projects envisaging the provision of instant payment solutions to be implemented in 2018, both the national solution within the framework of SICOI (Portuguese Interbank Clearing System), and TARGET Instant Payment Settlement (TIPS), the new pan-European instant payment settlement service of the Eurosystem, as part of Banco de Portugal's participation in the Eurosystem's work;
- concluded an agreement with the central banks of Belgium and Austria aimed at merging the production quotas of the three central banks and dividing them between Valora and the Austrian printing works. This initiative will bring the annual production of Valora closer to capacity utilisation running one shift. Banco de Portugal acquired a 0.25% shareholding in the capital of EUROPAPI, a fiduciary paper manufacturer, opening up the possibility of buying at more favourable prices the paper for the manufacture of banknotes;
- put into circulation the €50 banknote of the Europa series, conducting a number of initiatives to raise awareness of its security features;

- received and checked an exceptional volume of damaged banknotes as a result of the wildfires in Portugal, enabling households and businesses to recover part of the amounts delivered to Banco de Portugal;
- entered into an agreement on the swap and delivery of euro circulation coins with the central bank of Ireland, which has been the largest-ever logistical operation of its kind in Portugal since the cash changeover.



## Financial stability

Banco de Portugal:

- developed a wide set of supervisory actions, including a number of measures specifically targeting the main Portuguese banking groups (in liaison with the ECB in the case of significant institutions), which helped reinforce the banking system's resilience and consequently contribute to safeguarding financial stability. It participated in the prudential supervision of all euro area credit institutions, the member of the Supervisory Board having voting power;
- participated in the revision of the Capital Requirements Directive and the Capital Requirements Regulation and in the negotiation process of draft legislation governing the creation of a European deposit insurance scheme;
- began work with credit institutions and financial companies to prepare for implementation of International Financial Reporting Standard 9 (IFRS 9);
- participated in the setting-up of the new regulatory framework governing money laundering and terrorist financing and started revising its regulatory instruments in this field;
- defined a macroprudential measure to mitigate the risks associated with new credit agreements relating to residential immovable property and consumer credit, which was announced in early 2018, as a recommendation;
- maintained the buffer methodology and levels for other systemically important institutions and decided to extend the deadline for compliance from two to four years;
- concluded the work involved in the resolution measure applied to Banco Espírito Santo, S.A., with the sale of 75% of Novo Banco's capital to Lone Star, thus eliminating the uncertainty conditioning the external assessment of the Portuguese banking system;
- participated in Banco Popular Español's pre-resolution and resolution processes, which allowed for the normal functioning of its subsidiary in Portugal;
- carried out the annual Supervisory Review and Evaluation Process (SREP) in 2017 for all systemically important institutions in Portugal (in liaison with the Single Supervisory Mechanism in the case of significant institutions), which made it possible to improve their business models and internal governance systems as well as to significantly reinforce their capital and liquidity positions;
- carried out work to define a strategy to reduce non-performing assets on banks' balance sheets and requested these institutions to have strategic plans for said reduction, which contributed to a considerable decrease in these assets on the banking system's balance sheet in 2017;
- contributed to the stabilisation of the various institutions' management teams, based on particularly demanding assessment processes. Also, it issued determinations on the capital levels of institutions and monitored deleveraging plans, contributing to improve their soundness and liquidity position;

- completed the analysis of over 115 processes relating to authorisation procedures, acquisition of qualifying holdings and statutory changes, some of which were particularly complex and important for the system;
- developed a series of regulatory initiatives on mortgage credit, credit intermediaries and minimum banking services, to increase and reinforce bank customer rights and to widen the scope of banking conduct supervision;
- published a report on availability, contracting and use of banking products and services via digital channels in Portugal, identifying the main obstacles to take-up and market development. Also, it enabled the opening of bank accounts exclusively at a distance, through videoconference;
- increased financial training courses across the country, through its regional network and participated as a non-G20 member country in G20's *Global Partnership for Financial Inclusion*;
- set up a permanent multidisciplinary team tasked with studying the evolution of Digital Banking and fintech and foreseeing by 2020 the challenges posed in the wider context of its mission and within the framework of its regulatory and supervisory responsibilities;
- settled 271 and initiated 154 administrative proceedings, analysed 12 proceedings for a possible withdrawal of the authorisation of credit institutions, financial companies and payment institutions, and conducted 32 proceedings for a possible reassessment of the suitability of the members of the management and supervisory bodies of supervised institutions;
- concluded its participation in the assessment of the national anti-money laundering and counter terrorist financing (ML/TF) system by the Financial Action Task Force (FATF), which recognised the effectiveness and sophistication of Banco de Portugal's supervisory model in terms of ML/TF and illicit financial activity prevention;
- pursued the implementation of the resolution process of Banif – Banco Internacional do Funchal, S.A., allowing the judicial liquidation process to start;
- participated, within the framework of the Single Resolution Mechanism, in the elaboration or update of resolution plans for the main Portuguese banking groups and in the definition of resolution practices and methodologies;
- provided services to the Resolution Fund, the Deposit Guarantee Fund and the Mutual Agricultural Credit Guarantee Fund, and supported the development of an IT tool for repayments to depositors. In the specific case of the Resolution Fund, it provided the support needed for the exercise of its tasks as sole shareholder of Novo Banco, S.A. and Oitante, S.A.



## Economic advice and openness to society

Banco de Portugal:

- approved the research agenda for the period 2017-20 – which sets out the priority fields for analysis and research over the four-year period – and organised several specialised conferences and seminars;
- started to provide granular information to researchers, via its Microdata Research Laboratory, and launched the International Network for Exchanging Experience on Statistical Handling of Granular Data (INEXDA), together with central banks from EU countries that are part of the G20;
- adopted a stakeholder management model, supported by a client relationship management software. It diversified its communication channels, formats and contents, and launched a new Bank Customer Website;

- launched a new regular publication: the *Annual Report on Cooperation*, which focuses on the activities developed in conjunction with counterparties from emerging and developing countries;
- hosted the 3rd Workshop on Financial Inclusion and Education for Central Banks of Portuguese-speaking countries, under which a protocol for technical cooperation was signed with the Alliance for Financial Inclusion to advance financial inclusion and education in Portuguese-speaking countries;
- won the Valmor and Municipal Architecture Award for the renovation project of the former Church of São Julião. The Money Museum was a finalist in the European Museum of the Year Award, and received several national awards, most noticeably the Best Museum of the Year Award;
- continued to run several social responsibility projects, which chiefly promote social inclusion of children and teenagers. It ran an in-house campaign to raise funds to support those affected by the wildfires that hit the country, and donated the proceeds to the REVITA Fund.



## Internal management

Banco de Portugal:

- enhanced the organisational and internal governance model to meet the need to separate the tasks involved in its participation in the Banking Union and to improve the alignment with central bank standards in terms of management and control;
- created the Communication and Museum Department to develop an integrated and coherent communication policy;
- created the Data Protection Office, headed by the Data Protection Officer, appointed on 17 October 2017;
- pursued a policy of integrated management of financial and operational risks;
- carried out 33 internal audits, 28 of which were exclusively domestic and five related to systems and processes that are common or shared with the Eurosystem, in order to assess the effectiveness of the governance, risk management and internal control processes, as well as the systems supporting the Bank's operation.
- launched the Programme for Strategic Leadership and Change towards Excellence (*Programa de Liderança Estratégica e Mudança para a Excelência*) for top management, continued the Advanced Leadership Programme (*Programa Avançado de Liderança*) for middle management and modernised human capital management platforms;
- invested in technological renewal and redesigned several sites under its management. Changed the technological infrastructure to implement a corporate database, continued to work on the new statistical website, a new Central Credit Register, a technological platform to support the Microdata Research Laboratory (*Laboratório de Investigação de Microdados – BPLim*) and an application for the analysis of collateral eligibility.
- created the Security Operation Centre to respond to and cooperate with Portuguese and international organisations on cybersecurity.

**Table I.1 • Banco de Portugal's activity in numbers**

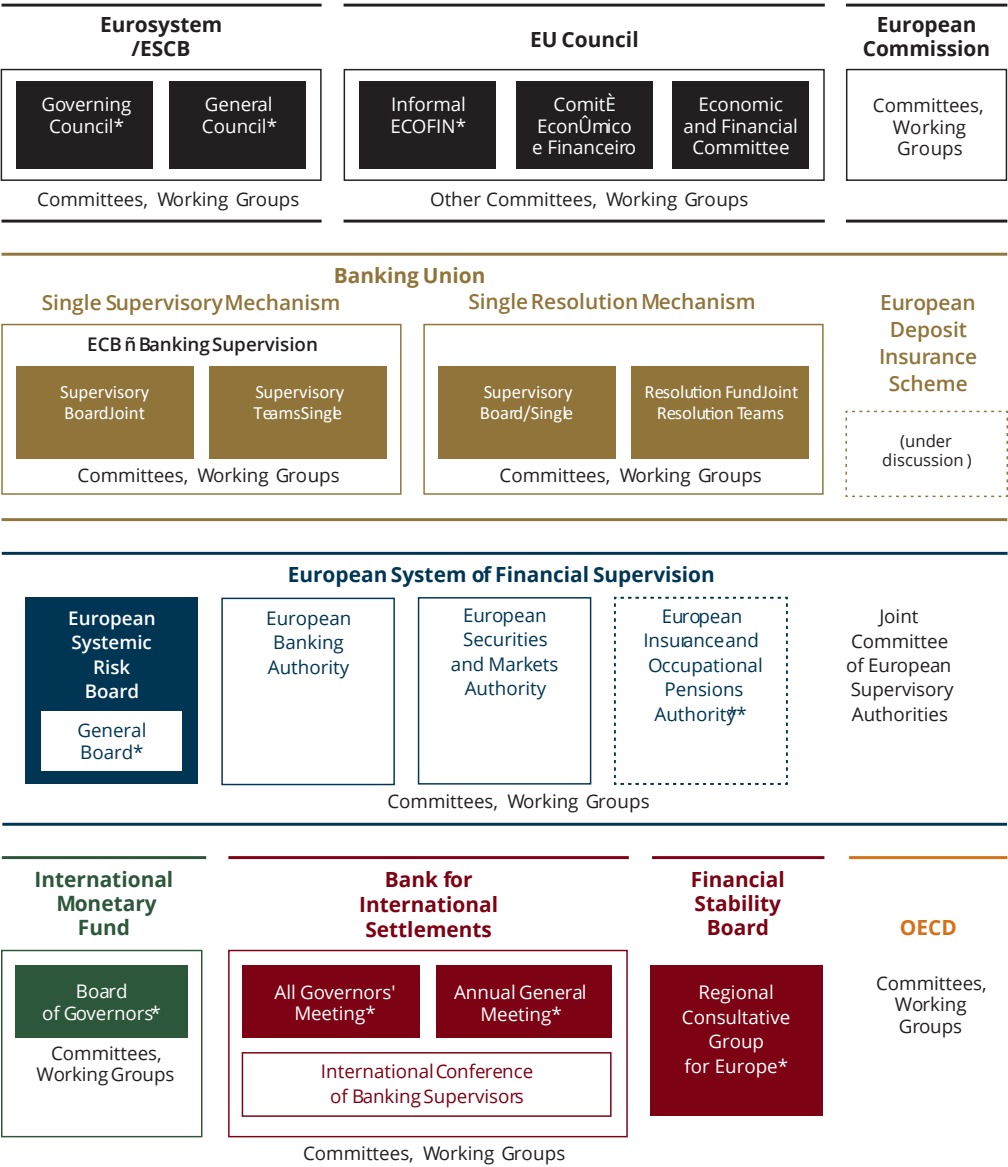
	2015	2016	2017
<b>As at 31 December</b>			
Number of employees	1,777	1,797	1,761
Number of active employees <sup>(a)</sup>	1,696	1,718	1,701
Average age of staff	44.1	43.8	43.5
Number of institutions registered in Portugal <sup>(b)</sup>	377	370	369
ECB foreign reserves managed by Banco de Portugal (EUR millions)	1,559	1,619	1,438
Gold portfolio			
(tonnes)	382.5	382.5	382.5
(EUR millions)	11,968	13,503	13,300
International institutional representation (groups in which Banco de Portugal participates)	391	462	480
<b>Annual total (volume)</b>			
Administrative proceedings initiated	283	276	154
Recommendations and specific orders – retail banking markets	1,034	1,020	753
Transactions settled through TARGET2-PT (thousands)	1,754	1,783	1,928
Transactions settled through SICOI (millions)	2,205	2,354	2,541
Processed euro banknotes (millions)	641	628	647
Counterfeit euro banknotes seized (c)	8,587	7,757	16,908
Cooperation initiatives carried out	106	129	126
Internal audits carried out	43	36	33
Statistical series reported to international organisations	628,371	690,541	716,000
Visitors to the Money Museum	29,142	58,467	62,859
Donated meals	11,213	10,529	10,637
<b>On average</b>			
"Average balance of open market operations and standing facilities – Resident counterparties (EUR millions)"	26,972	24,024	22,862
Average balance of monetary policy portfolios in Banco de Portugal's balance sheet (EUR millions)	10,250	24,729	40,174
Visits to Banco de Portugal's new institutional website (daily average)	–	41,210	41,416
Visits to the Bank Customer Website (daily average) (d)	–	–	3,342

(a) Excluding staff on secondment or on unpaid leave. (b) Credit institutions, financial companies and payment institutions. (c) In cooperation with the criminal police. (d) Available since 19 November 2017.

# Banco de Portugal in the European Union and international contexts

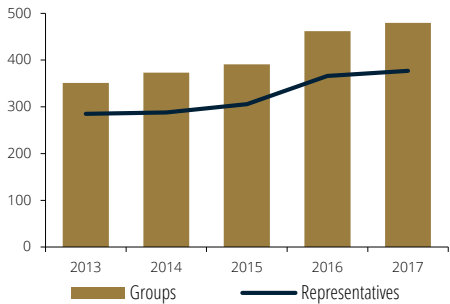
Banco de Portugal is part of the Eurosystem/European System of Central Banks (ESCB) and the Banking Union Mechanisms, participating in their governance at the highest level. It also participates actively in the European System of Financial Supervision – specifically in the European Systemic Risk Board and in the European Banking Authority – and in other European Union (EU) institutions. In addition, Banco de Portugal also participates in other organisations at global level (Figure I.1). In 2017, the Bank took part in 480 groups of international organisations (Charts I.1 and I.2).

**Figure I.1 • Main international bodies – Representation of Banco de Portugal and the Governor**

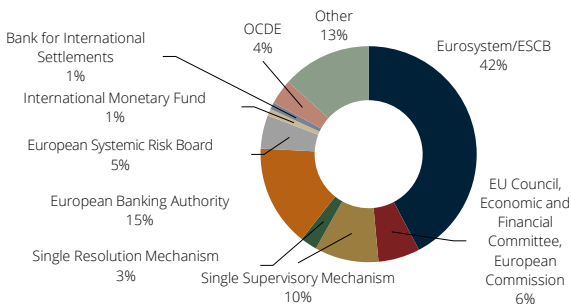


Source: Banco de Portugal. | \* Participation of the Governor. \*\* Banco de Portugal is not represented.

**Chart I.1 • Evolution of international activity**



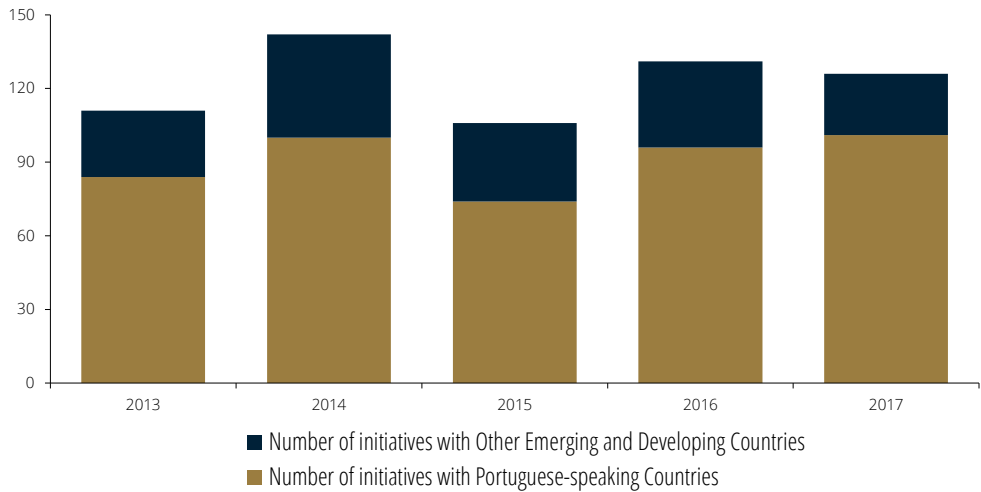
**Chart I.2 • International representation per organisation**



In 2017, Banco de Portugal’s international agenda chiefly focused on topics related to Economic and Monetary Union (in particular the Banking Union), the adjustment of banks’ balance sheets, namely in response to the need to reduce the weight of non-performing assets and to comply with the new regulatory requirements and technological evolution, the innovation and integration of payment and market infrastructures, and the impact of the United Kingdom’s exit from the EU. Banco de Portugal also has cooperation relations with its counterparts in emerging and developing countries, notably Portuguese-speaking countries.

In 2017, Banco de Portugal carried out 126 cooperation initiatives (Chart I.3), 80% of which with its counterparts in Portuguese-speaking countries. The Principles and Recommendations of Cooperation between Central Banks of Portuguese-speaking Countries promoted developments in this activity, which included the carrying out of remote initiatives and the commitment to making an explicit and systematic assessment of cooperation quality.<sup>1</sup> These principles and recommendations were also used as a benchmark for the best practice adopted by the ESCB in this domain.

**Chart I.3 • Cooperation activity**



Source: Banco de Portugal.

1. For further details, see the *Annual Report on Cooperation 2017*

Banco de Portugal participated as facilitator in the Financial Intelligence Units session of the Support Project for the Consolidation of the Rule of Law in Portuguese-speaking African countries and Timor-Leste.

The 27<sup>th</sup> *Lisbon Meeting* and the *Conference entitled Money in Africa – Monetary and financial decolonisation in Africa in the 20th Century*, the latter co-organised by Banco de Portugal, were high-profile events in the cooperation field in 2017. Also noteworthy was Banco de Portugal's organisation of the 3<sup>rd</sup> *Meeting of Portuguese-speaking Central Banks on Financial Inclusion and Education*, under which a cooperation protocol was signed between the said central banks and the Alliance for Financial Inclusion, a G20-partner non-governmental organisation aimed at promoting financial inclusion and education in Portuguese-speaking countries.

# 1 Monetary authority

## 1.1 Monetary policy

Banco de Portugal shares responsibilities over the definition of euro area monetary policy, in accordance with the main objective of the Eurosystem which is the maintenance of price stability. Monetary policy decisions are taken by the Governing Council of the ECB, which consists of the governors of the Eurosystem national central banks plus the members of the Executive Board of the ECB, totalling 25 members. In the course of 2017 eight meetings were held to discuss the Eurosystem's monetary policy.

In 2017 the Governing Council kept the key ECB interest rates unchanged, maintaining the rates on the main refinancing operations at 0%, on the marginal lending facility at 0.25% and on the deposit facility at -0.40%. As regards the non-standard monetary policy measures, the volume of monthly purchases under the asset purchase programme (APP) was scaled back from €80 to €60 billion, as of April 2017 to the end of the year. In October, the ECB decided to extend the APP by nine months, until September 2018, reducing the amount of monthly asset purchases to €30 billion during this additional period. Also in October, the ECB decided to extend the Fixed Rate Full Allotment (FRFA) tender procedures until the end of the last reserve maintenance period of 2019.

As part of the decentralised implementation of monetary policy in the Eurosystem, Banco de Portugal conducted the monetary policy operations with credit institutions established in the country, managed their collateral, produced the daily forecast of the liquidity needs of the banking system and monitored compliance with the minimum reserve requirements.

Of the 37 institutions established in Portugal that were eligible to participate in the Eurosystem's open market operations and standing facilities, 14 participated in at least one operation. The Eurosystem conducted 126 open market operations, including US dollar-denominated liquidity providing operations and the resident institutions participated in 71 of those operations. Recourse to the deposit facility and marginal lending facility decreased by 13% compared with 2016, reflecting higher excess liquidity in the institutions and a disincentive to use the deposit facility, given that excess reserves are remunerated at the rate of -0.40%. The average balance of open market operations and standing facilities decreased by 5% to the amount of €22,862 million.

Turning to the APP, the average balance of monetary policy portfolios on Banco de Portugal's balance sheet recorded a further significant increase in 2017, reaching €40,174 million.

As regards the list of eligible assets of the Eurosystem, Banco de Portugal analysed the eligibility of securities traded in Portuguese markets accepted for the purpose, having identified and reported 48 new securities eligible and introducing 1,782 updates in the list. At the end of 2017, the list contained 135 securities reported by Banco de Portugal as eligible, from a universe of 34,610 securities eligible in the Eurosystem. The regulations governing Banco de Portugal's In-house Credit Assessment System (Portuguese acronym: SIAC)<sup>2</sup> were published in March. SIAC is a credit-rating tool to evaluate the credit quality of collateral accepted for Eurosystem operations, which was made available in 2016. In December, the Governing Council of the ECB approved the expansion of SIAC to non-financial reporting entities, in line with the Standard Accounting System.

2. Instruction of Banco de Portugal No 2/2017, available at <https://www.bportugal.pt/instrucao/22017>.

**Table I.1.1 • Monetary policy implementation – main indicators**

	2014	2015	2016	2017	Δ 2017/2016
Number of Eurosystem open market operations	249	128	136	126	-7%
Number of open market operations in which resident counterparties participated	120	74	83	71	-14%
Number of uses of standing facilities by resident counterparties	185	88	60	52	-13%
Number of eligible (resident) counterparties	38	39	37	37	0%
Number of (resident) counterparties participating in open market operations and standing facilities	28	23	25	14	-44%
Average balance of open market operations and standing facilities (EUR millions)	39,455	26,972	24,023	22,862	-5%
Average balance of collateral pools (resident counterparties, EUR millions)	68,596	54,913	52,938	50,772	-4%
Average balance of monetary policy portfolios (EUR millions)	5506	10,250	24,729	40,174	62%

Source: Banco de Portugal. | Note: The average balance of open market operations and standing facilities corresponds to the balance of liquidity-providing operations net of the average balance of liquidity-absorbing operations.

Banco de Portugal controlled the risks of monetary policy operations by applying eligibility criteria to collateral and variation margins on the respective valuation and imposing limits on their use, as envisaged within the framework of the Eurosystem. Banco de Portugal also monitored and analysed the performance of the approved internal ratings-based (IRB) systems to be used by national credit institutions to evaluate the risk of collateral accepted for Eurosystem credit operations.

## 1.2 Asset management

Banco de Portugal manages two types of portfolios: (i) the ECB's foreign reserve portfolio, corresponding to the initial transfer of foreign reserve assets from Banco de Portugal to the ECB, according to the ECB's capital key; and (ii) Banco de Portugal's own investment asset portfolio. Banco de Portugal's non-monetary policy holdings are constrained by the limit established in the Agreement on Net Financial Assets between the euro area national central banks and the ECB.<sup>3</sup> In 2017, the average balance of net financial assets held by Banco de Portugal was €8,060 million.

### ECB foreign reserve management

The management of the ECB foreign reserves is decentralised, in accordance with an agency agreement concluded with the Eurosystem national central banks. On the basis of the currency specialisation model, Banco de Portugal has managed a US dollar-denominated portfolio as of early 2012. Since January 2015, this management has been jointly made with the central bank of Lithuania, comprising the amount of the ECB reserves allocated to the two countries. As at 31 December 2017, the portfolio amounted to USD 1,725 million (€1,438 million).

### Management of Banco de Portugal's own investment assets

Banco de Portugal's own investment asset portfolio is composed of assets denominated in euro, foreign currency and gold. Assets in the trading portfolio denominated in foreign currency and a large share of euro-denominated assets are actively managed and valued at market prices.

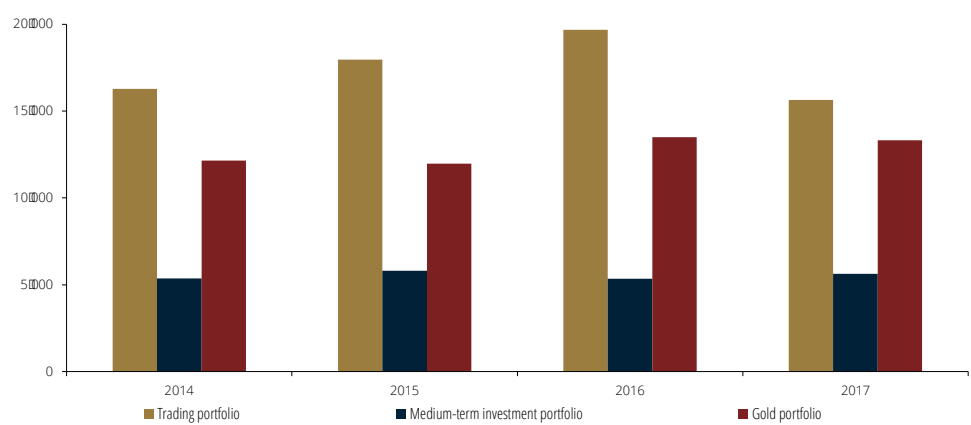
3. For further details, see the ECB's website.

Amid particularly difficult market conditions for management, with negative interest rates in a number of maturities as regards investment in euros and with the broad-based depreciation of foreign currencies against the euro, Banco de Portugal continued to diversify its sources of income, namely through an investment fund of the Bank for International Settlements (BIS) and the lending of securities held in its portfolio, against collateral.

Assets in the medium-term investment portfolio are held to maturity and valued at amortised cost. Assets in gold are valued at market prices.

As at 31 December 2017, Banco de Portugal’s own investment asset portfolio amounted to €34,596 million, i.e. 10.2% less than in the previous year, largely due to the decision to reduce the assets held in the trading portfolio, amid very low or even negative interest rates in the euro area (Chart I.1.1).

**Chart I.1.1 • Own investment asset portfolio**



Source: Banco de Portugal.

Reversing developments recorded in 2016, the medium-term investment portfolio increased 5.5% in 2017, due to the transfer of funds from the trading portfolio, as yields increased, enabling investment at positive rates. As a reflection, the trading portfolio, at year-end prices and exchange rates, decreased by 20.5%, with 77.1% of its funds invested in euro-denominated securities. Although, similarly to previous years, the quantity of gold held by Banco de Portugal remained unchanged (382.5 tonnes), the value of the gold reserve expressed in euros declined by 1.5% due to the depreciation of the US dollar.

Banco de Portugal controlled the risk of asset management operations by imposing eligibility criteria on the operations, instruments and institutions and setting maximum exposure limits. These criteria and limits are set out in the internal guidelines approved by the Board of Directors and were established taking into account the credit, exchange rate and interest rate risks of assets and operations.

Overall risk developments associated with asset management and monetary policy operations were monitored within the framework of the integrated management policy of financial risks and operational risks pursued by Banco de Portugal (Chapter 4).

## 1.3 Payment systems

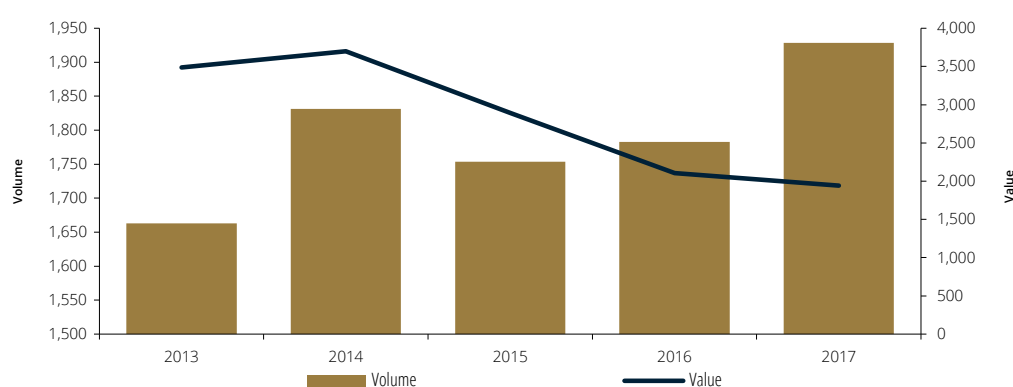
2017 was marked by the work preparing the implementation in Portugal of the revised Directive on payment services in the internal market (PSD2).<sup>4</sup> In the digital innovation and fintech field, Banco de Portugal fostered the dialogue and interaction with the relevant stakeholders in the payments market and co-organised with CIONET the *PayChallenge/The Future of Payments and Fintech*, an event intended to promote the creation of innovative technological solutions in the payments market within the scope of PSD2. 2017 also saw preparatory work for the provision, in the short run, of instant payment solutions for Portugal. As a result, in 2018, a new sub-system of SICOI (the Portuguese Interbank Clearing System) is due to be launched for the processing of instant transfers and the TARGET Instant Payment Settlement (TIPS), the new Eurosystem's pan-European instant payment settlement service.

As part of the payment systems oversight, Banco de Portugal monitored and assessed on a regular basis the retail payment system (SICOI) and the large-value payment systems (TARGET2-PT and TARGET2-Securities), as well as the other financial market infrastructures to ensure their reliability and efficiency.

### Gross payment and securities settlement systems

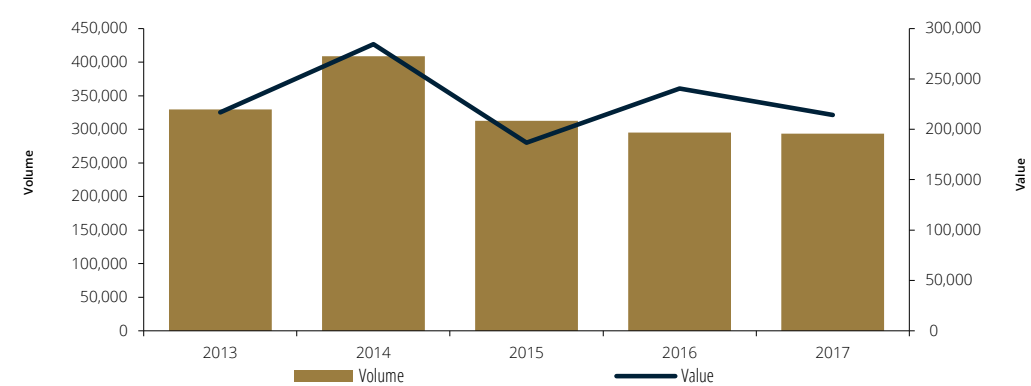
In 2017, TARGET2-PT (the Portuguese component of the real-time gross settlement system for euro payments) maintained operational availability at 100% and processed more than 1.9 million transactions, to the amount of €1,942 billion. Despite an increase of 8.2% in the volume of transactions, there was a 7.7% reduction in value (Chart I.1.2). The total value of securities transactions settled in TARGET2-Securities by the national community (€214 billion) also declined, dropping by 11% (Chart I.1.3).

**Chart I.1.2 • Overall transactions through TARGET2-PT | Volume in thousands and value in € billion**



4. Directive (EU) 2015/2366 of 25 November 2015.

**Chart I.1.3 • Settlement of securities of the national community | Volume in thousands and value in € billions**

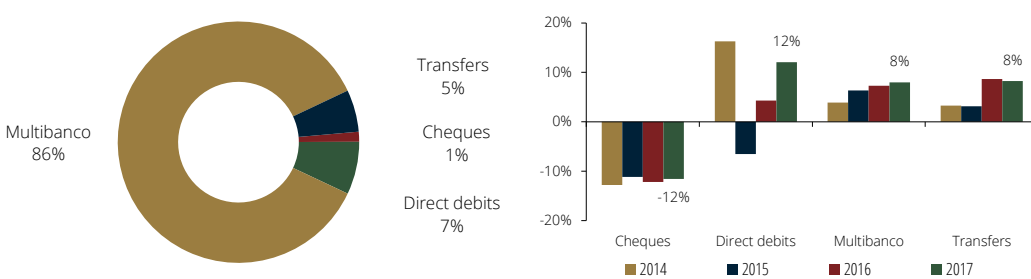


(a) Figures for the period between 2013 and March 2016 refer to Interbolsa operations settled in TARGET2.

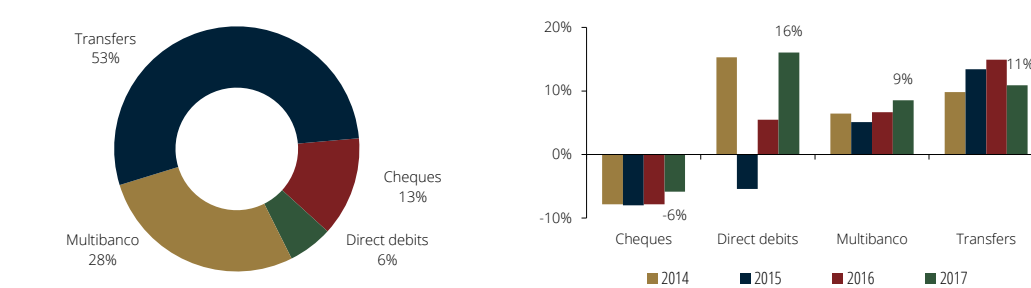
### Retail payment system

Banco de Portugal ensures the smooth running of the retail payment system, SICOI, which processes and clears payments by cheque, bills of exchange, direct debits, credit transfers and bank cards. In 2017, SICOI processed €2.5 billion transactions, totalling €417 billion, accounting for an increase of 8%, both in volume and value. The use of electronic payment instruments continued to grow, conversely to the use of cheques, which decreased by 12% in volume and 6% in value (Charts I.1.4 and I.1.5).

**Chart I.1.4 • Relative weight of payment instruments in SICOI in 2017 and year-on-year growth rates | in volume**



**Chart I.1.5 • Relative weight of payment instruments in SICOI in 2017 and year-on-year growth rates | in value**



In order to prevent the unlawful use of cheques, Banco de Portugal manages and discloses a List of Cheque Defaulters across the banking system. In 2017, 10,003 entities were added to the list; 12,671 were removed, following a decision of Banco de Portugal or upon expiry of the applicable legal period. On 31 December 2017, the list included 17,263 entities.

### Banknotes and metal coins

Banco de Portugal is the institution entrusted with the production of banknotes at national level. Since the introduction of the euro, banknote printing has been awarded to Valora S.A., a company fully owned by Banco de Portugal.

Pursuing the interaction strategy with other national central banks, with the ECB and with private printing works, Banco de Portugal concluded, in 2017, an agreement with the central banks of Belgium and Austria aimed at merging the production quotas of the three central banks and dividing them equally between Valora and the Austrian banknote printing works. This initiative will bring the annual production of Valora closer to capacity utilisation running one shift.

Banco de Portugal also acquired a 0.25% shareholding in the capital of EUROPAPI, a fiduciary paper manufacturer (in which the central bank of France has a majority shareholding), opening up the possibility of buying at more favourable prices the paper for the manufacture of banknotes, and during the periods in which Banque de France's capacity is not sufficient to meet its orders, Valora will be able to produce banknotes for this central bank, taking advantage of the production capacity installed in Carregado printing works.

In 2017, the 50 euro banknote of the Europa series was put into circulation. Banco de Portugal conducted a number of initiatives to raise awareness of the security features of this banknote.

As part of its cash handling functions, Banco de Portugal checked the authenticity and fitness for circulation of 647 million banknotes received from the general public and credit institutions, of which 141 million were considered unfit. Although most banknotes are processed through high-speed machines, the banknotes received by Banco de Portugal that are extremely damaged and fragmented are subject to a complex manual analysis and evaluation process.

As a result of the wildfires in Portugal in 2017, Banco de Portugal received a far higher volume of damaged banknotes. The analysis of damaged banknotes, requiring painstaking and demanding work, had a positive impact on households and businesses hit by the fires, as they were able to recover part of the amounts they had delivered to Banco de Portugal. 35,600 euro banknotes and 2,433 escudo banknotes (legacy currency) were evaluated in 2017, corresponding to an increase of approximately 64% from 2016, when 23,150 banknotes were evaluated (21,145 euro banknotes and 2,005 escudo banknotes).

16,908 counterfeit banknotes were withdrawn from circulation (corresponding to 2.4% of the total number of counterfeits seized in the euro area), mostly €20 and €50 banknotes.

Turning to coins, Banco de Portugal entered into an agreement on the swap and delivery of euro circulation coins with the central bank of Ireland, under which Banco de Portugal swapped at face value €2 coins, in excess in Portugal due to the significant migration of these coins into the country and their less frequent use in payments, for 1 and 2 cent coins, in excess in Ireland as a result of the adoption of voluntary rounding in payments. This operation involved moving 274 million coins, the largest-ever logistical operation of its kind in Portugal since the cash changeover.

In 2017, Banco de Portugal carried out a satisfaction survey of credit institutions and cash-in-transit companies on its cash-related services. Results show a degree of overall satisfaction of 3.6, on a scale of 1 to 4.

## 2 Financial stability

### 2.1 Regulatory framework

In 2017 Banco de Portugal participated in the following: (i) the negotiation process of European Commission draft legislation for the revision of the Bank Recovery and Resolution Directive (BRRD),<sup>5</sup> the Single Resolution Mechanism Regulation (SRMR),<sup>6</sup> the Capital Requirements Directive (CRD IV), and the Capital Requirements Regulation (CRR);<sup>7</sup> (ii) the negotiation of the European Commission draft legislation governing the creation of a European deposit insurance scheme (EDIS); (iii) the Commission's public consultation on the revision of the European System of Financial Supervision and the monitoring of the legislative initiatives that the Commission subsequently put forward (Box 1). Banco de Portugal monitored the negotiation process of said draft legislation, where applicable, in liaison with the Ministry of Finance and the Portuguese Permanent Representation to the European Union, so as to contribute to establish a national position. At domestic level, work was undertaken (and is still under way) to revise the Legal Framework of Credit Institutions and Financial Companies.

Banco de Portugal participated in the implementation in Portugal of the ECB's Guideline and Recommendation<sup>8</sup> on the exercise of options and discretions available in Union law by national competent authorities in relation to less significant credit institutions, which culminated in the publication of Notice of Banco de Portugal No 10/2017,<sup>9</sup> preceded by a public consultation. In addition, Banco de Portugal also began work with credit institutions and financial companies to prepare for implementation of International Financial Reporting Standard 9 (IFRS 9) on financial instruments, conducting horizontal evaluations of the institutions' readiness to implement this standard and promoting close interaction between institutions, auditors and advisers.

In 2017 Banco de Portugal concluded its participation in the setting-up of the new regulatory framework governing money laundering and terrorist financing (ML/TF) – closely monitoring the revision of Directive (EU) 2015/849 (Fourth Anti-Money Laundering Directive) – and started revising its regulatory instruments in this field.

Banco de Portugal also participated in the public consultation that followed the publication of the report by the Working Group for Financial Supervision System Reform.

5. Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.

6. Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund.

7. Directive 2013/36/EU and Regulation (EU) No 575/2013 respectively. Under the scope of the revision of Regulation (EU) No 575/2013, transitional arrangements for mitigating the impact of the introduction of IFRS 9 were adopted as of 1 January 2018 on own funds and for the large exposures treatment of certain public sector exposures (Regulation (EU) 2017/2395).

8. Guideline (EU) 2017/697 (ECB/2017/9) and Recommendation (ECB/2017/10).

9. See Notice of Banco de Portugal 10/2017 (in Portuguese only).

## 2.2 Macroprudential policy

In the exercise of its powers as the national macroprudential authority, Banco de Portugal worked on defining a measure to mitigate the risks associated with new credit agreements relating to residential immovable property and consumer credit. This measure, announced in early 2018 as a recommendation, consisted of the introduction of limits to the maturity of loans and to loan-to-value (LTV) and debt-service-to-income (DSTI) ratios.<sup>10</sup>

Banco de Portugal maintained the buffer methodology and levels for other systemically important institutions (O-SIIs), but decided to extend the deadline for compliance from two to four years.

On a quarterly basis, Banco de Portugal reassessed and introduced no changes to the countercyclical capital buffer, which remained at 0%. In addition, it carried out the annual exercise to identify the third countries that are relevant for the Portuguese banking system, keeping the same countries identified in the previous exercise.<sup>11</sup>

Within the scope of macroprudential policy, a special issue was published in the December *Financial Stability Report* assessing the need to include the leverage ratio in the set of macroprudential instruments in Portugal. It led to the conclusion that introducing this ratio as a microprudential requirement is for the time being deemed sufficient to alleviate excessive leverage in the financial system.

## 2.3 Stability of the portuguese financial system

In 2017 Banco de Portugal reinforced the analytical component of the *Financial Stability Report*, which focused on the issues that are most important from the viewpoint of financial stability at the current stage of the Portuguese economy's business and financial cycle:<sup>12</sup> the challenges posed to the Portuguese banking system, the strategy to address the stock of non-performing loans (NPLs), the assessment of a possible overvaluation of residential property market prices, and the vulnerability of resident economic agents to interest rate rises, given their high indebtedness level.

In the assessment of risks and vulnerabilities, Banco de Portugal took into consideration capital and funding plans and the top-down model<sup>13</sup> for the banking sector, which are key instruments for building scenarios and analysing the sensitivity of the Portuguese banking sector.

Work began to define a strategy to reduce the NPL stock on the banking sector's balance sheet<sup>14</sup>, given the excessive share of NPLs on Portuguese banks' balance sheets and the resulting constraints on the recovery of the system's profitability.

In 2017 the Portuguese banking system continued to show progress in various important fields, namely solvency, profitability and asset quality (Table I.2.1).

10. For further details, see Banco de Portugal's website.

11. Republic of Angola, Republic of Mozambique, and Macao Special Administrative Region of the People's Republic of China.

12. For further details, see the boxes and the special issue published in the *Financial Stability Report* of June 2017 and December 2017.

13. The top-down model is a model used for projecting the banking sector's balance sheet and income account and their impact on the relevant prudential ratios (capital and liquidity), given a specific macroeconomic and financial scenario.

14. For more information see Box 3 in the *Financial Stability Report* of June 2017 and Special issue in the *Financial Stability Report* of December 2017.

Banco de Portugal also participated in the IMF annual Article IV consultation with Portugal and in the post-programme monitoring associated with the EU/IMF Economic and Financial Assistance Programme.

**Table I.2.1 • Portuguese banking system indicators**

	Dec. 14	Dec. 15	Dec. 16	Dec. 17
Capital ratio (CET1)	11.3	12.4	11.4	13.9
Return on assets (ROA)	-1.3	0.2	-0.6	0.3
Asset quality:				
NPL ratio	n.d.	17.5	17.2	13.3
NPL coverage ratio	n.d.	40.8	45.3	49.3
Loan-to-deposit ratio	102.1	96.1	95.3	92.6

Source: Banco de Portugal. | Notes: NPL means non-performing loans. Information on NPLs follows the European Banking Authority definition.

### Prudential supervision

In 2017 a wide set of supervisory actions was developed, including a number of measures specifically targeting the main Portuguese banking groups. In the case of significant institutions, this involved very active participation at Single Supervisory Mechanism (SSM) level, which helped reinforce the banking system's resilience and consequently financial stability.

Completion of the sale of Novo Banco was one of the cornerstones of Banco de Portugal's intervention in 2017. The end of this process eliminated the uncertainty affecting the external assessment of the Portuguese banking system. Banco de Portugal's active intervention was instrumental for completion of this process on the forecast date, by assuming a proactive role that led to the SSM's approval of the operation.

Banco de Portugal also participated in Banco Popular Español's pre-resolution process, which allowed for the normal functioning of its subsidiary in Portugal, given its protection under the resolution measure adopted.

The annual supervisory process in 2017 for all systemically important institutions in Portugal (in liaison with the SSM in the case of significant institutions) made it possible to improve their business models and internal governance systems as well as to significantly reinforce their capital and liquidity positions.

As regards the business model, work was carried out at the level of non-performing assets, by imposing, challenging and monitoring strategic plans to reduce NPLs, which contributed to a considerable decrease of approximately €9,300 million in these assets on the banking system's balance sheet in 2017.

In terms of internal governance, given that it is a critical field for the stability of institutions, supervisory actions were carried out with a view to reinforcing the internal control and governance mechanisms. In this field, Banco de Portugal helped ensure the stabilisation of the various institutions' management teams (with 479 persons authorised and 84 recommendations issued), based on particularly demanding assessment processes.

As regards the capital position, the determinations issued in the supervisory process made it possible to strengthen the capital levels of the institutions under supervision, totalling more than €7 billion between September 2016 and December 2017.

In turn, the monitoring of deleveraging plans and the requesting of contingency plans led to a strengthening of institutions' liquidity position, which translated into an improvement in the liquidity ratios of the main institutions and the stabilisation of deposits collected.

In addition, with regard to authorisation procedures, the acquisition of qualifying holdings and statutory changes, over the course of 2017 more than 115 processes were analysed, some of which were particularly complex and important for the system.

### Banking conduct supervision

Banco de Portugal developed a series of regulatory initiatives, within the scope of the implementation of European Union legislative acts, covering, with regard to payment accounts, minimum banking services; with regard to mortgage credit, the compensation and technical skills of the institutions' staff; and for all types of credit, consumer creditworthiness assessment and credit intermediaries' activities. This regulatory framework resulted in an increase and reinforcement of bank customer rights and the widening of the scope of banking conduct supervision.

In a context of growing use of digital channels for banking products and services, Banco de Portugal published a report on availability, contracting and use of banking products and services via digital channels in Portugal, identifying the main obstacles to take-up and market development.<sup>15</sup> So as to mitigate any regulatory barriers identified in the marketing of banking products and services via digital channels and meet bank customer's expectations and needs, while enabling the mitigation of new risks, Banco de Portugal amended Notice No 5/2013 to allow for the opening of bank accounts exclusively at a distance, and bank customers may verify their identification data through videoconference.

In 2017 supervision by Banco de Portugal intensified, with a rise in the number of complaints received (8.1% more than in 2016, totalling 15,282) and advertising media analysed (10.8% more, totalling 9,501).

Banking conduct supervision by Banco de Portugal involved more (on-site) inspections of institutions to verify compliance in terms of their activity in branches and central services, covering more issues, focusing in particular on consumer credit, minimum banking services and payment instruments.

Following on from its supervisory activities, Banco de Portugal issued 753 specific recommendations and determinations requiring the correction of the irregularities detected, mostly on consumer credit issues. It also initiated 55 administrative offence proceedings to penalise serious breaches of the rules applicable to retail banking markets.

In international banking conduct supervision fora, Banco de Portugal's work was recognised with the invitation to participate as a non-G20 member country in G20's Global Partnership for Financial Inclusion. In addition, a report was developed within the scope of FinCoNet – which is vice-chaired by Banco de Portugal – entitled *Online and mobile payments: An overview of supervisory practices to mitigate security risks*, prepared by a FinCoNet working group chaired by Banco de Portugal.

Banco de Portugal launched the new *Portal do Cliente Bancário* (Bank Customer Website), Chapter 3, reinforcing its role in promoting financial information and training for bank customers. By using

15. This publication benefited from the information collected in a questionnaire sent to supervised institutions. The results of this questionnaire are published in a report entitled *Comercialização de produtos e serviços bancários nos canais digitais em Portugal* (2016), available for download at <https://cliente.bancario.bportugal.pt/sites/default/files/2017-10/QuestCanaisDigitais2016.pdf> (only available in Portuguese).

more advanced technologies, a simpler and more direct language, and more intuitive browsing, the new website renewed the content presentation, thus meeting more adequately the needs of its different target audiences. This effort was accompanied by an increase in financial training courses hosted by Banco de Portugal across the country, through its regional network.

Banco de Portugal participated in National Plan for Financial Education initiatives, promoted jointly with the other financial supervisors. Within this scope, new strategic partnerships were launched (with the Comissão de Coordenação e Desenvolvimento da Região Norte and the Sindicato dos Jogadores Profissionais de Futebol) to address new target audiences that, jointly with the already existing partnerships (school audiences, owners of small and medium-sized enterprises and social entrepreneurs), led to the holding of the first Financial Training Week (30 October-3 November).

### Legal enforcement

In terms of prevention and repression of illicit financial activity, Banco de Portugal conducted off-site and on-site inquiries in 193 proceedings. These led to the initiation of 14 administrative proceedings, 13 notifications to the Prosecutor General of the Portuguese Republic for signs of criminal offence, and public warnings to 30 entities not authorised to pursue financial activity. Furthermore, Banco de Portugal cooperated with police and judicial authorities, participating in investigations on matters of common competence.

In terms of preventive supervision of ML/TF, Banco de Portugal successfully concluded its participation in the assessment of the national anti-money laundering and counter terrorist financing system by the Financial Action Task Force (FATF), which recognised the effectiveness and sophistication of Banco de Portugal's supervisory model in terms of ML/TF and illicit financial activity prevention. Banco de Portugal also made an active contribution to the work of the AML/CFT Coordination Committee in the context of the FATF assessment and the preparation of a number of preliminary draft laws. In parallel, in this specific domain of Banco de Portugal's intervention it was also possible to continue particularly intense on-site and off-site supervisory activity, both in terms of ongoing monitoring of compliance with the preventive obligations of supervised entities and in the context of the acquisition of qualified holdings in financial institutions.

Legal enforcement recorded important progress as regards large and complex proceedings. The overall number of proceedings settled, which had already increased markedly in the previous year, increased further considerably. This, in parallel with a decline in the number of proceedings initiated, led to a reduction in pending proceedings (Table I.2.2).

**Table I.2.2 • Administrative proceedings**

Overall indicators	2013	2014	2015	2016	2017	Δ 2017-2016
Proceedings carried forward from the previous year	85	134	171	382	441	59
Proceedings initiated	183	128	283	276	154	-122
Proceedings settled	134	99	82	217	271 <sup>(a)</sup>	54
Proceedings pending at the end of the year	134	163	372	441	325	-116

Note: (a) Includes a new decision delivered in 2017 following referral of the case by the Competition, Regulation and Supervision Court regarding a process which had received an administrative decision in 2016 (and thus was not considered in the number of proceedings carried forward from the previous year).

In terms of non-sanctioning enforcement, there were 12 proceedings for the possible withdrawal of the authorisation of credit institutions, financial companies and payment institutions. Two institutions had their authorisations withdrawn, while, based on supervenient facts, 32 proceedings were conducted for a possible reassessment of the suitability of the members of the management and supervisory bodies of supervised institutions. The relations in this field between Banco de Portugal and the ECB continued to be deepened, given that, in the context of the SSM, joint action is necessary for the drafting of proposals for the withdrawal of the authorisation of credit institutions and the reassessment of the suitability of the members of the management and supervisory bodies of significant credit institutions. Banco de Portugal also monitored 20 winding-up proceedings, under the responsibility of State commissioners, judicial liquidators or liquidation committees appointed for the purpose, especially the complex winding-up of Banco Espírito Santo, S.A.

### **Deposit guarantee and resolution funds**

In 2017 Banco de Portugal provided the technical and administrative services required for the smooth operation of the Deposit Guarantee Fund (FGD), the Mutual Agricultural Credit Guarantee Fund (FGCAM) and the Resolution Fund (FR). Furthermore, it cooperated in financial resource management, set the relevant parameters for computing the contributions owed by the participating institutions and carried out the procedures for collecting these contributions.

The IT tool for repayments to depositors by the FGD and the FGCAM was concluded, and in-depth assessments were made of the institutions' data models on deposits guaranteed by the Deposit Guarantee Fund.

As far as the Resolution Fund is concerned, Banco de Portugal also provided the support needed for the exercise of its tasks as shareholder of Novo Banco, S.A. and Oitante, S.A.

As regards the administrative and financial support provided by Banco de Portugal to the autonomous funds included in general government since 2015, there was an effort to adapt the support systems to ensure timely compliance with the requirements of the Accounting Standards System for general government in early 2018.

## **2.4 Resolution**

In 2017, the resolution process of Banco Espírito Santo, S.A. came to an end with the Resolution Fund's sale of its holding in Novo Banco, S.A. (Box 2). After the completion of the sale, work began on monitoring the execution of the respective contracts, including the installation of the appointed Monitoring Committee.

In turn, the resolution process of Banif – Banco Internacional do Funchal, S.A. (BANIF) also made decisive progress. Although the revocation of the bank's authorisation to carry out activity has not yet been decided by the Single Supervisory Mechanism, the necessary conditions were materially fulfilled for the judicial winding-up proceedings to start, following the approval of the bank's accounts for 2015, Banco de Portugal's selection of the independent entity tasked with carrying out the assessments laid down in the resolution regime and the approval of decisions relevant to the determination of the resolution perimeter. Also with regard to the BANIF resolution process, the activity of Oitante, S.A. was monitored, particularly in regard to the closure of the company's first accounts and the analysis of certain asset sales that required Banco de Portugal's opinion.

In relation to the work within the Single Resolution Mechanism (SRM), Banco de Portugal intensified its participation on the decision-making bodies, committees and working groups comprised in the Single Resolution Board (SRB) for the definition of resolution practices and methodologies. It also took an active role in the work of the SRB's Internal Resolution Teams, essentially in drawing up or updating the resolution plans of the main Portuguese banking groups.

Banco de Portugal took part in the resolution process of Banco Popular Español, S.A., since a branch of this bank is located in Portuguese territory. Banco Popular Portugal, S.A. was not subject to any resolution measure but was included in the perimeter of the sale to Banco Santander, S.A. as defined by the SRB.

With the goal of reviewing the first full year of the SRM's operations and to prepare the work for 2017, the SRB and Banco de Portugal organised the 2nd Industry Dialogue on Banking Resolution in Lisbon. This initiative involved the participation of the Portuguese credit institutions, represented at the highest level.

Also within the SRM, Banco de Portugal provided the support necessary for the operation of the Single Resolution Fund, participating in the specification, collection and delivery of the periodical contributions for 2017.

During the year, due to its experience in the area of resolution, Banco de Portugal took part in seminars, conferences and bilateral meetings organised by its foreign counterparts and other international organisations.

**Box 1 • Banco de Portugal within the European financial supervision architecture**

Within its mission to safeguard financial stability, Banco de Portugal operates today in a context marked by the institutional and regulatory framework of the European Union and, more specifically, the Banking Union.

The financial supervision architecture of the European Union consists of four levels: (i) regulation; (ii) microprudential supervision; (iii) macroprudential supervision; and (iv) resolution. Each of these levels comprises the competences exercised by the national supervisory authorities.

At the regulatory level, the European System of Financial Supervision (ESFS) began operations in 2011. The ESFS is based on a sectoral model, comprising the three European Supervisory Authorities (ESAs) – the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) – and the European Systemic Risk Board (ESRB), a cross-cutting entity responsible for macroprudential oversight, chaired by the President of the European Central Bank.

Similarly, the Banking Union was created, based on a banking prudential supervision pillar, the Single Supervisory Mechanism (SSM); a bank resolution pillar, the Single Resolution Mechanism (SRM); and its third pillar, still under development, the creation of a European deposit insurance scheme.

These considerable achievements within the European institutional framework in turn go hand in hand with significant progress in terms of financial legislation (specifically banking), with the approval of several important legal acts (inter alia, CRD IV, CRR and BRRD).

Although the work of the ESAs has mainly centred on prudential regulation and supervisory convergence, these last few years have seen an increasing focus on banking conduct supervision, most specifically on standards of conduct in the sale of financial products. Banco de Portugal provides Portuguese representation in the EBA in this field. European Union legislation on the sale of financial products establishes separate rules for the banking, market and insurance sectors, and has clarified their scope of intervention in terms of supervision.

Also within the ESFS, the ESRB – with macroprudential policy responsibilities within the European Union financial system – contributes to the prevention or mitigation of systemic risks to financial stability. The ESRB was assigned non-binding intervention tools, and may give addressees warnings and recommendations, which must be implemented according to a “comply or explain” mechanism. Central banks play a key role in the ESRB’s organisational and operating model. The large majority of voting members in the ESRB’s General Board (which makes all the decisions necessary for the performance of its tasks) come from central banks, including the ECB’s President and Vice-President and the Governors of national central banks. This structure thus recognises the key importance of central banks for financial stability in the European Union, without prejudice to the growing need for coordination among sectoral supervisory authorities. In terms of macroprudential supervision, the role of the ESRB must also be coordinated with the macroprudential powers conferred on the ECB under the SSM. Indeed, the SSM Regulation confers on the ECB both microprudential competences and the powers of a macroprudential authority.

In turn, the SSM operates under the aegis of the ECB, which has specific tasks relating to the prudential supervision of credit institutions subject to the SSM, without prejudice to the cooperation mechanisms which confer on competent national authorities a particularly important role in monitoring and supervising less significant institutions. Thus, the microprudential supervision pillar is built on strong European integration, as the ECB was assigned relevant powers and national authorities actively participate in a supervisory model led by the ECB, regardless of the size of supervised institutions. Banco de Portugal has been part of the SSM since its creation, on 4 November 2014.

In turn, the SRM Regulation establishes the creation of an integrated institutional framework to ensure the resolvability and orderly winding up of credit institutions in Member States within the Banking Union. The SRM comprises a single resolution authority, the Single Resolution Board (SRB), and a single mechanism to fund resolution measures, the Single Resolution Fund (SRF), financed by contributions from participating institutions.

The Portuguese bank resolution authority (Banco de Portugal, under the terms of the law) is directly responsible for the supervision of a share of the Portuguese banking system, without prejudice to the direct responsibilities of the SRB. In addition, the powers of national resolution authorities (NRAs) are limited and not fully autonomous, even over less significant institutions. Firstly, as with significant institutions, the SRB has full resolution powers over less significant institutions with cross-border activities within the Banking Union. Secondly, even for other entities established in Member States within the Banking Union and less significant groups – which are subject to the supervision of NRAs under the SRM Regulation – these authorities are only responsible for resolution decisions where measures applied do not require the use of resolution financing arrangements. The SRF has provided these arrangements since January 2016 (replacing national resolution financing arrangements).

To sum up, the European model has evolved from mostly regulatory powers (the establishment of ESAs), and is characterised today by true European supervisory and resolution authorities (the ECB and the SRB within the Banking Union). Even though this transformation reduces the scope of intervention of national authorities in their respective fields, it also underlines how important it is for them to closely cooperate and effectively work with European authorities. Against this background, it is important to ensure that existing mechanisms of supranational representation are used and optimised to the fullest extent, without prejudice to the specific circumstances of each Member State. This would help national authorities achieve the desired level of prompt and proactive participation at European level in the pursuit of public interest. In addition, national authorities retain powers related to the supervision of relations between financial institutions and their customers (specifically compliance with the European regulatory framework) and the prevention of money laundering and terrorist financing.

## Box 2 • Sale of Novo Banco

In 2017, Banco de Portugal completed the work arising from the resolution measure applied to Banco Espírito Santo, S. A. in August 2014. Following analysis of the offers received at the end of 2016, on 4 January 2017,<sup>16</sup> Banco de Portugal invited Lone Star to deepen the negotiations, while allowing all other potential investors to improve their offers. All the investors had the opportunity to complete complementary and confirmatory due diligence processes and to improve their offers under equitable conditions.

The offer presented by Lone Star was deemed the one that best fulfilled the assessment criteria in the tender specifications for the sale. As a result, on 31 March,<sup>17</sup> Banco de Portugal decided to choose Lone Star to complete the sale operation of Novo Banco. On the same day, Banco de Portugal announced the terms of the sale operation, which were conditional on the necessary regulatory authorisations, particularly from the European Commission and the European Central Bank, as well as on Novo Banco's execution of a liability management exercise.

On 18 October,<sup>18</sup> Banco de Portugal and the Resolution Fund completed the sale operation of Novo Banco to Lone Star through the new shareholder's injection of €750 million, which was followed by a new capital injection of €250 million at the end of the year. Novo Banco is owned by Lone Star and the Resolution Fund, with holdings of 75% and 25% of the share capital respectively. The operation led to a significant reinforcement of Novo Banco's share capital, bringing to an end the bridge status applying to the bank since its creation, and eliminated an uncertainty which was holding back the external assessment of the Portuguese banking system.

The sale process – open, transparent, competitive, and with international reach – respected the demands of the European Central Bank and the European Commission, and enabled the entry of new investors into the financial system, diversifying its sources of financing.

With the conclusion of this sale, the purposes underlying the resolution of Banco Espírito Santo, S. A. were fully met. Despite the irreparable financial imbalance and the imminent interruption of activity faced by Banco Espírito Santo, S. A. in 2014: (i) most of the activity of one of the most important financial institutions in the Portuguese economy continued; (ii) the depositors were protected and did not suffer any losses; (iii) the financing capacity to companies and households was preserved. In other words, the stability of the Portuguese financial system was preserved.

16. See Banco de Portugal's press release of 4 January 2017.

17. See Banco de Portugal's press release of 31 March 2017.

18. See Banco de Portugal's press release of 18 October 2017.

## 3 Economic advice and openness to society

### 3.1 Research and statistics

Banco de Portugal conducts analysis and research on the Portuguese economy, the euro area economy and the financial system and, in its role as national statistical authority, compiles and disseminates monetary, financial, exchange rate and balance of payments statistics. Research and statistics are key to monetary, economic and prudential policy advice and their publication helps fosters awareness and public discussion on the Portuguese economy and European integration.

In 2017 the Board of Directors approved Banco de Portugal's research agenda for the duration of the Strategic Plan. The agenda sets out three priority fields for in-house analysis and research up to 2020: new challenges for monetary policy and financial stability, economic growth in Portugal as part of the euro area (its constraints and sustainability), and the future of public institutions and policies in Portugal and the European Union.

The *Economic Bulletin*, in addition to analytical texts and macroeconomic projections, focused on topics important for a better understanding of the Portuguese economy: distribution mechanisms of monetary policy in the Portuguese economy, saving and investment dynamics of Portuguese firms, the gains and challenges of international trade, and the challenges and uncertainties surrounding potential output.

*Banco de Portugal's Economic Studies* series featured essays written by in-house researchers looking into several strands of research on the Portuguese economy: productivity in civil justice, firm creation and survival, business cycles, wealth taxes, investment in education, the macroeconomic impact of uncertainty, GDP developments, spillovers of prudential policy across borders, corporate credit risk, the link between the financial sector and macroeconomics, international trade, the Basel III leverage ratio requirement, and house prices in Portugal.

In the course of the year, 17 working papers were published, presented or discussed in over 100 international technical meetings.

Banco de Portugal fully complied with the targets set in its *Statistical Activity Plan* for 2017.<sup>19</sup> In the course of the year, it published around 290 thousand statistical series in *BPstat* and 7 thousand in the *Statistical Bulletin*. Banco de Portugal reported to international bodies (ECB, EUROSTAT, IMF, OECD and BIS) on approximately 716 thousand statistical series, i.e. 6.2% more than in 2016. It also published four *Central Balance Sheet Studies* – on the manufacture of beverages sector, the transport sector, profitability of Portuguese and European enterprises between 2006-2015, and the sectoral analysis of non-financial corporations in Portugal between 2012-2016 – and a *Supplement to the Statistical Bulletin*, featuring statistical articles presented in national and international fora.

To foster the quality of statistics produced on the Portuguese economy, Banco de Portugal concluded three protocol agreements with respectively: (i) Statistics Portugal, the Directorate-General for Budget and ten other bodies that compile general government statistics; (ii) the

19. For further details on Banco de Portugal's statistical activities in 2017, see the Plan and sectoral report available on its [website](#).

Portuguese Insurance and Pension Funds Supervisory Authority; and (iii) the Portuguese Tourism Institute and Statistics Portugal, in the field of tourism statistics.

Together with central banks from EU countries that are part of the G20, Banco de Portugal established the International Network for Exchanging Experience on Statistical Handling of Granular Data (INEXDA), which provides a framework whose aim is to facilitate the use of granular data for analytical and research purposes. Its first meeting was held in Lisbon.

Banco de Portugal strengthened its integrated approach to microdata bases for which it is responsible, more specifically, datasets with granular information – on an entity-by-entity and transaction-by-transaction basis – on credit, securities, the economic and financial position of Portuguese firms, and corporate transactions with non-residents. Progress was made to improve the quality and comprehensiveness of the Database of Banking Accounts.

In 2017 Banco de Portugal's Microdata Research Laboratory (BPLim) started to make granular information on the Portuguese economy available to in-house and external researchers. As at the end of the year, BPLim was involved in 41 scientific projects, 7 of which exclusively undertaken by external researchers.

Banco de Portugal also continued to foster the development of the Legal Entity Identifier (LEI), a single and universal identifier of entities, which is internationally accepted and recognised. Within this scope, it hosted the Legal Entity Identifier Regulatory Oversight Committee's plenary meeting (LEI ROC), which gathered representatives of financial regulators from 27 countries, international bodies and the Global LEI Foundation. It also hosted the conference *Meet the Market – The Uses of LEI*, to introduce LEI to firms, banks and associations in Portugal.

With a view to sparking debate on key issues related to its core functions, Banco de Portugal held specialised conferences on monetary policy, financial intermediation, remuneration of senior officers in the financial sector, and financial stability. It hosted the ESCB conference included in the *European Economic Association Congress*, a meeting with the Spanish, French and Italian central banks on structural reforms, and a workshop on data produced by national central credit registers for research purposes. Together with the ECB, it organised a conference on macroprudential policy and a conference on risk management in central banks. In conjunction with the European Investment Bank (EIB), it hosted a conference on investment. Targeting firms and business associations, it organised two sessions of the *6<sup>th</sup> Conference of the Central Balance-Sheet Database*, in Vila Real and Évora, focusing on the modernisation of the Portuguese corporate landscape. Furthermore, it held 36 seminars on economic research.








### 3.2 Communication and stakeholder management

Banco de Portugal provides all pertinent information on its activities to the public and its counterparties, reflecting the realisation that timely and transparent communication is key to performing the public interest task entrusted to it and to the discharge of accountability.

With a view to developing an integrated and consistent communication policy, Banco de Portugal established the Communication and Museum Department in 2017, entrusting it with communication and social responsibility tasks, as well as the Money Museum's programming. It also adopted a stakeholder management model, supported by a client relationship management software, which helped increase the promptness and quality of feedback provided to the public and the media and to recognise improvement opportunities in terms of institutional communication.

In accordance with the strategic plan for communication adopted in 2015, Banco de Portugal has diversified its communication channels, formats and contents. It has consolidated its presence in social networks, by creating official Twitter and YouTube accounts, and, in November, it launched a new Bank Customer Website, featuring more accessible language and user-friendly web design. In the course of the year, it published 232 press releases across its channels (including 124 statistical press releases) and 28 explainers – text-based, infographic and video formats – on the rules applicable to retail banking products and services, the services provided to the public and statistical information (Table I.3.1).

Table I.3.1 • Communication: main indicators | 2017

						
Website	BPstat	Twitter <sup>(a)</sup>	LinkedIn	Youtube <sup>(b)</sup>	E-mail <sup>(c)</sup>	Telephone
Users: 2,049,933	Statistical series released: 287,465	Tweets: 907	Posts: 235	New videos: 31	Requests from the public: 4,012	Calls: 28,313
Viewed webpages: 15,117,198	Consultations: 2,291,690	Impressions: 773,400	Impressions: 2,006,007	Views: 35,760	Requests from journalists: 245	Duration (min.): 80,325

Source: Banco de Portugal. | (a) Since its launch, on 8 February. (b) Since its launch, on 10 March. (c) Since the client relationship management software was implemented, on 2 May.

The sale process of Novo Banco, S. A., was the most discussed topic with the media, followed by other clarifications related to the national banking system. The public mostly asked about the Credit Central Register and the operation of retail banking markets.

In 2017 Banco de Portugal launched a new regular publication: the Annual Report on Cooperation, which focuses on the activities developed in conjunction with counterparties in emerging and developing countries (Table I.3.2).

Table I.3.2 • Regular publications | 2017

Publication	Objective	Frequency	Language*
<i>Annual Report</i>	Describes Banco de Portugal's activities and financial statements	Annual	PT and EN
<i>Official Bulletin</i>	Comprises all legal acts produced by Banco de Portugal in its regulatory capacity	Monthly	PT
<i>Economic Bulletin</i>	Provides a detailed analysis of the Portuguese economy and releases macroeconomic projections	Quarterly	PT and EN
<i>Banco de Portugal Economic Studies</i>	Publishes theoretical and applied studies prepared by Banco de Portugal's economists, frequently co-written by external researchers	Quarterly	PT and EN
<i>Coincident Indicators</i>	Publishes the coincident indicators for economic activity and private consumption in Portugal	Monthly	PT and EN
<i>Spillovers</i>	Publishes research, economic analysis and economic events promoted by Banco de Portugal	Semi-annual	EN
<i>Statistical Bulletin</i>	Presents Banco de Portugal's statistics on the Portuguese economy and other indicators	Monthly	PT and EN
<i>Supplements to the Statistical Bulletin</i>	Publishes methodological notes and analysis on statistical data	–	PT and EN
<i>Central Balance Sheet Studies</i>	Publishes analysis on data collected by the Central Balance Sheet Database, Banco de Portugal's database with economic and financial information on firms in Portugal	–	PT and EN
<i>Statistical Activity Plan</i>	Sets out Banco de Portugal's statistical objectives and priorities	Annual	PT
<i>Statistical Activity Report</i>	Describes Banco de Portugal's activities as national statistical authority	Annual	PT
<i>Financial Stability Review</i>	Assesses emerging risks in the Portuguese markets and financial system	Semi-annual	PT and EN
<i>Portuguese Banking System</i>	Reports developments in the Portuguese banking system, based on indicators on the balance sheet structure, asset quality, liquidity and funding, profitability, solvency and leverage, as well as other information on the macroeconomic environment	Quarterly	PT and EN
<i>Banking Conduct Supervision Report</i>	Provides information on the regulation and audit of retail banking markets, as well as on Banco de Portugal's initiatives in terms of financial information and training	Annual	PT   Note: English version of the executive summary only.
<i>Summary Report on Banking Conduct Supervision</i>	Provides summary information on Banco de Portugal's retail banking markets supervision in the first half of each year. Published between issues of the Banking Conduct Supervision Report	Annual	PT and EN
<i>Retail Banking Markets Monitoring Report</i>	Presents developments in markets for simple term deposits, structured deposits, mortgage credit and consumer credit	Annual	PT
<i>Report on Payment Systems</i>	Presents the most relevant facts on the operation of payment systems	Annual	PT   Note: English version of the executive summary only.
<i>Report on Cash Issuance</i>	Describes Banco de Portugal's cash issuance activities and main indicators	Annual	PT and EN
<i>Bulletin on Banknotes and Coins</i>	Discusses cash-related topics	Semi-annual	PT
<i>Annual Report on Cooperation (NEW)</i>	Describes Banco de Portugal's cooperation work with counterparties in emerging and developing countries	Annual	PT and EN
<i>Economic Developments in Portuguese-speaking African Countries and Timor-Leste</i>	Provides an analysis of the economic environment in Portuguese-speaking African countries and Timor-Leste and their economic and financial relations with Portugal	Annual	PT and EN
<i>#Lusofonia</i>	Presents individual and aggregate indicators on the economies of the eight Portuguese-speaking countries	Annual	PT and EN

Source: Banco de Portugal. | (a) PT – Portuguese; EN – English.

To highlight the importance of monetary policy, Banco de Portugal organised the 6<sup>th</sup> *Generation Euro Students' Award* edition, a joint ECB/Eurosystem NCB initiative, where 1,044 secondary school students from 96 Portuguese schools participated.

Banco de Portugal provides services to households and firms in the scope of its tasks: it releases information on accounts, credit liabilities and the prohibition on the use of cheques, reports the loss/theft of personal identification documents to the banking system, reviews complaints made by bank customers against financial institutions, and acts as a cash office. In terms of corporate services, Banco de Portugal also releases individual economic and financial information and on the respective sector of activity as well as efficient ways to comply with Banco de Portugal's reporting requirements, more specifically as regards reporting of external operations and positions and securities.

In 2017 demand for Banco de Portugal's services increased further, particularly in terms of consultations to the Central Credit Register (Table I.3.3).

**Table I.3.3 • Services: main indicators | 2014-2017**

Services	Indicators	2014	2015	2016	2017
Database of Banking Accounts	Charts issued	–	135 thousand	165 thousand	226 thousand
	Costumers	–	78 thousand	93 thousand	125 thousand
Central Credit Register	Charts issued	1,3 million	1,5 million	1,7 million	2,1 million
	Costumers	290 thousand	350 thousand	390 thousand	470 thousand
	Consultations by participating institutions	5,6 million	5,9 million	6,1 million	6,5 million
Prohibition on the use of cheques	Consultations of the List of Cheque Defaulters	6,523	6,893	7,033	7,023
Information on personal identification documents	Requests disseminated	508	380	304	289
Complaints on financial institutions	Complaints received	14,2 thousand	13,5 thousand	14,1 thousand	15,3 thousand
Enterprise and Sector Tables (information on firms and their sector of activity)	Firms covered	371 thousand	364 thousand	381 thousand	390 thousand
Reporting of external transactions and positions	Summary charts issued	–	–	5 thousand	36 thousand
Cash office	Visits to customer services	130 thousand	172,5 thousand	190,5 thousand	141,9 thousand
Library	Consultations	5,869	5,444	5,523	5,543
Historical archive	Consultations	404	1,850	1,291	3,517

Source: Banco de Portugal.

Banco de Portugal carried out a public satisfaction survey on its face-to-face services provided in the Lisbon cash offices, the Porto branch, the Azores and Madeira regional delegations and the district agencies. According to the survey, the general satisfaction rate was 3.7 (out of 4).

A key aspect of Banco de Portugal's openness to the community has been the Money Museum, which, throughout the year, maintained an extensive cultural and educational programme. While taking a contemporary approach, the Museum looks into the history of money throughout the world, illustrated by pieces from Banco de Portugal's banknote and coin collection, and gives visitors the opportunity to see the only known remaining section of King Dinis' Wall, which has been classified as a national monument.

In 2017 the Money Museum was a finalist in the European Museum Forum's 'European Museum of the Year Award', under the auspices of the Council of Europe, and was named 'Best Museum of the Year' by the Portuguese Museology Association. It also won the Acesso Cultura Award for 'Integrated Accessibility'. Acesso Cultura gives this annual award to recognise projects or entities that stand apart for their promotion of physical, social and intellectual conditions in accessing cultural spaces and offerings in Portugal. The Numismatic Forum deemed the opening of the Money Museum the 'Numismatic Event of the Year' in 2016. The renovation project of the former Church of São Julião with a view to housing the Money Museum was distinguished by Lisbon's City Council with the 2014 Valmor and Municipal Architecture Award in 2017.

In the course of the year, the Money Museum hosted five temporary exhibitions: four on art and one on archaeology. It welcomed 62,859 visitors, averaging 305 visitors per day. Overall, as part of the Museum's cultural and educational programme, 1,227 activities were held, totalling 25,265 participants.

Banco de Portugal also runs several social responsibility projects, which chiefly promote social inclusion of children and teenagers.

In partnership with *EPIS – Empresários pela Inclusão Social* (Entrepreneurs for Social Inclusion), Banco de Portugal has three tutoring programmes in Portuguese, Maths and English, which, in 2017, included 30 students enrolled in lower secondary education.

Together with Ajudaris, it has implemented the *Ler + Histórias* (Reading + Stories) project to provide support to in-patient children in Dona Estefânia Hospital in Lisbon. In 2017, 17 employees participated in this project and visited the hospital on a weekly basis to read to the children. Also with Ajudaris, the second book *Histórias da Ajudaris com o Banco de Portugal* (Ajudaris Stories with Banco de Portugal) was published, whose receipts were entirely donated to children and families receiving support by this association.

Banco de Portugal has joined the *Voluntários da Leitura* (Reading Volunteers) programme, hosted by the Centro de Investigação para Tecnologias Interativas of Universidade Nova de Lisboa and the Associação para o Voluntariado de Leitura. In 2017 Banco de Portugal's volunteers in this programme provided support to the Padre Abel Varzim, Sampaio Garrido, Maria Barroso and Luísa Ducla Soares primary schools.

It has also implemented a job shadowing project, under which it welcomed seven students from Dona Filipa de Lencastre secondary school in 2017 to give them a first look into real job experience, over a one-week period.

Banco de Portugal and its cafeteria concessions donated a total of 10,637 meals within the scope of the *Zero Desperdício* (zero waste) project, fostered by the DariAcordar association.

In 2017, in addition to other one-off initiatives, Banco de Portugal ran an in-house campaign to raise funds to support those affected by the wildfires that hit the Leiria district in June. As a result of this campaign, Banco de Portugal donated, on its own behalf and on behalf of its employees, €61,818 (€50,000 on its own and €11,819 from its employees) to the REVITA Fund (*Fundo de Apoio às Populações e à Revitalização das Áreas Afetadas pelos incêndios*).

## 4 Internal management

### 4.1 Internal governance

Banco de Portugal has enhanced its organisational and internal governance model both to meet the need to separate the tasks involved in its part in building the Banking Union and to align its functioning with central bank standards. In 2017 it continued the process to improve its internal organisation by restructuring the Audit Department and the Administration Services Department. In light of the European framework mentioned above, the Financial Stability Department and the Banking Prudential Supervision Department were restructured. New structures were also developed for the Resolution Department and the Legal Services Department, which entered into force in January 2018. The need to develop an integrated and coherent communication policy led to the creation of the Communication and Museum Department. The Banking Conduct Supervision Department was also subject to structural and functional adjustments to enable it to perform its new tasks related to the supervision of credit intermediation and the provision of consultancy services on loan contracts.<sup>20</sup>

The entry into force of the General Data Protection Regulation in May 2018 led Banco de Portugal to consider how this regulation should be applied to its activity. The Data Protection Office was established, headed by the Data Protection Officer (appointed on 17 October 2017).

The Compliance Office's scope of intervention was established, largely coinciding with the tasks assigned to the ECB's Compliance and Governance Office. This office provides advice to employees and units and technical support to the Ethics Committee, carries out training and communication initiatives and monitors compliance with the rules set out in *Regulamento da Comissão de Ética e dos Deveres Gerais de Conduta dos Trabalhadores do Banco de Portugal* (Regulation of the Ethics Committee and of the General Duties of Conduct of the Employees of Banco de Portugal). In 2017 the Compliance Office prepared the *Plano de Gestão de Riscos de Corrupção e Infrações Conexas* (Management Plan for Risks of Corruption and Related Offences), in light of the recent recommendations of the Conselho de Prevenção da Corrupção (Council for the Prevention of Corruption).<sup>21</sup> The plan's implementation report was published on Banco de Portugal's website.<sup>22</sup>

In order to assess and ensure the effectiveness of the governance, risk management and internal control processes, as well as the systems supporting Banco de Portugal's operation, 33 audits were carried out, 28 of which were exclusively domestic and five related to systems and processes that are common or shared with the Eurosystem/ESCB (Table I.4.1).

20. Decree-Law No 81-C/2017 of 7 July 2017 (in Portuguese only).

21. <https://www.bportugal.pt/page/plano-de-gestao-de-riscos-de-corrupcao-e-infracoes-conexas> (in Portuguese only).

22. [https://www.bportugal.pt/sites/default/files/anexos/documentos-relacionados/plano\\_de\\_gestao\\_de\\_riscos\\_de\\_corrupcao\\_e\\_infracoes\\_conexas\\_-\\_relatorio\\_de\\_execucao\\_-\\_2016.pdf](https://www.bportugal.pt/sites/default/files/anexos/documentos-relacionados/plano_de_gestao_de_riscos_de_corrupcao_e_infracoes_conexas_-_relatorio_de_execucao_-_2016.pdf) (colocar link 2017) (in Portuguese only).

**Table I.4.1 • Audits | 2017**

	Domestic	ESCB	Total
Governance, internal functioning and management quality	2	–	2
Deposit guarantee and resolution funds	4	–	4
Monetary policy	–	1	1
Reserve and financial asset management	1	–	1
Legal enforcement	1	–	1
Prudential supervision	2	–	2
Cash issuance	4	1	5
Payment systems and means	1	–	1
Statistics	1	–	1
Human resources	2	–	2
Information technology systems	2	1	3
Security	4	1	5
Budget and accounting	2	–	2
Purchases and logistics	1	1	2
Communication	1	–	1
<b>Total</b>	<b>28</b>	<b>5</b>	<b>33</b>

Sorce: Banco de Portugal.

Banco de Portugal pursued a policy of integrated management of financial and operational risks. Overall developments in financial risks – mainly associated with asset management and monetary policy operations – were monitored through the calculation of several statistical indicators, such as value at risk and expected shortfall, complemented by the monitoring of financial buffers that are part of Banco de Portugal's balance sheet (provisions, reserves and profits) and risk coverage. Banco de Portugal also conducted medium-term projection exercises for risks (including sensitivity tests) and for the major financial variables affecting its accounts.

As regards non-financial risk, Banco de Portugal updated the regulation establishing the principles, objectives, actors, responsibilities and operational model of the operational risk management policy, which covers internal governance, organisation of activities, recording of incidents and risk assessment.

## 4.2 Human resources

At the end of 2017 the number of staff members employed by Banco de Portugal was 1,761 (Tables I.4.2, I.4.3 and I.4.4), of which 1,701 were active (60 were on secondment, public interest assignment or unpaid leave). In 2016 the number of staff members decreased by 36, in accordance with the goal of 1,700 active staff members by 2020, set in the Strategic Plan for 2017-2020. Over the course of the year, 78 staff members were recruited, 50% of which for supervision and financial stability roles, and 114 left the Bank (85 retirements and 29 terminations of labour contracts). In addition, there were 46 internships.

**Table I.4.2 • Staff developments | 2017**

	2013	2014	2015	2016	2017	Δ 2017-2016
Total staff	1,733	1,777	1,777	1,797	1,761	-36
Active <sup>(a)</sup>	1,676	1,685	1,696	1,718	1,701	-17
Supervisory tasks <sup>(b)</sup>	352	378	409	431	440	9
On unpaid leave/secondment	57	92	81	79	60	-19

Source: Banco de Portugal. | Notes: (a) Excluding staff members on unpaid leave and public interest assignment. (b) Staff members in the fields of prudential supervision, banking conduct supervision, financial stability, legal enforcement and resolution.

**Table I.4.3 • Staff developments: gender, movements and age groups | 2017**

		2013	2014	2015	2016	2017
Gender	Male	894	910	913	913	900
	Female	839	866	864	884	861
Movements	Recruitments	126	101	109	112	78
	Retirements	69	48	70	62	85
	Terminations of contracts	5	13	37	30	29
Age group	<=25	64	64	65	72	74
	[26;35]	469	516	546	570	556
	[36;45]	293	308	320	353	381
	[46;55]	484	394	314	288	265
	[56;65]	418	491	522	505	474
	>=66	5	3	10	9	11

Source: Banco de Portugal.

**Table I.4.4 • Staff: breakdown by function | 2017**

	Male	Female	Total	%
Senior management	38	17	55	3%
Middle management	140	134	274	16%
Professional staff	579	662	1241	70%
Technical-administrative staff and support services	114	17	131	7%
Secondment/on unpaid leave	29	31	60	3%
<b>Total</b>	<b>900</b>	<b>861</b>	<b>1761</b>	<b>100%</b>

Source: Banco de Portugal.

There was a 0.75% salary update in 2017, in accordance with the banking sector's collective bargaining instruments.

A proposal revising Banco de Portugal's company-level agreement (*Acordo de Empresa*) was prepared, and is now in its final stages of negotiation with trade unions. A general teleworking policy for staff was also approved and implemented.

Through the Banco de Portugal Academy (*Academia do Banco de Portugal*), the Bank carried out staff training and development courses, as well as initiatives in partnership with external entities to improve knowledge and enhance technical and management skills. In particular, a Programme

for Strategic Leadership and Change towards Excellence (*Programa de Liderança Estratégica e Mudança para a Excelência*) was launched for top management and the Advanced Leadership Programme (*Programa Avançado de Liderança*) continued for middle management.

As part of its strategic priorities, Banco de Portugal implemented the *Conhecer para Desenvolver* (Knowledge for Development) programme, aimed at progressively mapping employee skills and boosting their potential using professional development plans either through technical specialisation or team management and leadership. In addition, a pilot mentoring programme was launched.

The second Banco de Portugal Open Day was held to promote the Bank's image and awareness in academia, with the presence of around 100 final-year students from the main Economics and Management Schools in Lisbon.

New IT platforms supporting human capital management were also implemented to speed up the processes involved in recruitment, performance management, self-development and knowledge sharing.

As at 31 December 2017 the assets of the Pension Fund – Defined-benefit Plan – a closed-end pension fund covering staff who started working in the banking sector before March 2009 – and the health benefits plan, which covers all staff – amounted to €1,939.1 million invested in euro area bonds and liquidity (82.5%), real estate (9.6%) and equity (7.9%). On the same date, the overall funding level of the Pension Fund – Defined-benefit Plan – was 102.2 per cent, i.e. above the minimum level established in Notice of Banco de Portugal No 12/2001 (98.1%). In 2017 the asset portfolio of this fund had a profitability of 1.9%.

At the end of 2017, the Pension Fund – Defined-contribution Plan – a supplementary pension plan that is voluntary for staff who started working in the banking sector after March 2009 – had 723 participants, as the majority of new staff members have opted for this fund. In 2017 the asset portfolio of the Pension Fund – Defined-contribution Plan, to the amount of €26.5 million, reached a profitability of 3.8%.

## 4.3 Information systems, technology and management

Under the programme *Digital Bank 2020*, Banco de Portugal has invested in technological renewal and in providing solutions to increase productivity, cooperation and improve internal communication.

In 2017 the Bank made the technological infrastructure investments required to integrate business information into a single corporate database with a view to reducing internal and red-tape costs.

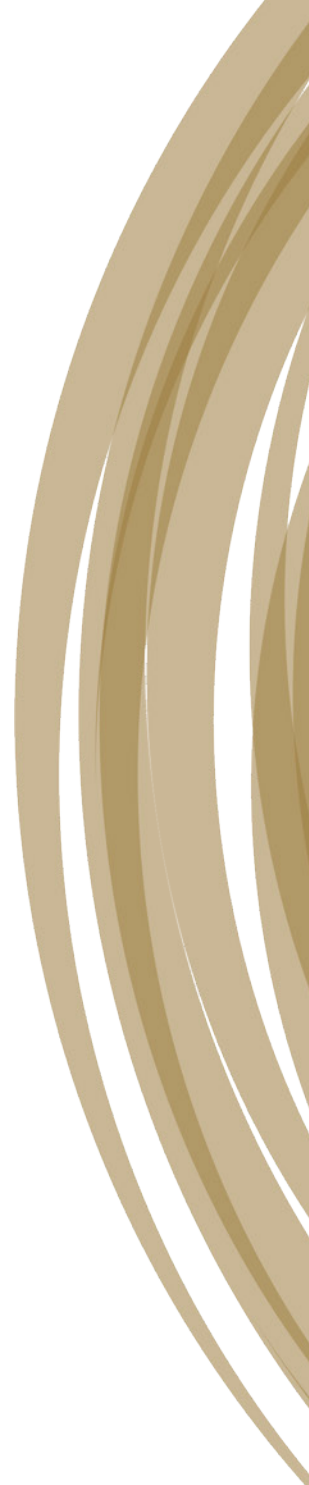
Several websites managed by Banco de Portugal were redesigned: the Bank Customer Website, the Portuguese-speaking central banks website and the websites of the Deposit Guarantee Fund, the Mutual Agricultural Credit Guarantee Fund and the Credit Mediator. Work on the new Banco de Portugal statistics website – which will replace the BPstat website – also continued.

Work also progressed on the projects to develop a new Central Credit Register, provide a new technological platform to support the Microdata Research Laboratory (*Laboratório de Investigação de Microdados – BPLim*) and a new application for the analysis of collateral eligibility (Marketable Assets Analysis Platform).

As regards cybersecurity, the Security Operation Centre began operations, focusing on responding to threats and cooperating with Portuguese and international organisations, namely the European System of Central Banks. In 2017 Banco de Portugal also organised the 1<sup>st</sup> conference on cybersecurity, open to the financial system and focusing on governance issues, the application of new EU regulations and financial system practices.

With a view to sharing experiences and benchmarking among central banks, Banco de Portugal organised the Central Banker's Club for IT (CBC IT) in Porto to celebrate its 40<sup>th</sup> anniversary. This meeting was attended by representatives of 21 institutions<sup>23</sup> and discussed issues related to IS/IT strategic and operational management, application solutions, infrastructural and security components and digital transformation of the banking system.

23. The central banks of Austria, Belgium, Bulgaria, Cyprus, Denmark, Finland, Greece, Hungary, Iceland, Ireland, Israel, Luxembourg, Macedonia, Malta, Netherlands, Norway, Portugal, Serbia, Sweden and Switzerland, and the Bank for International Settlements (BIS).





## II Report and Financial Statements

1 Management Report

2 Financial Statements

3 Notes on the Financial Statements

4 External Auditors' Report

5 Report and Opinion  
of the Board of Auditors



# 1 Management Report

## Presentation

The balance sheet of Banco de Portugal totalled €153 billion in 2017, representing a €15 billion increase from 2016, with a notable contribution from the increase of monetary policy assets, namely from the securities portfolio regarding Banco de Portugal's active participation in the asset purchase programme (APP), in accordance with the decisions of the Governing Council of the ECB.

Profit for the year 2017 was €656 million, driven by interest margin of around €1 billion, reflecting the impact of the aforementioned increase in the monetary policy securities portfolio. Furthermore, the net result of financial operations and unrealised losses was €-525 million, which was almost fully offset by the reduction in the general risk provision.

The Board of Directors of Banco de Portugal presents the Management Report and, in compliance with Article 54 of the Organic Law of Banco de Portugal, the financial statements for the year 2017 (see Sections 2 and 3), which have been prepared according to the Chart of Accounts of Banco de Portugal (Plano de Contas do Banco de Portugal – PCBP).

The annual accounts of Banco de Portugal are subject to an external audit, pursuant to the provisions laid down in Article 46 of its Organic Law (see Section 4), and, in accordance with the provisions of Article 43 of the same Law, the Board of Auditors prepared a report and issued an opinion on the financial statements (see Section 5).

The Management Report, which accompanies Banco de Portugal's annual accounts, presents the operations performed during the year and their impact on the financial statements.

The first part of the Report sets out the most important developments in the balance sheet, and the second part highlights the main components of the Profit and Loss Account.

## 1.1 Developments in the balance sheet

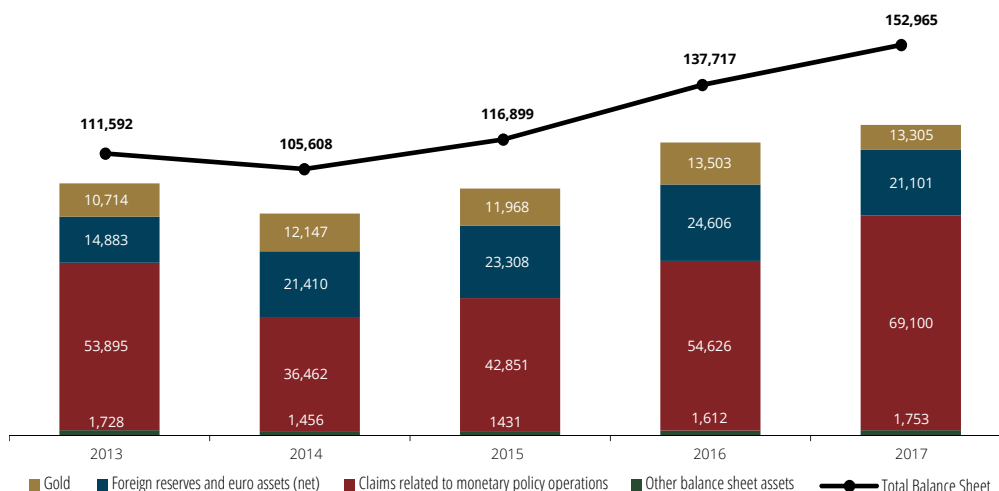
Table 1 shows the developments in the year-end positions of Banco de Portugal's main balance sheet items for the 2013-2017 period. The logic followed in the order of these items is the same as that of the analyses made in this Report.

**Table II.1.1**

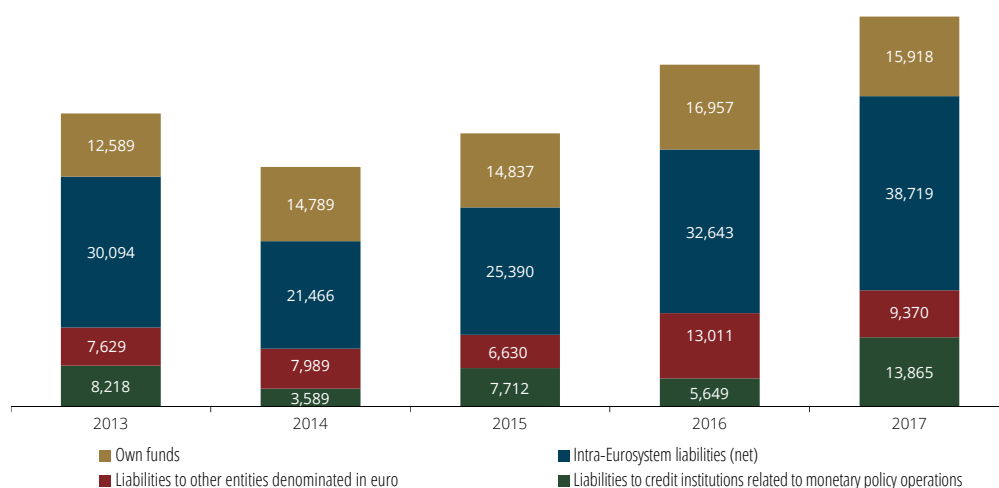
EUR millions

	2013	2014	2015	2016	2017	Δ 2017-2016
<b>TOTAL BALANCE SHEET</b>	<b>111,592</b>	<b>105,608</b>	<b>116,899</b>	<b>137,717</b>	<b>152,965</b>	<b>15,247</b>
<b>1.1.1 Claims and liabilities related to monetary policy operations</b>	<b>45,676</b>	<b>32,873</b>	<b>35,139</b>	<b>48,977</b>	<b>55,235</b>	<b>6,258</b>
Claims related to monetary policy operations	53,895	36,462	42,851	54,626	69,100	14,474
Lending to credit institutions	47,864	31,191	26,161	22,372	22,131	(241)
Securities held for monetary policy purposes	6,031	5,272	16,690	32,254	46,969	14,715
Liabilities to credit institutions related to monetary policy operations	(8,218)	(3,589)	(7,712)	(5,649)	(13,865)	(8,216)
<b>1.1.2 Gold and foreign reserves and euro assets (net)</b>	<b>25,597</b>	<b>33,556</b>	<b>35,276</b>	<b>38,109</b>	<b>34,405</b>	<b>(3,704)</b>
Gold	10,714	12,147	11,968	13,503	13,305	(198)
Foreign reserves and euro assets (net)	14,883	21,410	23,308	24,606	21,101	(3,505)
<b>1.1.3 Other balance sheet assets</b>	<b>1,728</b>	<b>1,456</b>	<b>1,431</b>	<b>1,612</b>	<b>1,753</b>	<b>141</b>
IMF (net)	288	272	247	248	232	(16)
Other claims	1,439	1,184	1,184	1,364	1,521	157
<b>1.1.4 Banknotes in circulation</b>	<b>22,303</b>	<b>23,299</b>	<b>24,686</b>	<b>25,661</b>	<b>26,675</b>	<b>1,014</b>
Banknotes put into circulation (net)	(5,895)	(8,621)	(10,394)	(11,976)	(14,486)	(2,510)
Adjustments to circulation	28,198	31,920	35,080	37,636	41,160	3,524
<b>1.1.5 Intra-Eurosystem liabilities (net)</b>	<b>30,094</b>	<b>21,466</b>	<b>25,390</b>	<b>32,643</b>	<b>38,719</b>	<b>6,076</b>
Intra-Eurosystem claims	(29,471)	(33,172)	(36,315)	(38,945)	(42,528)	(3,582)
Intra-Eurosystem liabilities	59,565	54,638	61,705	71,588	81,246	9,658
<b>1.1.6 Other liabilities</b>	<b>8,015</b>	<b>8,331</b>	<b>6,933</b>	<b>13,437</b>	<b>10,082</b>	<b>(3,355)</b>
Liabilities to other entities denominated in euro	7,629	7,989	6,630	13,011	9,370	(3,641)
Other liabilities	386	342	303	426	711	284
Provisions	–	–	–	–	2	2
<b>1.1.7 Own funds</b>	<b>12,589</b>	<b>14,789</b>	<b>14,837</b>	<b>16,957</b>	<b>15,918</b>	<b>(1,039)</b>
Revaluation accounts	7,758	9,637	9,296	11,027	10,329	(698)
General risk provision	3,322	3,567	4,047	4,247	3,727	(520)
Capital and reserves	1,483	1,534	1,594	1,641	1,729	88
Retained earnings	(227)	(252)	(333)	(397)	(523)	(125)
Profit for the year	253	304	233	441	656	216

**Chart II.1 • Developments in the balance sheet – total and main assets (net) | EUR millions**



**Chart II.2 • Developments in the balance sheet – main liabilities (net) and own funds | EUR millions**



### 1.1.1 Claims and liabilities related to monetary policy operations

The net value of claims and liabilities related to monetary policy operations as at 31 December 2017 was €55,235 million, a €6,258 million increase from 2016, as a result of the €14,474 million increase in assets (to €69,100 million), partly offset by the €8,216 million increase in liabilities (to €13,865 million).

In 2017, the non-standard monetary policy programmes continued to be strengthened, as securities purchases under the APP maintained their fast pace, and the second series of targeted longer-term refinancing operations (TLTRO II) was implemented, as announced in March 2016 by the ECB (Charts II.1.3 to II.1.5).

Chart II.3 • Aggregates of monetary policy operations | EUR millions

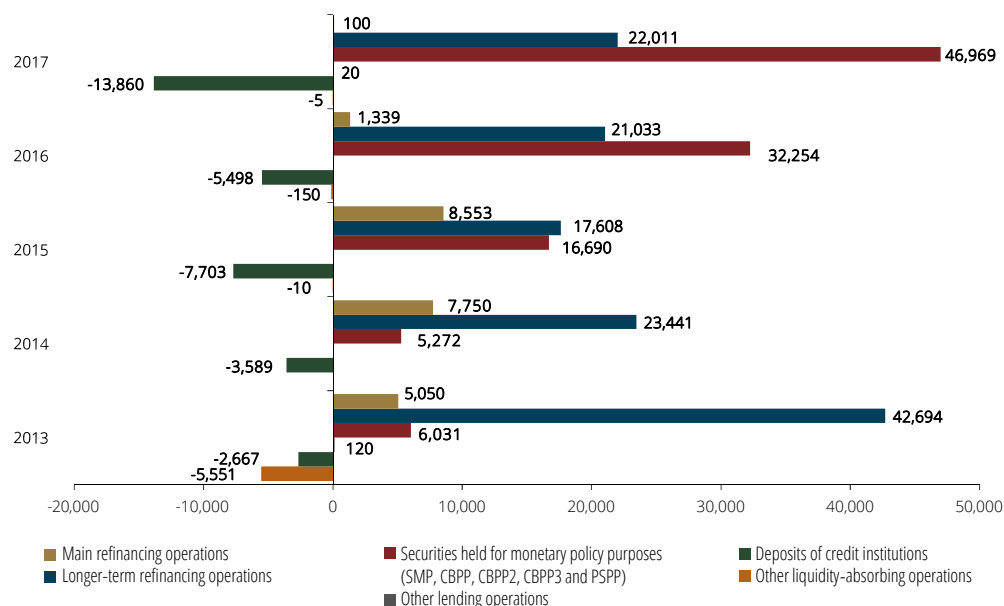
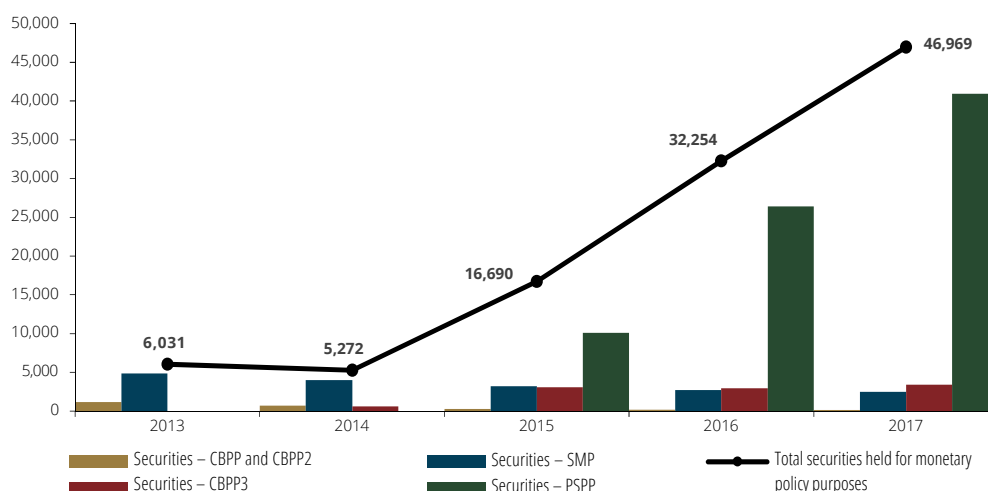


Chart II.4 • Securities held for monetary policy purposes | EUR millions



The portfolio of securities held for monetary policy purposes reflects Banco de Portugal's active participation in various programmes decided by the Governing Council of the ECB, namely (i) the securities markets programme (SMP) and the covered bond purchase programmes (CBPP and CBPP2), currently closed to new purchases, the behaviour of which only reflects the maturing of securities in the portfolio and (ii) the third covered bond purchase programme (CBPP3) and the public sector purchase programme (PSPP), both still open to new purchases, which are included under the aforementioned APP. Purchases of these securities are made by the national central banks (NCBs) and the ECB, reflecting the principle of decentralised implementation of the Eurosystem's monetary policy. At the end of 2017, this portfolio totalled €46,969 million, 31% of the Bank's total assets.

Banco de Portugal's balance sheet for 2017 shows purchases under the PSPP, reflecting the Eurosystem's decisions to extend purchases under the APP, after the Governing Council of the ECB approved an overall purchasing rate of €80 billion per month until March 2017 and €60 billion per month for the rest of that year. In terms of Banco de Portugal's participation, these decisions led to growth of €14,509 million in the overall PSPP level in 2017, reaching a total of €40,923 million. This programme is divided into supranational securities and government securities, of Portuguese government debt (accounting for 37% and 63% respectively of total PSPP at the end of 2017), with the latter included in the non-shared-risk component at Eurosystem level. The part relating to supranational securities grew more sharply than the purchases of Portuguese government debt securities (accounting for 69% and 31% respectively of total increase in PSPP in 2017).

In terms of developments in Banco de Portugal's financial risks, the increase in the government securities component of this programme was not accompanied by a corresponding change in risk, since the effect of the increase in their volume was offset by the improvement in the Portuguese government debt's rating. These risks are measured using the methodology decided by the Governing Council of the ECB for the Eurosystem and are monitored from a medium and long-term perspective. These risks are covered by holding adequate financial buffers on Banco de Portugal's balance sheet (see 1.1.7).

Additionally in the case of the APP, Banco de Portugal also strengthened its CBPP3 securities portfolio in 2017, with a €463 million increase from 2016 (reaching a total of €3,408 million).

All the portfolios of securities held for monetary policy purposes are valued at amortised cost less potential impairment losses, not reflecting gains that may materialise in the case of the early sale of securities.

Furthermore, in regard to non-standard monetary policy operations, in March 2017 new operations were implemented as part of the second series of targeted longer-term refinancing operations (TLTRO II), with the additional goal of strengthening the Eurosystem's accommodative monetary policy. TLTRO-II operations have a four-year maturity, with a possibility of repayment at the end of two years. The applicable interest rate for TLTRO-II operations will be between the rate on the main refinancing operations (MRO) and the rate on the deposit facility at the time of the allotment. Banks' adoption of these non-standard operations, which began in June 2016, triggered a substitution effect within the item Lending to credit institutions, reducing the main refinancing operations and longer-term refinancing operations with a maturity of 1 year or less and 3 years (Chart II.1.5). At the end of 2017, the item Lending to credit institutions reached a total of €22,131 million.

Chart II.5 • Regular financing operations | EUR millions

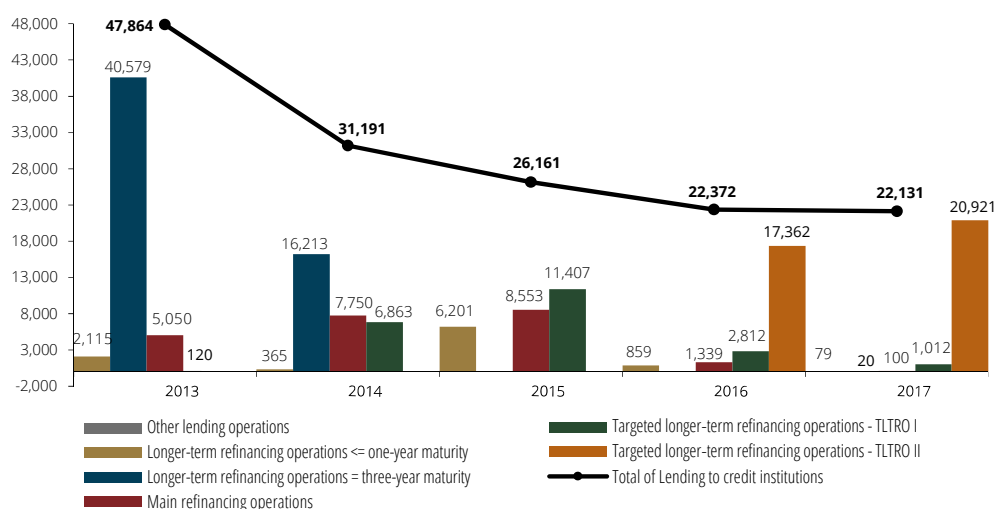
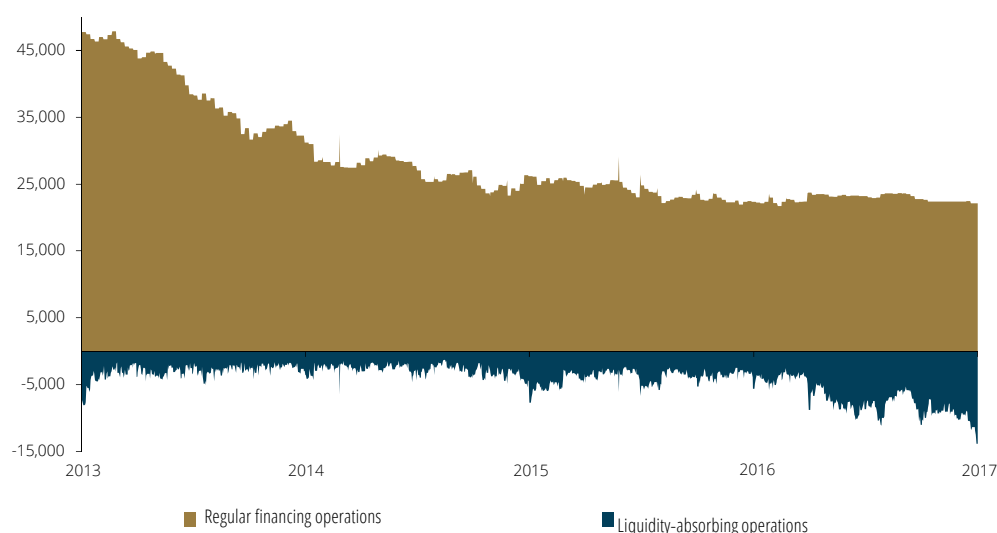


Chart II.6 • Daily balances in regular financing and liquidity-absorbing operations | EUR millions



Lastly, during 2017, developments in overall levels of liquidity injected by Banco de Portugal into the financial system through the decentralised implementation of lending to credit institutions (open market operations and lending facilities), as well as developments in the current accounts of credit institutions held at Banco de Portugal (including current accounts for compliance with minimum reserve requirements) and in the deposit facilities, show that Banco de Portugal has always had higher lending than liquidity absorption, even if the liquidity injection made through the monetary policy securities purchases is ignored (Chart II.1.6).

### 1.1.2 Gold, foreign reserves and euro assets (net)

#### Gold

Banco de Portugal's Gold reserve totalled €13,305 million at the end of 2017, a €198 million decrease from 2016, arising from the negative trend in the quote price of gold. The volume of this reserve remained unchanged at 382.5 tonnes. The reduction in the euro value's counterbalance is a change of an equal amount in the balance sheet item Revaluation accounts (Chart II.1.7) (see 1.1.7). At the end of 2017, the revaluation differences for gold came to €10,274 million.

In 2017, gold swaps for foreign currency were entered into, with the aim of profiting from gold assets.

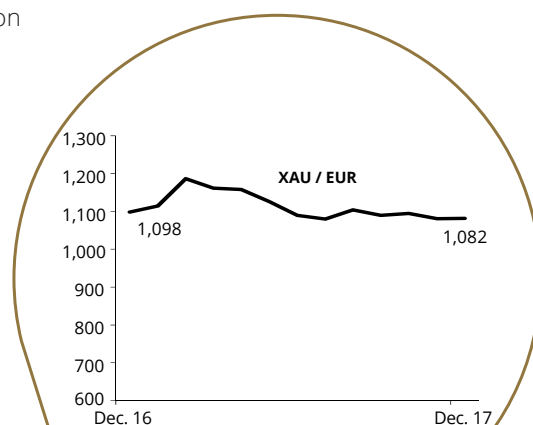
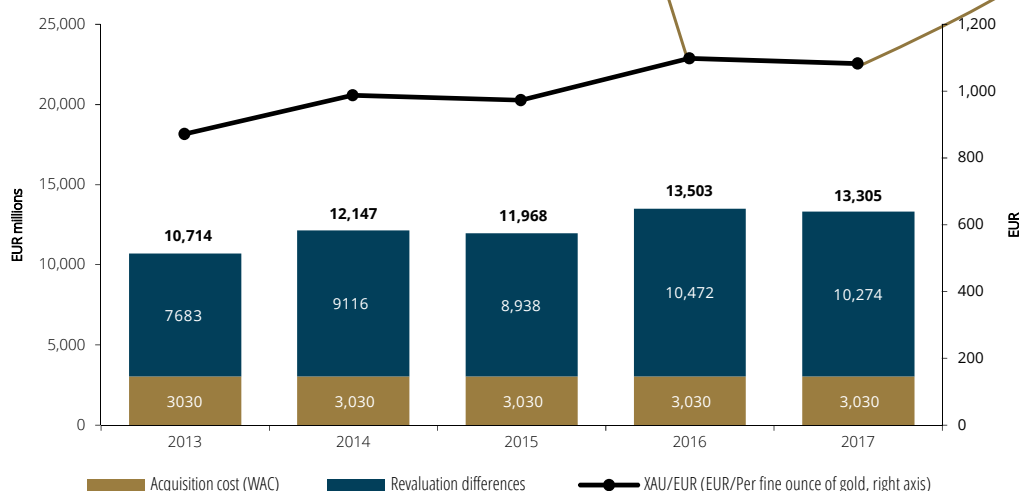


Chart II.7 • Gold reserve and quote price



#### Foreign reserves and euro assets (net)

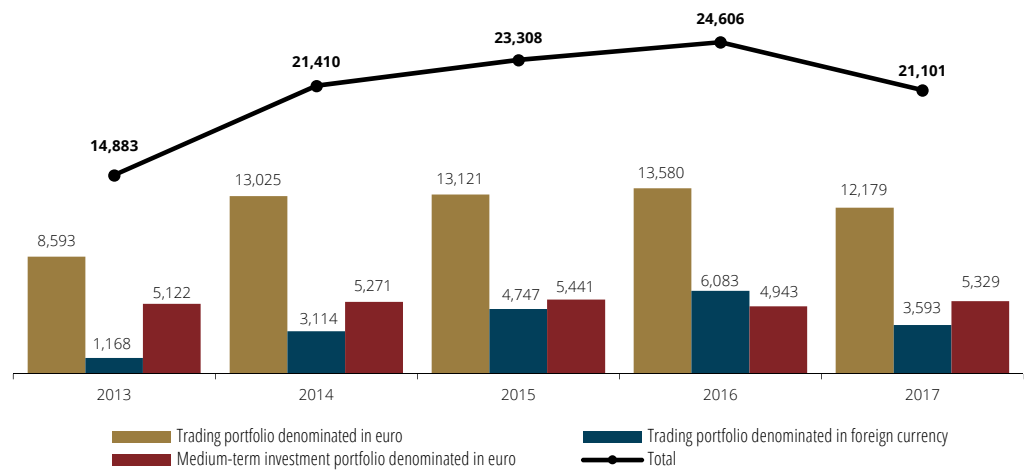
In 2017, Banco de Portugal's portfolio of foreign reserves and euro assets fell by €3,505 million from 2016 (Chart II.1.8).

Banco de Portugal's foreign reserves and euro assets netted to €21,101 million at the end of 2017, breaking down into €12,179 million in the trading portfolio denominated in euro (58% of the total), €3,593 million in the trading portfolio denominated in foreign currency (17%) and €5,329 million regarding the medium-term investment portfolio denominated in euro (25%). Contributing to the fall in the overall value of these assets were the decreases in the trading portfolio denominated in foreign currency and the trading portfolio denominated in euro, which reflect Banco de Portugal's investment decisions within the flexibility allowed by the agreements established at Eurosystem level, resulting from the trade-off between risk and profitability, given the present economic and financial situation. One of the agreements reached was the Agreement on Net Financial Assets (ANFA),<sup>1</sup> between the national central banks of the euro area, which sets rules and limits for non-

1. Press release of the ECB of 5 February 2016, 'ECB explains the Agreement on Net Financial Assets'.

monetary policy holdings that are related to national tasks of Eurosystem central banks.

**Chart II.8 • Foreign reserves and euro assets (net) | EUR millions**



• Trading portfolios (denominated in euro and foreign currency)

As at December 2017, the trading portfolio denominated in euro fell €1,401 million (-10%) from the end of 2016, which essentially reflected a decrease in the securities portfolio.

As in previous years, this trading portfolio is almost completely made up of securities (98% of the total), mainly issued by euro area residents (€11,876 million). By type of issuer, government debt bonds accounted for €11,542 million and paragonovernmental and supranational bonds for €339 million.

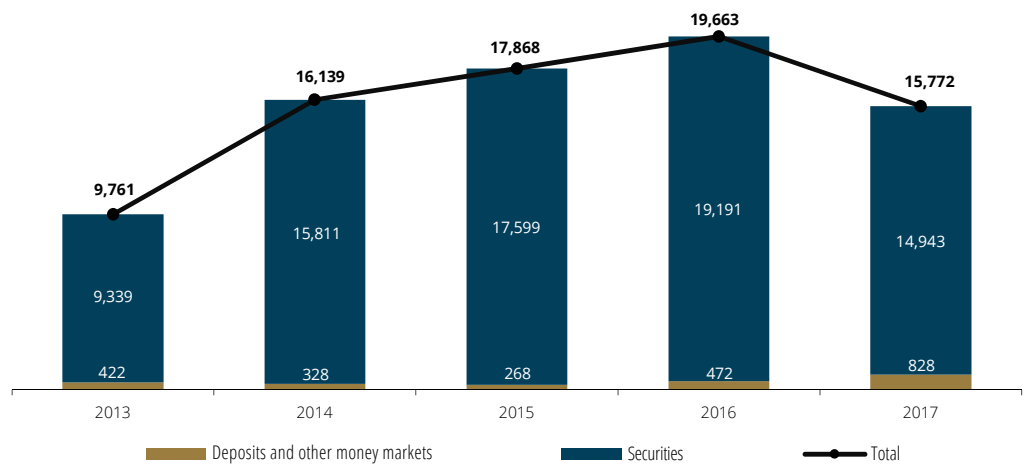
In regard to the trading portfolio denominated in foreign currency, it fell sharply by €2,490 million to €3,593 million at the end of the year versus 2016. This was due to Banco de Portugal's strategic investment decision during a period of appreciation of the euro (up 14% against the US dollar from December 2016). The sale of assets denominated in foreign currency in 2017 led to the realisation of significant exchange rate losses, impacting the Profit and Loss account. Exchange rate loss risk was covered by the general risk provision.

The structure in terms of composition by currency did not change in 2017, continuing to be mainly composed of US dollars (around 84% of total investment in foreign currency as at December 2017 compared with 90% in 2016 and 87% in 2015).

In terms of composition by instrument, the investments in the trading portfolio denominated in foreign currency tend to be in securities, representing around 84% of the total as at December 2017, mainly denominated in US dollars (81%), almost all of which are issued by non-euro area residents. Regarding type of issuer, the securities portfolio is comprised by government debt bonds (€1,693 million), securities issued by paragonovernmental and supranational entities (€1,061 million) and participation units in the Bank for International Settlements (BIS) (€256 million).

Furthermore, as at December 2017, there are outstanding gold swap operations for foreign currency, with the value presented in the item Deposits and other money markets (Chart II.1.9) reflecting the net effect of the assets and liabilities denominated in foreign currency relating to the funds invested and taken in these gold swap operations, which contribute positively to the profitability of the management of assets.

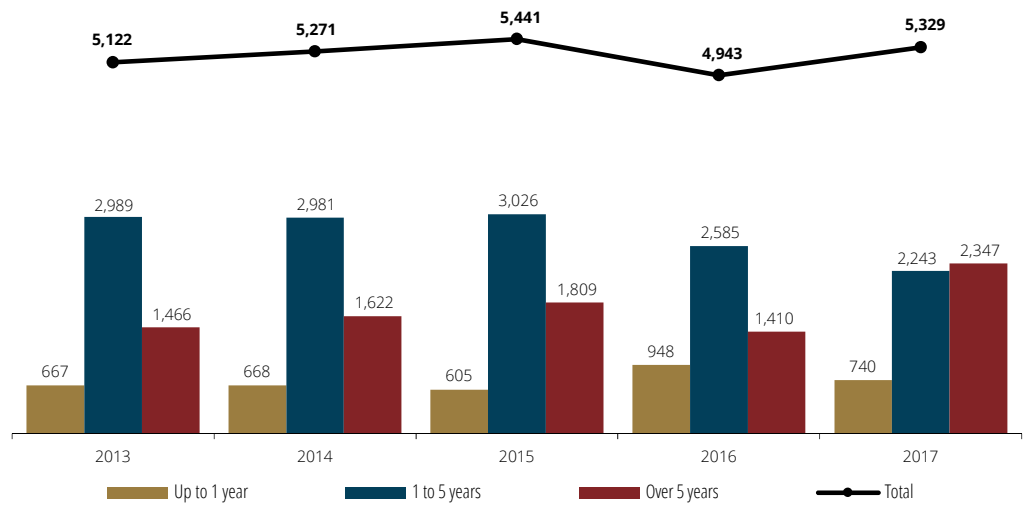
Chart II.9 • Trading portfolio (euro and foreign currency) | EUR millions



• Medium-term investment portfolio

The medium-term investment portfolio (Chart II.1.10) is, as at 31 December 2017, fully composed of securities denominated in euro, and valued at amortised cost less potential impairment losses. This portfolio, with a total value of €5,329 million, increased €386 million from 2016, essentially as a result of inflows from the trading portfolio denominated in euro. The main component in terms of type of issuer was government debt bonds by euro area issuers (€5,268 million).

Chart II.10 • Medium-term investment portfolio by maturity | EUR millions



1.1.3 Other balance sheet assets

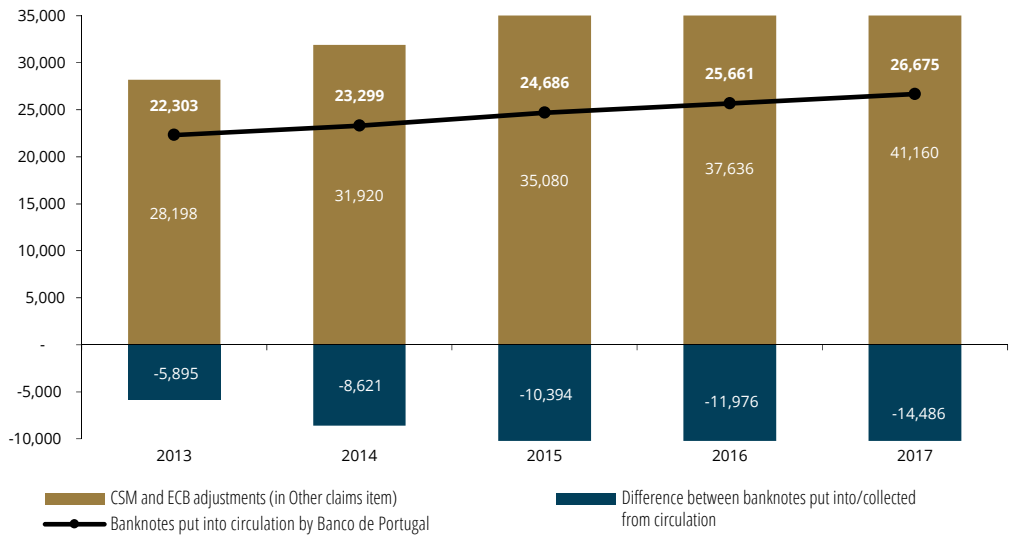
In the Other balance sheet assets item, aside from the net IMF position, the only other item of significance was the Accruals and prepaid expenses item, essentially relating to accrued revenue from core central banking activity operations (monetary policy and asset management).

1.1.4 Banknotes in circulation

The aggregate Banknotes in circulation, recorded on the liabilities side of Banco de Portugal's balance sheet, reflects the share of the Eurosystem's banknotes in circulation allocated to Portugal (Chart II.1.11). This aggregate has continued to grow since the euro entered into circulation, reflecting a rise in circulation at Eurosystem level (increasing by €+1,014 million to €26,675 million).

The adjustments to the banknotes in circulation reflect the differential between Portugal's share, as mentioned above, and the positive difference between the banknotes withdrawn from circulation and banknotes put into circulation by Banco de Portugal. As at December 2017 these adjustments totalled €41,160 million (€+3,524 million from December 2016). As in previous years, the growth in these adjustments reflects the combination of increased circulation in the Eurosystem and the widening of the aforementioned difference.

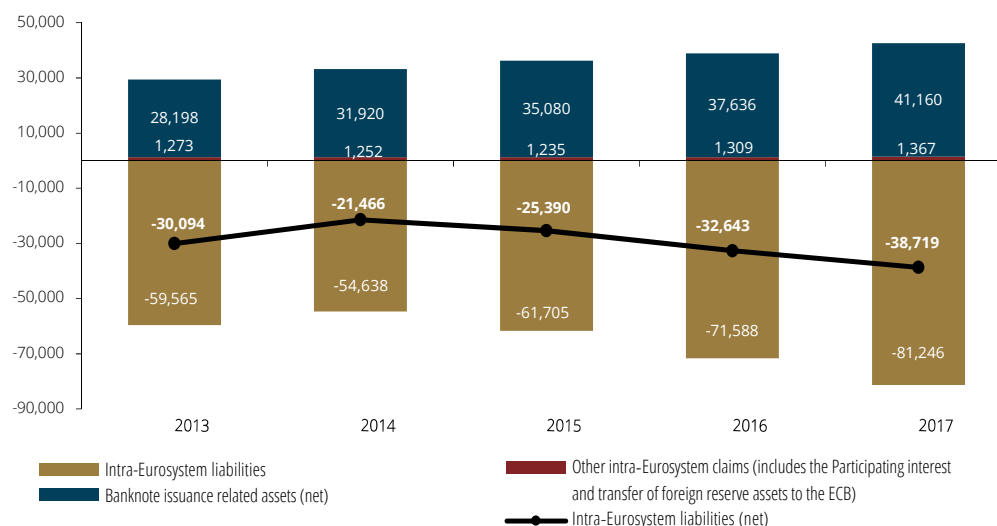
Chart II.11 • Banknotes in circulation and Adjustments to circulation | EUR millions



1.1.5 Intra-Eurosystem liabilities (net)

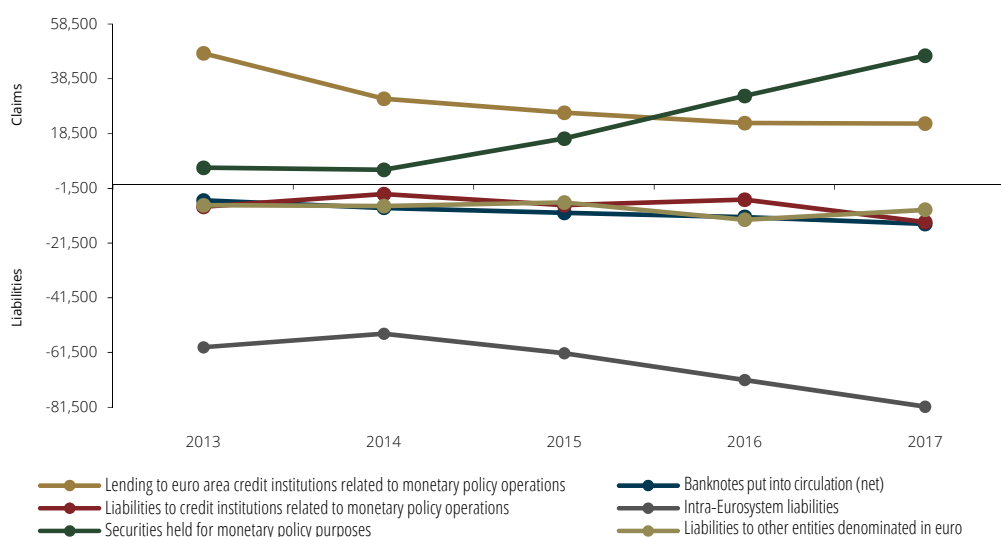
The value of Intra-Eurosystem liabilities (net), standing at €38,719 million, essentially reflects the net amount of TARGET account liabilities and Adjustments to circulation (banknote issuance related assets) (Chart II.1.12). These net liabilities grew by €6,076 million from 2016.

Chart II.12 • Intra-Eurosystem claims and liabilities | EUR millions



As at 31 December 2017, intra-Eurosystem liabilities grew €9,658 million from 2016 to €81,246 million, arising fully from TARGET account liabilities. This increase is explained principally by the financing of purchases of securities held for monetary policy purposes (outlined above), the increase in the positive difference between the banknotes withdrawn from circulation and banknotes put into circulation by Banco de Portugal and the reduction in liabilities associated with the general government current accounts (see 1.1.6 Other liabilities). These effects are partly offset by the increase in the item Liabilities to credit institutions related to monetary policy operations and the settlement of operations that led to the above-mentioned decline in the trading portfolio (Chart II.1.13).

Chart II.13 • Intra-Eurosystem liabilities and main offsetting balance sheet items | EUR millions



Regarding the Intra-Eurosystem claims item, it included the remunerated position relating to Adjustments to circulation, mentioned in 1.1.4 on Banknotes in circulation.

### 1.1.6 Other liabilities

The €3,355 million negative change in the Other liabilities aggregate mainly reflects the decline in the item Liabilities to other euro area entities denominated in euro, which essentially comprises the general government current accounts and autonomous funds' deposits held by Banco de Portugal (€8,953 million and €362 million respectively as at 31 December 2017). The general government current accounts, managed by the Portuguese Treasury and Debt Management Agency (Agência de Gestão da Tesouraria e da Dívida Pública – IGCP), relate to funds from the European Union (EU) under the Economic and Financial Assistance Programme to Portugal (Programa de Assistência Económica e Financeira a Portugal – PAEF).

Despite their low relative significance on Banco de Portugal's balance sheet, specific provision was taken due to their nature, as decided by the Governing Council of the ECB in December 2017 (to a sum of around €1.7 million), for expected losses from securities included in the CSPP, which constitute a shared risk at Eurosystem level, even though they are not in Banco de Portugal's portfolio. Therefore, the level of the provision reflects Banco de Portugal's key share of the total impairment and is offset by a loss recognised in the Profit and Loss account, in the item net result of pooling of monetary income.

### 1.1.7 Own funds

Banco de Portugal's own funds (the items Revaluation accounts, General risk provision, Equity and Profit for the year) fell by €1,039 million in 2017 (to €15,918 million), largely due to the decreases in the Revaluation accounts item and in the General risk provision, partly offset by the positive Profit for the year (Chart II.1.14).

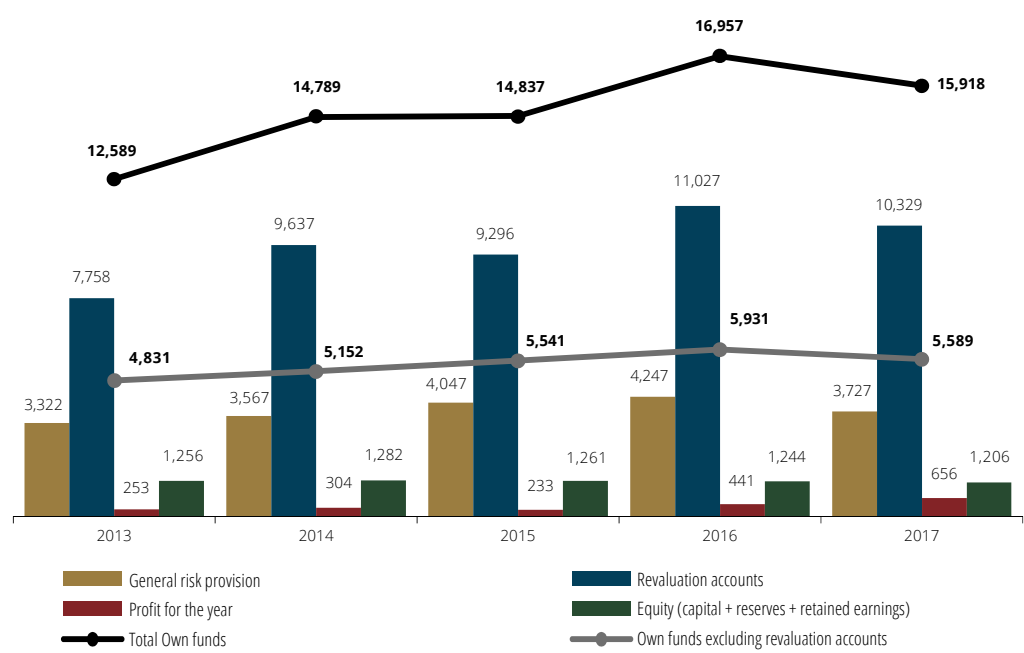
Contributing to the decline in revaluation accounts (of €698 million, totalling €10,329 million) was the decrease in potential exchange rate gains from assets denominated in foreign currency (€363 million), in potential gains from Gold (€199 million) and in potential gains from trading portfolio securities (€136 million).

Excluding revaluation accounts, this aggregate declined €341 million from 2016, due to the combined effect of (i) the €520 million decrease in December 2017 of the General risk provision; (ii) the recognition of €656 million in net profit for 2017; (iii) the impact of the distribution of €352 million in dividends to the State by investing the net profit for 2016; and (iv) the recognition in retained earnings of actuarial and financial losses of 2017, relating to the Pension Fund – Defined-benefit plan (totalling €-150 million, essentially the result of the revision of the life table assumptions) and of positive current tax adjustments (€30 million).

The General risk provision was reduced by €520 million in 2017, reaching a total of €3,727 million as at December. The level of this provision is assessed periodically as part of Banco de Portugal's internal projection exercises for the financial statements over the medium term, which assess results and financial risks, the latter calculated according to the methodology defined at Eurosystem level. The General risk provision amount is established annually, with a view to setting own funds at a level that allows for appropriate financial autonomy for Banco de Portugal's mission and to enable it to cover any losses (namely financial losses), including those resulting from risk-sharing with the Eurosystem. The reduction recorded this year was essentially the result of the

combination of various factors, some exceptional in nature, which caused a decrease in financial risk exposure, namely the recognition of financial losses, the decrease and recomposition of the portfolio of foreign reserves and euro assets, the decline in the foreign currency exposure and the increase in the Portuguese Republic's rating. However, with the extension of the APP in the euro area up to at least the end of 2018, as announced by the Governing Council of the ECB in October 2017, the risk reduction resulting from the aforementioned rating increase is likely to be negated almost completely over the medium term by the estimated increase in the volume of monetary policy securities, namely from non-shared risk in the governmental component of the PSPP.

Chart II.14 • Own funds | EUR millions



## 1.2 Developments in the Profit and Loss Account

The main components of the Profit and Loss Account from 2013 to 2017 are shown in Table 2.

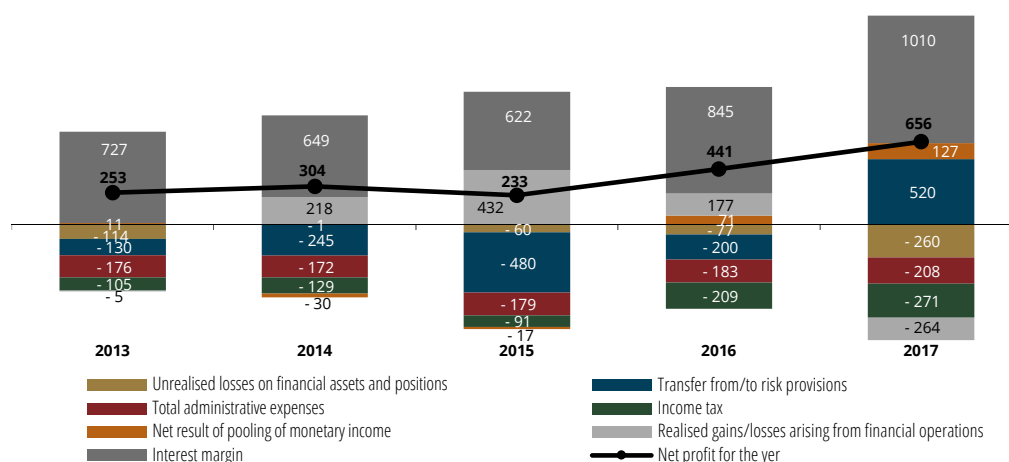
The Profit for the year 2017 was €656 million.

**Table II.1.2**

(EUR millions)

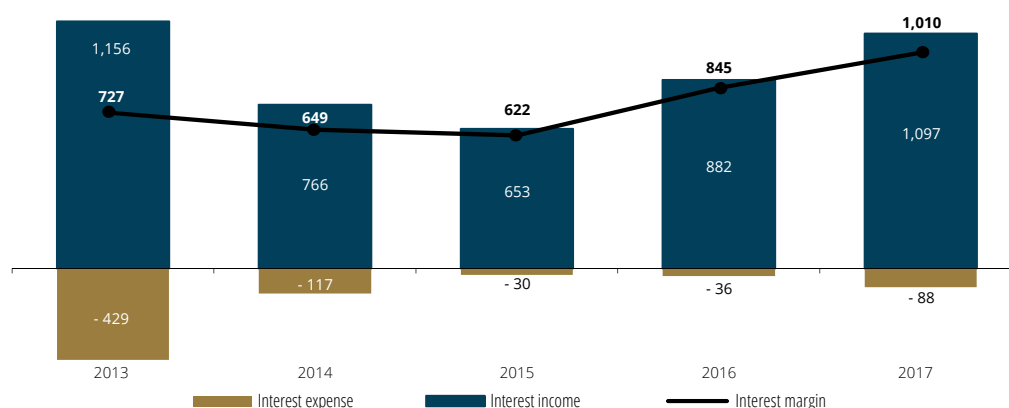
	2013	2014	2015	2016	2017	Δ 2017-2016
<b>Interest margin</b>	<b>727</b>	<b>649</b>	<b>622</b>	<b>845</b>	<b>1,010</b>	<b>164</b>
Interest income	1,156	766	653	882	1,097	216
Interest expense	(429)	(117)	(30)	(36)	(88)	(51)
<b>Realised gains/losses arising from financial operations</b>	<b>(5)</b>	<b>218</b>	<b>432</b>	<b>177</b>	<b>(264)</b>	<b>(441)</b>
<b>Unrealised losses on financial assets and positions</b>	<b>(114)</b>	<b>(1)</b>	<b>(60)</b>	<b>(77)</b>	<b>(260)</b>	<b>(183)</b>
<b>Income from equity shares and participating interests</b>	<b>54</b>	<b>25</b>	<b>26</b>	<b>33</b>	<b>33</b>	<b>0</b>
<b>Net result of pooling of monetary income</b>	<b>11</b>	<b>(30)</b>	<b>(17)</b>	<b>71</b>	<b>127</b>	<b>56</b>
<b>Total administrative expenses</b>	<b>176</b>	<b>172</b>	<b>179</b>	<b>183</b>	<b>208</b>	<b>25</b>
Staff costs	123	115	120	122	136	14
Related to supervision	22	23	25	26	28	2
Excluding those related to supervision	102	91	95	96	108	12
Supplies and services from third parties	38	42	47	48	56	8
Related to extraordinary factors	1	6	7	5	12	7
Related to exogenous factors to the management of Banco de Portugal	1	2	2	3	4	1
Excluding those related to extraordinary or exogenous factors	35	34	38	39	40	1
Other administrative expenses	1	1	1	1	1	–
Depreciation and amortisation for the year	14	14	11	13	15	2
<b>Banknote production costs</b>	<b>13</b>	<b>13</b>	<b>16</b>	<b>15</b>	<b>23</b>	<b>8</b>
<b>Other net profit/loss</b>	<b>4</b>	<b>4</b>	<b>(3)</b>	<b>(1)</b>	<b>(7)</b>	<b>(6)</b>
<b>Income before provisions and taxes</b>	<b>488</b>	<b>678</b>	<b>804</b>	<b>850</b>	<b>408</b>	<b>(442)</b>
Transfer from/to risk provisions	(130)	(245)	(480)	(200)	520	720
<b>Income before taxes</b>	<b>358</b>	<b>433</b>	<b>324</b>	<b>650</b>	<b>928</b>	<b>278</b>
Income tax – current	(75)	(128)	(91)	(191)	(272)	(81)
Income tax – deferred	(31)	(1)	–	(18)	1	19
<b>Net profit for the year</b>	<b>253</b>	<b>304</b>	<b>233</b>	<b>441</b>	<b>656</b>	<b>216</b>

Chart II.15 • Developments in the main profit/loss items | EUR millions



Income before provisions and taxes was €408 million, representing a €442 million decrease from 2016. The main factors underlying this decrease were the negative items Realised gains/losses arising from financial operations and Unrealised losses on financial assets and positions, partly offset by the increase in the items Interest margin and Net result of pooling of monetary income. The General risk provision was also reduced, following consideration of the various factors relevant to its movements, as identified before, and the materialisation of the losses mentioned.

Chart II.16 • Interest margin | EUR millions

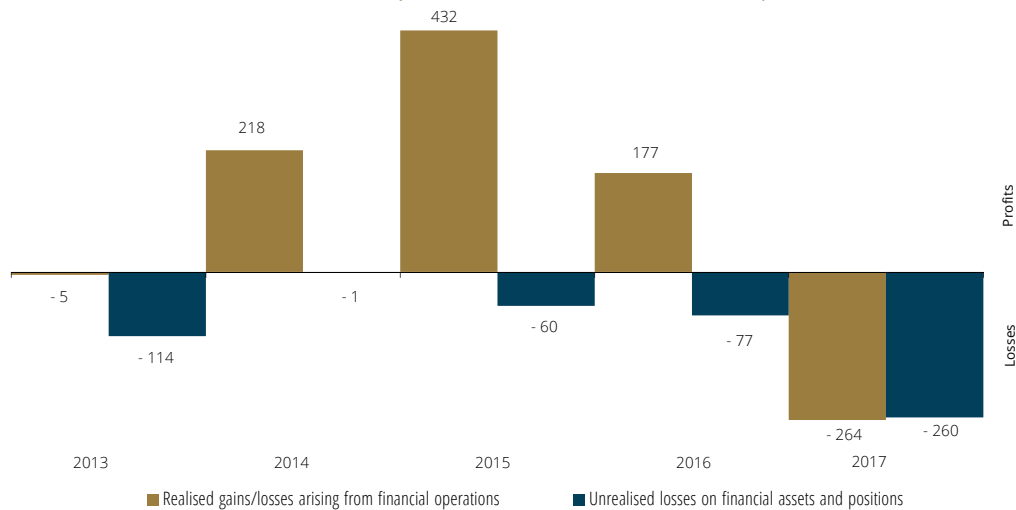


The main component of Banco de Portugal's Profit and Loss account is the Interest margin, which reached €1,010 million in 2017, representing growth of €164 million from 2016 (+19%) (Chart II.1.16). Contributing to the sharp increase in interest assets was interest on the portfolio of securities held for monetary policy purposes, specifically the sharp growth in volume of the PSPP's government securities component. The average yield on the portfolio of securities held for monetary policy purposes is by nature substantially higher than most other interest-bearing assets on the portfolio, but all these assets posted yields below the average of the year before. In 2017, the interest on this portfolio represented around 73% of Interest income.

Furthermore, the Interest margin item for 2017 was driven by (i) the increase in interest on the trading portfolio denominated in foreign currency, principally as a result of income from securities and from gold swap operations for foreign currency and (ii) in the area of monetary policy, the increase in interest receivable from the current accounts of credit institutions with Banco de Portugal (minimum reserve surplus), principally due to the increase in their average balance, in a context of negative rates.

The positive impact of these was partly offset by the general reduction in yields on the main assets, as well as the increase in interest payable on lending to credit institutions, in particular interest on TLTRO-II operations. As the interest rate applicable to these operations will only be known in 2018, their treatment was standardised across the Eurosystem, using the deposit facility rate for accruing interest on these operations (set at -0.40% from 16 March 2016), as it was deemed the best estimate to date.

**Chart II.17 • Net result of financial operations and unrealised losses | EUR millions**

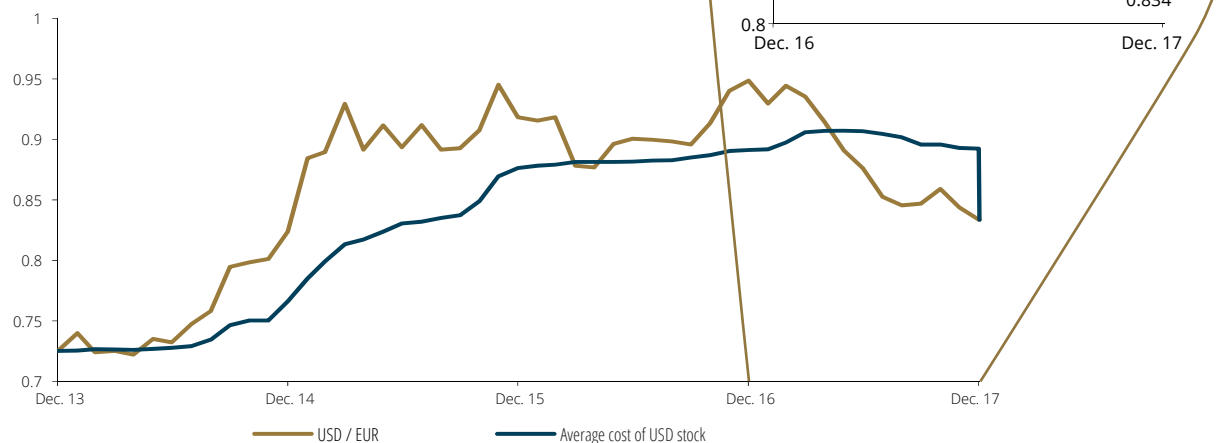


The item Realised gains/losses arising from financial operations in 2017 reached a cumulative negative total of €-264 million, which is a €441 million decrease on 2016 (Chart II.1.17).

This negative result arose chiefly from foreign currency losses realised when reducing the volume of the portfolio denominated in foreign currency, essentially comprising losses on sales of securities in US dollars, which devalued 12% during 2017 (Chart II.1.18). Along with this effect, interest rate futures also realised net losses (€-117 million), which resulted from the hedging of interest rate risks associated with the trading portfolios denominated in euro and US dollars. It should be noted that the gains realised from these assets reached €110 million in 2017.

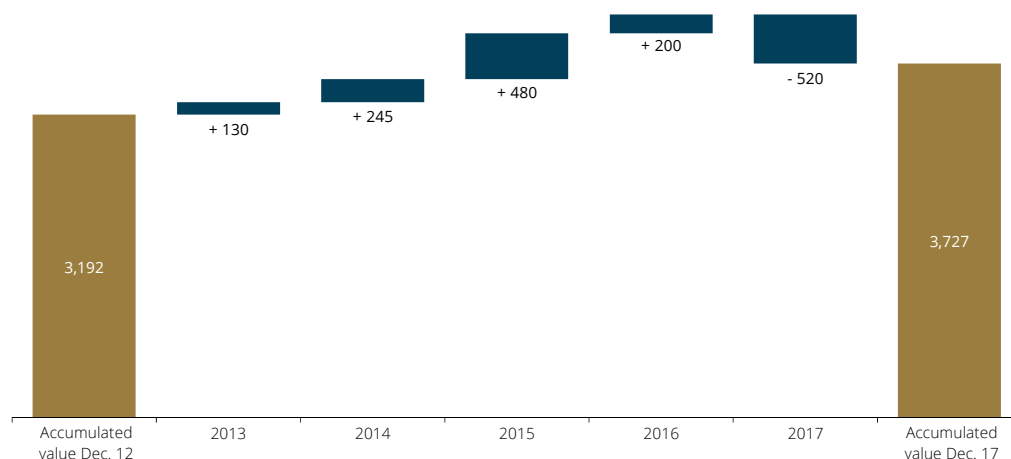
Regarding the item Unrealised losses on financial assets and positions, the overall amount of €260 million recognised in 2017 was mainly related to unrealised foreign currency losses associated with portfolio assets denominated in US dollars (€210 million), as well as losses from price decreases in securities in the trading portfolio denominated in euro and foreign currency (€19 million and €11 million respectively). In accordance with the harmonised accounting rules of the Eurosystem, unrealised losses are recognised as expenses for the period as at 31 December, while unrealised gains continue to be recognised in the balance sheet in the respective revaluation differences items.

**Chart II.18 • Evolution of the USD/EUR exchange rate**  
| EUR millions



At the end of the year, the General risk provision was reduced by €520 million (II.1.19), taking into consideration the decrease in the financial risks on the balance sheet faced by Banco de Portugal over the medium term, as mentioned above, including the materialisation of foreign currency losses on sale operations in US dollars.

**Chart II.19 • Movements in the General risk provision** | EUR millions



In 2017, an important component in the item Net result of pooling of monetary income was the result of the method of sharing monetary income for the year (totalling €129 million). The sharp increase in the result of the method of sharing monetary income (€58 million) arose from Banco de Portugal's share of net contributions in the Eurosystem having decreased from the year before, in a context of increasing overall monetary income shared by the Eurosystem, which largely resulted from the very sharp increase in monetary policy deposit operations in the rest of the Eurosystem, remunerated at the deposit facility rate (-0.4%). The reduction of Portugal's net

contributions is chiefly due to lower contributions in relation to the SMP and a greater volume of TLTRO II with negative shared interest. Banco de Portugal's share of these contributions remains below its adjusted capital key, due to which a receivable from other Eurosystem national central banks was recorded. In 2017, this item also included the recording of the specific provision for the Eurosystem, mentioned in 1.1.6.

In 2017 Total administrative expenses came to €208 million (Chart II.1.20).

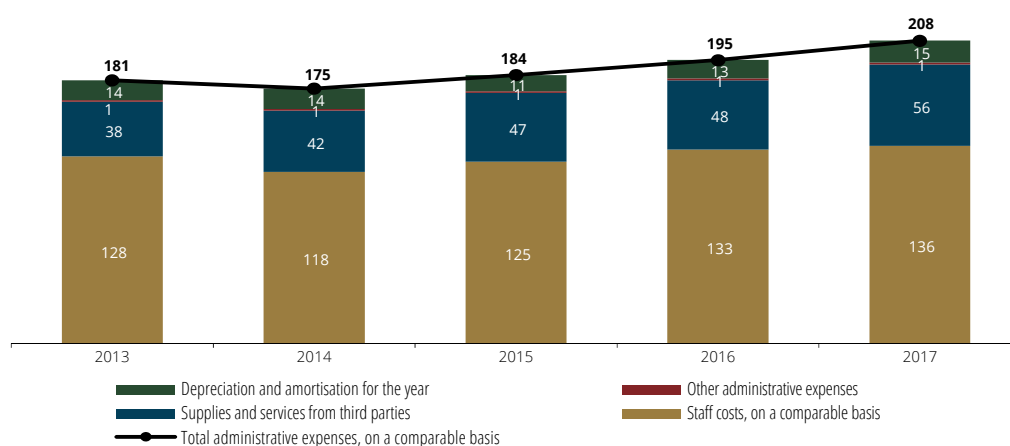
The increase in Staff costs in 2017 essentially reflects increased liabilities in the Pension Fund – Defined-Benefit Plan, resulting from the awarding of early retirements, which came to be recognised in Staff costs, instead of Equity as was the case up to 2016. In 2017 these costs totalled €10 million, compared to €11 million in 2016. The increase in staff costs from 2016 (€14 million) reflects this change. On a like-for-like basis, the Staff costs item increased around €3 million (+2%).

**Table II.1.3**

	2013	2014	2015	2016	2017	EUR millions Δ 2017-2016
<b>Staff costs</b>	<b>123</b>	<b>115</b>	<b>120</b>	<b>122</b>	<b>136</b>	<b>14</b>
Increase in Pension Fund liabilities, on early retirements	5	3	5	11	10	-1
<b>Staff costs, on a comparable basis</b>	<b>128</b>	<b>118</b>	<b>125</b>	<b>133</b>	<b>136</b>	<b>3</b>

Disregarding this effect, the increase in staff costs was mainly explained by the increase in compulsory social charges, namely the increased annual charge from the Pension Fund – Defined-Benefit Plan (€2 million more than in 2016). This increase results from the actuarial assessment made by Sociedade Gestora dos Fundos de Pensões do Banco de Portugal (Banco de Portugal Pension Funds Management Company), and chiefly reflects the reduction of the discount rate on liabilities, dictated by the sharp fall in sovereign debt interest rates in the euro area included in the calculation of that assumption. Furthermore, the 0.75% salary update agreed for 2017 as part of the collective labour agreement for the banking sector (ACT) also contributed to the increase in staff costs. Offsetting these effects in 2017, in annual average terms, was the reduction in the number of Banco de Portugal staff (-34 employees in non-supervisory areas, as against a slight increase of +5 in supervisory areas).

**Chart II.20 • Administrative expenses | EUR millions**



The item Supplies and services from third parties (accounting for around 27% of total administrative expenses) grew €8 million from 2016. Contributing to this increase was the growth in expenses related to extraordinary factors, including legal and financial advice expenses in the sale process of Novo Banco and the resolution measure on Banco Espírito Santo, S. A. (€+7 million from 2016), partly resulting from the fact that Banco de Portugal began to bear in full these kinds of expenses relating to the sale of Novo Banco in 2017, by decision of the Ministry of Finance in October 2017.

Supplies and services from third parties regarding factors exogenous to Banco de Portugal, which mainly relate to software development and technology expenses within the scope of the Eurosystem, increased around €1 million from 2016.

Excluding these effects of expense components that are extraordinary or exogenous to the management of Banco de Portugal, the Supplies and services from third parties item was slightly higher in 2017, (by €1 million, +2%). Contributing to this growth in expenses was the strategic line of innovation of Banco de Portugal's information systems and technologies, the use of outsourcing for IT, logistics, security and HR management, as well as the reinforcement of the training plan for Banco de Portugal's employees.

These increases were partly mitigated by reductions in expenses due to effective savings, essentially relating to utilities contracts and contracts for maintenance and repairs of Banco de Portugal premises, and due to the reduction in rent paid on buildings that were no longer used by Banco de Portugal. The Board of Directors of Banco de Portugal have introduced measures across the organisation to manage resources efficiently and contain costs, in a context of additional functions and responsibilities resulting from its mission as central bank within the Eurosystem.

Lisbon, 13 March 2018

**BOARD OF DIRECTORS**

**Governor**

Carlos da Silva Costa

**Vice-Governors**

Elisa Ferreira | Luís Máximo dos Santos

**Directors**

Hélder Rosalino | Luís Laginha de Sousa | Ana Paula Serra

**Profit distribution**

In accordance with the provisions set forth in Article 53 (2) of the Organic Law of Banco de Portugal, the net profit for the year 2017, to the amount of €656.48 million, was distributed as follows:

10% to the legal reserve .....	€65,648,419.60
10% to other reserves .....	€65,648,419.60
and, pursuant to subparagraph (c),	
80% to the State, as dividends .....	€525,187,356.78

pursuant to Decision No 304/18 – SEAFin of 24 April 2018 of the Deputy Minister and Secretary of State of Finance.

## 2 Financial Statements

**Table II.1 • Balance sheet of Banco de Portugal**

Assets	Note number	31 Dec. 2017		31 Dec. 2016
		Gross assets	Depreciation, amortisation and impairment	Net Assets
1 Gold and gold receivables	2	13,304,644		13,304,644
2 Claims on non-euro area residents denominated in foreign currency		8,451,598		8,451,598
2.1 Receivables from the IMF	3	1,189,726		1,189,726
2.2 Balances with banks and security investments, external loans and other external assets	4	7,261,872		7,261,872
3 Claims on euro area residents denominated in foreign currency	4	552,154		552,154
4 Claims on non-euro area residents denominated in euro	5	64,066		64,066
4.1 Balances with banks, security investments and loans		64,066		64,066
4.2 Claims arising from the credit facility under the Exchange Rate Mechanism II (ERM II)		–		–
5 Lending to euro area credit institutions related to monetary policy operations denominated in euro	6	22,131,400		22,131,400
5.1 Main refinancing operations		100,000		100,000
5.2 Longer-term refinancing operations		22,011,400		22,011,400
5.3 Fine-tuning reverse operations		–		–
5.4 Structural reverse operations		–		–
5.5 Marginal lending facility		20,000		20,000
5.6 Credits related to margin calls		–		–
6 Other claims on euro area credit institutions denominated in euro	5	239,140		239,140
7 Securities of euro area residents denominated in euro		58,844,194		58,844,194
7.1 Securities held for monetary policy purposes	7	46,968,576		46,968,576
7.2 Other securities	5	11,875,619		11,875,619
9 Intra-Eurosystem claims	8	42,527,539		42,527,539
9.1 Participating interest in the ECB		203,700		203,700
9.2 Claims equivalent to the transfer of foreign reserves to the ECB		1,010,318		1,010,318
9.3 Net claims arising from balances of TARGET accounts		–		–
9.4 Net claims related to the allocation of euro banknotes within the Eurosystem		41,160,392		41,160,392
9.5 Other intra-Eurosystem claims		153,130		153,130
10 Items in the course of settlement		1		1
11 Other assets		7,113,966	263,872	6,850,094
11.1 Coins of the euro area		42,538		42,538
11.2 Tangible fixed assets and intangible assets	9	376,412	260,290	116,121
11.3 Other financial assets	10	5,383,265		5,383,265
11.4 Off-balance-sheet instruments revaluation differences		1,335		1,335
11.5 Accruals and prepaid expenses	11	918,389		918,389
11.6 Sundry	12/19	392,027	3,581	388,446
Total depreciation and amortisation			260,290	
Total impairment	19		3,581	
Total assets		153,228,703	263,872	152,964,831
				137,717,390

		EUR thousands	
Liabilities, revaluation accounts, general risk provision and equity	Note number	31 Dec. 2017	31 Dec. 2016
<b>1 Banknotes in circulation</b>	<b>13</b>	<b>26,674,764</b>	<b>25,660,832</b>
<b>2 Liabilities to euro area credit institutions related to monetary policy operations denominated in euro</b>	<b>14</b>	<b>13,864,548</b>	<b>5,648,523</b>
2.1 Current accounts of credit institutions for compliance with minimum reserve requirements		13,859,548	5,498,141
2.2 Deposit facility		5,000	150,000
2.3 Fixed-term deposits		–	–
2.4 Fine-tuning reverse operations		–	–
2.5 Deposits related to margin calls		–	383
<b>3 Other liabilities to euro area credit institutions denominated in euro</b>		<b>–</b>	<b>–</b>
<b>5 Liabilities to other euro area residents denominated in euro</b>	<b>15</b>	<b>9,369,829</b>	<b>13,010,559</b>
5.1 General government		8,952,911	11,845,234
5.2 Other liabilities		416,918	1,165,325
<b>6 Liabilities to non-euro area residents denominated in euro</b>	<b>16</b>	<b>6,009</b>	<b>413</b>
<b>7 Liabilities to euro area residents denominated in foreign currency</b>		<b>–</b>	<b>–</b>
<b>8 Liabilities to non-euro area residents denominated in foreign currency</b>	<b>4</b>	<b>4,221,095</b>	<b>3,397,681</b>
8.1 Deposits, balances and other liabilities		4,221,095	3,397,681
8.2 Liabilities arising from the credit facility under ERM II		–	–
<b>9 Counterpart of special drawing rights allocated by the IMF</b>	<b>3</b>	<b>957,772</b>	<b>1,027,936</b>
<b>10 Intra-Eurosystem liabilities</b>	<b>8</b>	<b>81,246,236</b>	<b>71,588,292</b>
10.1 Liabilities related to the issuance of ECB debt certificates		–	–
10.2 Net liabilities arising from balances of TARGET accounts		81,246,162	71,588,283
10.3 Net liabilities related to the allocation of euro banknotes within the Eurosystem		–	–
10.4 Other net liabilities within the Eurosystem		74	9
<b>11 Other liabilities</b>		<b>704,558</b>	<b>425,678</b>
11.1 Off-balance-sheet instruments revaluation differences		–	–
11.2 Accruals and income collected in advance	17	142,548	56,237
11.3 Sundry	18	562,010	369,441
<b>12 Provisions</b>	<b>19</b>	<b>1,706</b>	<b>–</b>
<b>13 Revaluation accounts</b>	<b>20</b>	<b>10,328,833</b>	<b>11,026,701</b>
<b>14 General risk provision</b>	<b>19</b>	<b>3,726,622</b>	<b>4,246,622</b>
<b>15 Equity</b>	<b>21</b>	<b>1,206,375</b>	<b>1,243,563</b>
15.1 Capital		1,000	1,000
15.2 Reserves and retained earnings		1,205,375	1,242,563
<b>16 Profit for the year</b>		<b>656,484</b>	<b>440,590</b>
<b>Total liabilities, revaluation accounts, general risk provision and equity</b>		<b>152,964,831</b>	<b>137,717,390</b>

Head of the Accounting Department  
José Pedro Silva Ferreira

Note: Totals/sub-totals included in the financial statements may not equal the sum of the figures presented due to rounding, since this section presents figures in EUR thousands

Table II.2 • Profit and loss account

EUR thousands

	Items	Note number	31 Dec. 2017	31 Dec. 2016
1	Interest income		1,097,343	881,792
2	Interest expense		87,593	36,494
3	<b>Net interest income</b>	22	<b>1,009,750</b>	<b>845,298</b>
4	Realised gains/losses arising from financial operations	23	(264,191)	176,757
5	Unrealised losses on financial assets and positions	24	260,333	77,421
6	Transfer from/to risk provisions	19	520,000	(200,000)
7	<b>Net result of financial operations, unrealised losses and risk provisions</b>		<b>(4,525)</b>	<b>(100,663)</b>
8	Fees and commissions income		4,995	5,027
9	Fees and commissions expense		10,244	8,174
10	<b>Net income from fees and commissions</b>		<b>(5,250)</b>	<b>(3,147)</b>
11	Income from equity shares and participating interests	25	33,234	32,930
12	Net result of pooling of monetary income	19/26	126,886	70,903
13	Other income	27	9,181	5,198
14	<b>Total net income</b>		<b>1,169,276</b>	<b>850,518</b>
15	Staff costs	28	135,721	121,980
16	Supplies and services from third parties	29	55,871	47,524
17	Other administrative expenses		1,338	1,269
18	Depreciation and amortisation for the year	9	15,058	12,630
19	<b>Total administrative expenses</b>		<b>207,989</b>	<b>183,402</b>
20	Costs of banknote production		22,814	14,884
21	Other expenses	27	14,754	2,731
22	Losses for impairment of assets (losses/reversals)	19	(4,002)	(5)
23	Transfer to the reserve relating to capital gains on gold sales		–	–
24	<b>Totals costs and losses (net)</b>		<b>241,555</b>	<b>201,012</b>
25	<b>Income before taxes</b>		<b>927,721</b>	<b>649,506</b>
26	Income tax		271,237	208,916
26.1	Income tax – current	30	271,964	190,977
26.2	Income tax – deferred	30	(727)	17,939
27	<b>Profit for the year</b>		<b>656,484</b>	<b>440,590</b>

Head of the Accounting Department  
José Pedro Silva Ferreira

Note: Totals/sub-totals included in the financial statements may not equal the sum of the figures presented due to rounding, since this section presents figures in EUR thousands.

Table II.3 • Statement of changes in equity

EUR thousands

Description	Note number	Paid up capital	Legal reserves	Other reserves	Distributable retained earnings	Non-distributable retained earnings	Net profit for the year	Total equity
Position as at 31 December 2015 (1)		1,000	328,611	1,264,813	–	(333,421)	232,892	1,493,895
<b>2015 profit distribution</b>								
Dividends distribution to shareholders	21						(186,313)	(186,313)
Other operations	21		23,289	23,289	–		(46,578)	–
Sub-total of 2015 profit distribution (2)		–	23,289	23,289	–	–	(232,892)	(186,313)
<b>Changes in 2016</b>								
Changes to accounting policies								–
Revaluation of tangible fixed assets and intangible assets								–
Actuarial gains/losses of the Pension Fund	32					(79,371)		(79,371)
Income tax – current	30				16,610			16,610
Adjustments on account of deferred taxes	30					(1,257)		(1,257)
Other changes recognised in equity								–
Sub-total of changes in 2016 (3)		–	–	–	16,610	(80,628)	–	(64,018)
<b>Net profit for the year (4)</b>							440,590	440,590
<b>Comprehensive income for the year (5) = (3) + (4)</b>		–	–	–	16,610	(80,628)	440,590	376,572
<b>Position as at 31 December 2016 (6) = (1) + (2) + (5)</b>		1,000	351,900	1,288,102	16,610	(414,049)	440,590	1,684,153
<b>Position as at 31 December 2016 (7)</b>		1,000	351,900	1,288,102	16,610	(414,049)	440,590	1,684,153
<b>2016 profit distribution</b>								
Dividends distribution to shareholders	21						(352,472)	(352,472)
Other operations	21		44,059	44,059			(88,118)	–
Sub-total of 2016 profit distribution (8)		–	44,059	44,059	–	–	(440,590)	(352,472)
<b>Changes in 2017</b>								
Actuarial gains/losses of the Pension Fund	32					(150,417)		(150,417)
Income tax – current	30				29,694			29,694
Adjustments on account of deferred taxes	30					(4,584)		(4,584)
Sub-total of changes in 2017 (9)		–	–	–	29,694	(155,001)	–	(125,307)
<b>Net profit for the year (10)</b>							656,484	656,484
<b>Comprehensive income for the year (11) = (9) + (10)</b>		–	–	–	29,694	(155,001)	656,484	531,177
<b>Position as at 31 December 2017 (12) = (7) + (8) + (11)</b>		1,000	395,959	1,332,161	46,304	(569,049)	656,484	1,862,858

Head of the Accounting Department  
José Pedro Silva Ferreira

Note: Totals/sub-totals included in the financial statements may not equal the sum of the figures presented due to rounding, since this section presents figures in EUR thousands.

# 3 Notes on the Financial Statements

(Figures in EUR thousands, save as otherwise stated)

## NOTE 1 • BASES OF PRESENTATION AND MAIN ACCOUNTING POLICIES

### 1.1 Bases of presentation

The financial statements of Banco de Portugal have been prepared in accordance with the Chart of Accounts of Banco de Portugal (Plano de Contas do Banco de Portugal – PCBP), approved by the member of Government responsible for Finance, in accordance with the provisions laid down in Article 63 (1) of the Organic Law of Banco de Portugal, and entered into force on 1 January 2012. The PCBP is a regulation specifically and appropriately designed for the central bank activity.

The bases for preparation of the financial statements, envisaged in the PCBP in force, rely on two major regulations: (i) the Accounting Guideline of the European Central Bank (ECB) (hereinafter “the ECB Accounting Guideline”),<sup>2</sup> which, taking into account Article 26.4 of the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the ‘Statute of the ESCB’), establishes the adoption of the mandatory rules defined by the Governing Council of the ECB on the treatment of core central banking activity, with Banco de Portugal having decided to also adopt the optional rules recommended in that Guideline for participating interests; and (ii) technical guidance on the recognition and measurement based on the IFRS<sup>3</sup> for the other activities, which will be applied provided the cumulative conditions laid down in the PCBP are met.

The PCBP defined two single balance sheet items: (i) Revaluation accounts, representing potential gains that are not recognised in Profit/loss (Section 1.2 (d) and (p) of this Note); and (ii) the General risk provision, which unlike the other provisions, is equivalent to a reserve, although its increases and reductions are directly made against Profit/loss (Section 1.2 (q) of this Note). These two items are recorded in the balance sheet between Liabilities and Equity.

In accordance with the ECB Accounting Guideline, the classification of assets and liabilities shall be made according to the residence in the euro area criterion. Euro area assets and liabilities are those relating to euro area residents.

Participating interests in subsidiaries and associated companies have a long-standing nature and their maintenance is connected with Banco de Portugal’s activity. These participating interests are measured in compliance with the accounting policy described in Section 1.2 (e) of this Note. Given the immaterial nature of the results of a possible consolidation process, as well as the lack of economic sense justifying it, Banco de Portugal does not prepare consolidated financial statements.

With regard to the disclosures of positions relating to the participation in the operation of the European System of Central Banks (ESCB), Banco de Portugal uses the harmonised procedures laid down by the ECB as a basis. As to the other business areas, the disclosures are on the information

2. Guideline of the European Central Bank of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2016/34) with its subsequent amendments – available from [www.ecb.eu](http://www.ecb.eu).

3. IFRS: International Financial Reporting Standards, as adopted in the European Union.

defined by the IFRS, whenever it does not collide with (i) the day-to-day activity of the markets and market players; (ii) the purposes of the operations conducted by Banco de Portugal; and (iii) the objective of Banco de Portugal as the central bank.

## 1.2 Synopsis of the main accounting policies

The main accounting policies and valuation criteria used in the preparation of the financial statements of Banco de Portugal for the year are the following:

### **a)** Accounting assumptions and qualitative characteristics of the financial statements

The financial statements of Banco de Portugal reflect the economic reality of its assets and liabilities and are prepared in accordance with the following accounting assumptions: accrual basis of accounting principle (in relation to most financial statement items, namely with regard to interest income and interest expense, which is recognised in the accounting period in which it is generated and not according to the moment in time in which it is paid or received) and continuity. The qualitative characteristics of the financial statements are understandability, relevance, reliability and comparability.

### **b)** Recognition of assets and liabilities

Assets are resources controlled by Banco de Portugal on an individual basis, or by the Eurosystem on a collective basis (pooling), resulting from past events and which are expected to generate future economic benefit. Liabilities are commitments resulting from past events and their settlement is expected to result in an outflow of funds or investment of resources representing economic benefit.

### **c)** Recognition date

Assets and liabilities in general are recognised on the settlement date rather than on the trade date. When the year ends between the settlement date and the trade date, transactions are recognised in off-balance-sheet accounts on the trade date.

Foreign exchange forward transactions are recognised in the balance sheet not on the settlement date, but on the trade date, having an influence on the average cost of the foreign currency position as from that date.

The spot leg of foreign exchange swaps is recognised on the spot settlement date. The forward leg is recognised on the settlement date of the spot leg by the same amount, the difference between the two legs being treated as interest and recorded over the life of the swap on a straight-line basis (Section 1.2 (g) of this Note).

### **d)** Recognition of gains and losses

Banco de Portugal applies an asymmetric valuation approach to unrealised gains in accordance with the ECB Accounting Guideline. Thus, over the course of the period, revaluation differences (i.e. between the market value and the weighted average cost) are recognised in the balance sheet, in specific revaluation accounts for each type of asset and currency. At the end of the fiscal year, negative revaluation differences are recognised in the Profit and Loss Account under 'Unrealised losses on financial assets and positions'. There is no netting of revaluation differences in any one security (ISIN code), or in any currency.

Realised gains and losses arising from financial operations, determined by the difference between the transaction value and the weighted average cost, are recognised in the Profit

and Loss Account on the settlement date under 'Realised gains/losses arising from financial operations', except in the situations envisaged in the 'economic approach' alternative method, described in the ECB Accounting Guideline. In these situations, where the operations are traded in one year but settlement only occurs in the subsequent year, gains and losses arising from financial operations are immediately recognised on the trade date.

In accordance with the Eurosystem's accounting framework, each balance sheet sub-item's interest payable or receivable is presented net under 'Interest income' or 'Interest expense' depending on whether its value is positive or negative.

#### e) Measurement of balance sheet items

Gold, foreign exchange transactions and securities in the trading portfolio are valued at the end of the period at the exchange rates and market price prevailing on the reporting date. The securities classified as held-to-maturity and securities held for monetary policy purposes regarding the programmes currently implemented are measured at amortised cost less potential impairment losses (Section 1.2 (f) of this Note).

Foreign currency revaluation is made on a currency-by-currency basis and no distinction is made between spot and forward currency positions. Securities price revaluation is also made on a security-by-security basis (ISIN code).

Special Drawing Rights (SDRs) are treated as a currency for accounting purposes. Currency holdings underlying the SDR basket are treated jointly with the SDRs, forming a single holding.

The accounting treatment of gold and foreign currencies is similar, with the average cost of the gold stock being only changed when the amount purchased on a given day is higher than the amount sold.

Participating interests in subsidiaries and associated companies, recorded under Other financial assets, are valued in accordance with the recommendations of the ECB Accounting Guideline, through the Net Asset Value valuation method.<sup>4</sup> The remaining participating interests are recognised according to the acquisition cost criterion, subject to potential impairment losses.

Tangible fixed assets and intangible assets are measured at the acquisition cost less accumulated depreciation and amortisation, in accordance with the rules laid down in IAS 16 and IAS 38 respectively. This acquisition cost includes expenditure directly attributable to the acquisition of goods.

Depreciation and amortisation are recorded in twelfths, according to the straight-line method, by applying annual depreciation and amortisation rates (according to the estimated useful life) which fall within the fiscally accepted intervals under Regulatory Decree No 25/2009:

	Number of years
<b>Tangible fixed assets</b>	
Buildings and other constructions	10 to 50
Facilities	4 to 20
Equipment	
Machinery and tools	4 to 8
Computer hardware	3 to 5
Transport equipment	4 to 8
Furniture and fittings	4 to 8
<b>Intangible assets</b>	3 to 6

4. Net Asset Value (NAV) = total assets less total liabilities of entities in which Banco de Portugal has a participating interest, multiplied by the percentage level of that participating interest.

According to IAS 36, whenever there is any indication that a tangible fixed asset or an intangible asset may be impaired, the asset's recoverable amount must be estimated, with an impairment loss recognised in the Profit and Loss Account whenever the estimated recoverable amount is below the net carrying amount.

Assets under construction are valued at the total expenses already charged to Banco de Portugal and transferred to tangible fixed assets and intangible assets when they start to be available for use, and when their amortisation/depreciation starts also.

Accounts receivable and payable and deposits with third parties and held by third parties with Banco de Portugal, as well as the remaining balance sheet positions denominated in euro not previously mentioned in this item, are recognised at nominal value, less any impairment losses where applicable (Section 1.2 (o) of this Note).

#### **f) Securities**

Banco de Portugal holds in its portfolio marketable securities (trading portfolio), held-to-maturity securities (medium-term investment portfolio) and securities held for monetary policy purposes.

Premiums or discounts arising on securities are calculated and presented as part of interest income and are amortised over the remaining life of the securities, either according to the straight-line method, in the case of coupon securities, or the internal rate of return (IRR) method, in the case of zero coupon securities.

- Securities for other than monetary policy purposes

Securities for other than monetary policy purposes are in the following portfolios:

- Trading portfolio

The portfolio of marketable securities is measured at market price. The market value of this portfolio is assessed using indicative market quotes.

The costing method adopted by Banco de Portugal uses the adjusted weighted average cost of the accumulated amortisation of the premium or discount. The difference between the value of sales and the adjusted weighted average cost of the security is treated as realised gain/loss.

The acquisition cost of the daily purchases is added to the weighted average cost of each type of security from the previous working day, so that a new weighted average cost can be calculated. Sales are deducted from the stock at the weighted average cost for the sale's value date, which already incorporates all the purchases made on that day.

Revaluation differences correspond to the difference between the amortised cost of the security and the respective market value, and are recognised as referred to in Section 1.2 (d) of this Note.

- Medium-term investment portfolio

The portfolio of held-to-maturity securities is measured at amortised cost, calculated totally independently of the other securities classified as trading securities, and is subject to impairment tests according to the model defined by Banco de Portugal, which follows the guidelines defined at Eurosystem level. The accounting treatment of interest and premiums and discounts of securities held in this portfolio is similar to that of the portfolio of marketable securities.

- Securities held for monetary policy purposes

The item Securities held for monetary policy purposes includes securities related to non-standard monetary policy operations, namely: (i) the covered bond purchase programmes – CBPP, CBPP2 and CBPP3; (ii) the securities markets programme – SMP; (iii) the outright monetary transactions programme

– OMT, which was not activated; (iv) the asset-backed securities purchase programme – ABSPP, currently centralised on the balance sheet of the ECB; (v) the public sector purchase programme – PSPP; and (vi) the corporate sector purchase programme – CSPP, in which Banco de Portugal holds no securities.

The securities currently held for monetary policy purposes are measured at amortised cost, being subject to impairment tests conducted at Eurosystem level, regardless of the holding intention (in terms of how long they will be held for).

#### **g)** Derivative financial instruments

Foreign exchange forward transactions and forward legs of foreign exchange swaps are recognised in on-balance-sheet and off-balance-sheet accounts. In the case of foreign exchange forward transactions, the difference between the market exchange rate of the trade date and the agreed exchange rate is recognised as interest and recorded on a straight-line basis during the lifetime of the transaction. In the case of foreign exchange swaps, this interest is determined by the difference between the agreed currency spot rate and the agreed forward rate of exchange.

Interest rate swaps and interest rate futures are recorded on the balance sheet and revalued on a case-by-case basis. As to interest rate swaps, the revaluation gain/loss is treated as described in Section 1.2 (d) of this Note. In the case of interest rate futures, the result of the daily revaluation is recognised in 'Realised gains/losses arising from financial operations', in line with the cash flows resulting from the change in the respective margin account.

In accordance with the Eurosystem's accounting framework, gold swaps are treated as repurchase agreements and gold flows relating to these operations do not affect gold reserve levels. A gold swap for foreign currency (or for euro) is treated as the taking of funds, in which interest is agreed (the difference between the spot and forward prices) and is accrued over the transaction's life.

#### **h)** Intra-ESCB balances

Pursuant to the Statute of the ESCB, the NCBs of the ESCB are the sole subscribers to and holders of the capital of the ECB (Article 28). The subscription of capital is made according to the key established in Article 29. Thus, Banco de Portugal's share in the capital of the ECB and claims allocated by the ECB relating to the transfer of foreign reserve assets as envisaged in Article 30 result from applying the weightings referred to in Article 29. Banco de Portugal's share in the capital of the ECB is recorded in the balance sheet in Assets under Participating interest in the ECB.

Intra-Eurosystem balances, recognised under Claims/liabilities arising from balances of TARGET accounts, result from cross-border payments in the EU that are settled in euro. These transactions are for the most part initiated by private entities and are initially settled in TARGET2<sup>5</sup> and give rise to bilateral balances in the TARGET accounts of EU central banks. These bilateral balances are netted out by each NCB on a daily basis, leaving each NCB with a single position vis-à-vis the ECB only.

The intra-Eurosystem balance arising from the transfer of reserve assets to the ECB when Banco de Portugal joined the Eurosystem is denominated in euro and is recorded in the balance sheet under Transfer of foreign reserve assets to the ECB.

Intra-Eurosystem balances arising from the allocation of euro banknotes are included as a net single position and are recorded in the balance sheet under Claims related to the allocation of euro banknotes within the Eurosystem (Section 1.2 (i) of this Note).

5. Trans-European Automated Real-time Gross settlement Express Transfer

#### i) Banknotes in circulation

The ECB and the NCBs of the euro area, which together comprise the Eurosystem, put euro banknotes in circulation.<sup>6</sup> The ECB and 12 of these NCBs have issued euro banknotes since 1 January 2002; the central bank of Slovenia adopted the euro on 1 January 2007; the central banks of Cyprus and Malta adopted the euro on 1 January 2008; the central bank of Slovakia adopted the euro on 1 January 2009; the central bank of Estonia adopted the euro on 1 January 2011; the central bank of Latvia adopted the euro on 1 January 2014; and the central bank of Lithuania adopted the euro on 1 January 2015. The total value of euro banknotes in circulation is allocated on the last working day of each month in accordance with the 'banknote allocation key'.<sup>7</sup>

The ECB has been allocated a share of 8% of the total value of euro banknotes in circulation, whereas the remaining 92% has been allocated to NCBs according to the key for subscription to the ECB's capital (adjusted capital key). The share of euro banknotes allocated to each NCB is disclosed under the balance sheet item Banknotes in circulation.

The difference between the value of euro banknotes allocated to each NCB in accordance with the banknote allocation key and the value of the difference between banknotes put into circulation and banknotes withdrawn from circulation by that NCB gives rise to remunerated intra-Eurosystem balances.<sup>8</sup> These claims or liabilities are disclosed under the sub-items Net claims/liabilities related to the allocation of euro banknotes within the Eurosystem.

When a Member State adopts the euro, those intra-Eurosystem balances referring to euro banknotes in circulation are adjusted over a five-year period so that changes in banknote circulation patterns do not significantly alter NCBs' relative income positions. These adjustments are effected by taking into account the differences between the average value of banknotes in circulation of each NCB in the reference period and the average value of banknotes that would have been allocated to them during that period under the bank's banknote allocation table. The adjustments of intra-Eurosystem balances will cease to apply as of the first day of the sixth year after the cash changeover of each new Eurosystem participant.

The interest income and expense on these balances is cleared through the account of the ECB and disclosed in the Profit and Loss Account of NCBs under the item Net interest income.

#### j) Distribution of the ECB's income

The Governing Council of the ECB decided that the seigniorage income of the ECB, which arises from the 8% share of euro banknotes allocated to the ECB, as well as income from the securities purchased by the ECB under the SMP, CBPP3, ABSPP and PSPP portfolios, shall be due to the NCBs in the same period it accrues and distributed on the last working day of January of the following financial year in the form of an interim distribution of profit.<sup>9</sup> It shall be distributed in full unless the ECB's net profit for the year is expected to be lower than its income earned on euro banknotes in circulation and the above-mentioned securities purchase programmes or subject to any decision by the Governing Council to reduce this income in respect of expenses incurred by the ECB in connection with the issue and handling of euro banknotes. The Governing Council may also decide to transfer all or part of the ECB's seigniorage income to a provision for foreign exchange rate, interest rate, credit and gold price risks.

6. Decision of the European Central Bank of 13 December 2010 on the issue of euro banknotes (ECB/2010/29), OJ L 35, 9.2.2011, p. 26.

7. 'Banknote allocation key' means the percentages that result from taking into account the ECB's share in the total euro banknote issue and applying the subscribed capital key to the NCBs' share in that total.

8. Decision of the European Central Bank of 3 November 2016 on the allocation of monetary income of the national central banks of Member States whose currency is the euro (recast), OJ L 347, 20/12/2016, p. 26.

9. Decision of the European Central Bank of 15 December 2014 on the interim distribution of the income of the European Central Bank (recast) (ECB/2014/57), OJ J 53, 25.2.2015, p.24.

The amount distributed is recorded in the Profit and Loss Account under the item Income from equity shares and participating interest.

**k) Pension Fund of Banco de Portugal – Defined-benefit plan**

The Bank's liabilities related to the Pension Fund, detailed in Note 32, are calculated on an annual basis, on the cut-off date for the accounts, by Sociedade Gestora dos Fundos de Pensões do Banco de Portugal – SGFPBP, using the Projected Unit Credit Method. The main actuarial assumptions (financial and demographic) used in the calculation of these liabilities are also presented in Note 32.

The recognition of costs and liabilities related to retirement pensions is made in accordance with IAS 19. According to the provisions laid down therein, the amount recorded in staff costs refers to the current service cost and to net interest cost, which is calculated by applying a single interest rate to the Fund's assets and liabilities. Actuarial gains and losses result chiefly from (i) differences between the actuarial and financial assumptions used and actual values and (ii) changes in the actuarial and financial assumptions. These gains and losses will be directly recognised under Retained earnings.

The Pension Fund – Defined-benefit plan comprises two benefit plans, i.e. the Pension Plan and the Healthcare Plan, described in detail in Note 32.

As regards these Plans, contributions made for the Fund aim to ensure the Plans' solvency. The minimum funding ratio required is 100% for current liabilities towards pensioners and retired employees and 95% for past service liabilities of active members.

**l) Pension Fund of Banco de Portugal – Defined-contribution plan**

The employees who have started working at the Bank after 3 March 2009, pursuant to Decree-Law No 54/2009 of 2 March 2009, are covered by the general social security scheme. Nonetheless, these employees may opt for a supplementary pension plan, for which Banco de Portugal contributes with 1.5% of the actual monthly compensation. However, since this is a defined-contribution plan, the Bank has no legal or constructive obligation to pay any additional contribution.

**m) Seniority bonuses**

Banco de Portugal recognises on the liabilities side of its balance sheet the present value of liabilities for years of service, regarding seniority bonuses.

The SGFPBP calculates the current value of benefits with seniority bonuses on an annual basis, on the cut-off date for the accounts, using the Projected Unit Credit Method. The main actuarial assumptions (financial and demographic) used in the calculation of the present value of these benefits are presented in Note 32.

On an annual basis, Banco de Portugal recognises directly under Profit/loss for the year the current service cost, interest cost and net actuarial gains/losses, arising from changes in assumptions or in the conditions of the benefits.

**n) Income tax**

Charges for the year from income tax are calculated in accordance with the provisions laid down in the Corporate Income Tax Code (*Código do Imposto sobre o Rendimento das Pessoas Coletivas* – CIRC) and the tax incentives and benefits applicable to Banco de Portugal.

Deferred tax assets and liabilities correspond to the value of the tax to be recovered and paid in future periods, arising from temporary differences between the accounting values of assets and liabilities and

their tax base. In compliance with IAS 12, deferred taxes are calculated taking as a basis the best estimate of the amount of tax to recover and pay in the future and are recognised in Profit/loss, except when they are related to items directly recognised in equity, in which case they are also recorded against equity.

**o) Impairment and provisions**

Impairment of assets is recognised on the balance sheet and shall be deducted from the book value of those assets, in accordance with IAS 36. The value of this impairment results from the best estimate of losses associated with each asset class and takes as a reference the best estimate of future cash flows.

In accordance with IAS 37, provisions are recognised when: (i) Banco de Portugal has a present, legal or constructive obligation, (ii) their payment is likely to be required and (iii) a reliable estimate can be made of the value of that payment obligation. These provisions are recognised in liabilities through the best estimate of the payment amount, as at the date of preparation of the financial statements.

The PCBP also provides for the setting up of provisions resulting from risk shared with all other euro area NCBs, according to decisions and within the limits set by the Governing Council of the ECB. These provisions are deductible for tax purposes. For other provisions or impairment, Banco de Portugal follows the regime defined in the Corporate Income Tax Code.

**p) Revaluation accounts**

Revaluation differences are calculated as described in Section 1.2 (d) of this Note. When these differences are positive, they are retained in the balance sheet in order not to distribute unrealised gains. Positive revaluation differences at the end of the year are presented on an item-by-item basis in the balance sheet between Liabilities and Equity.

At the end of the year, in accordance with the principle of prudence, when the revaluation differences are negative they are transferred to the Profit and Loss Account in the item Unrealised losses, contributing to the calculation of net profit/loss for the year.

**q) General risk provision**

In accordance with Article 5 (2) of the Organic Law of Banco de Portugal, the Board of Directors may establish other reserves and provisions namely to meet depreciation risks or losses to which certain types of assets or operations are particularly liable.

The PCBP provides for the setting up of a General risk provision, which is different from the other provisions, as it is similar to a reserve, although its increases and decreases are directly made against the Profit and Loss Account. Given its similarity to a reserve, the General risk provision is only increased when the results created previously allow it.

The General risk provision is considered as a separate item on the balance sheet, recorded between Liabilities and Equity (Section 1.1 of this Note).

The General risk provision amount is defined taking into consideration, among other factors, the assessment of balance sheet risks from a medium-term perspective, ensuring that own funds are sufficient for the liabilities taken on by Banco de Portugal, and that the capital ratio is held at levels allowing the coverage of potential losses, including those resulting from decisions taken by the Governing Council of the ECB with an impact on Banco de Portugal's accounts.

Movements in the General risk provision are decided upon by the Board of Directors, in accordance with Article 5 (2) of the Organic Law of Banco de Portugal, based, among other things, on an in-depth technical assessment of developments in the financial statements, balance sheet risks – following methodologies common to the Eurosystem Central Banks – and financial buffers that allow the aforementioned risks to be covered over a medium-term time horizon.

#### r) Reserves and retained earnings

Banco de Portugal's reserves are set up and used according to the provisions of the Organic Law of Banco de Portugal, being divided as follows: (i) legal reserve; (ii) special reserve relating to gains on gold sales; and (iii) other reserves.

The special reserve relating to gains on gold sales, provided for in Article 53 (1) (b) of the Organic Law of Banco de Portugal is annually endowed with the exact amount of gains on these operations, with no maximum limit. Annual appropriations to increase this reserve are recognised in the Profit and Loss Account and contribute to the calculation of net profit/loss for the year.

Retained earnings represent profit/loss of previous years pending distribution by the Board of Directors, or profit/loss not recognised in the Profit and Loss Account as set out in the accounting rules.

## 1.3 Post-balance-sheet events

In compliance with IAS 10, the assets, liabilities and profit and loss of Banco de Portugal are adjusted for favourable or unfavourable events which occur between the balance sheet date and the financial statements' approval date, where there is evidence that these events existed at the balance sheet date. Events indicative of a condition that arose after the balance sheet date which did not give rise to any adjustment are disclosed in this appendix to the accounts.

## 1.4 Main estimates and uncertainties in the preparation of Banco de Portugal's financial statements

The annual accounts were prepared taking into consideration Banco de Portugal's estimates in quantifying certain assets, liabilities, income items, expenses, contingencies and, in particular, provision levels recorded. These estimates are based on the best information available at the time of closing the accounts.

Regarding monetary policy operations, which are made by Banco de Portugal in a decentralised way as they follow a common Eurosystem-wide policy, the estimates made for these operations by the Eurosystem are also taken into consideration in the preparation of the financial statements.

The main estimates and uncertainties assumed for the preparation of the financial statements relate to the following: asset impairments and risk provisions (Note 19), current and deferred taxes (Note 30) and liabilities related to retirement pensions and other benefits (Note 32).

## 1.5 Other subjects

Given the role of Banco de Portugal as a central bank, publication of the statement of cash flows was deemed not to provide additional information of importance for readers of the financial statements.

Banco de Portugal, as an integral part of the ESCB, is subject to the provisions laid down in Article 27 (1) of the Statute of the ESCB, according to which the annual accounts of the national central banks (NCBs) of the Eurosystem shall be audited by independent external auditors. For the purpose of ensuring the independence of the external auditors, Banco de Portugal follows Eurosystem best practice to this end.

## NOTE 2 • GOLD AND GOLD RECEIVABLES

	31 Dec. 2017		31 Dec. 2016	
	Fine ounces <sup>(a)</sup>	EUR thousands	Fine ounces <sup>(a)</sup>	EUR thousands
Gold stored at the Bank	5,549,238	6,003,615	5,549,238	6,093,319
Gold sight accounts	2,716,456	2,938,882	3,611,918	3,966,053
Gold allocated to swaps	4,032,003	4,362,147	3,136,000	3,443,472
<b>Gold reserve</b>	<b>12,297,697</b>	<b>13,304,644</b>	<b>12,297,156</b>	<b>13,502,843</b>

(a) Ounce of fine gold.

As at 31 December 2017 the value of gold decreased by €198,199 thousand compared with the 2016 end balance. This decrease was chiefly due to the falling price of gold denominated in euro. The variation in the gold reserve level arises from small changes in the execution of gold transactions.

Banco de Portugal's gold reserve was valued on 31 December 2017 at the market price of €1,081.88 per fine ounce of gold, which corresponds to a 1.5% price decrease, from €1,098.05 on 31 December 2016.

There were also gold swap transactions for foreign currency in 2017, although these do not affect the gold reserve level, as described in Section 1.2 (g) of Note 1 on accounting policy.

Unrealised gains resulting from this asset (€10,273,653 thousand on 31 December 2017 and €10,472,463 thousand on 31 December 2016) are recognised on the balance sheet (Note 20) as positive revaluation differences according to the accounting policy described in Section 1.2 (e) and (p) of Note 1.

The location of gold reserves invested in deposits is as follows:

Location	31 Dec. 2017		31 Dec. 2016	
	Fine ounces	EUR thousands	Fine ounces	EUR thousands
Bank of England	1,957,472	2,117,751	2,852,934	3,132,653
Bank for International Settlements (BIS)	640,658	693,115	640,658	703,472
Federal Reserve Bank – United States	118,327	128,015	118,327	129,928
<b>Total</b>	<b>2,716,456</b>	<b>2,938,882</b>	<b>3,611,918</b>	<b>3,966,053</b>

## NOTE 3 • LENDING AND DEPOSIT OPERATIONS WITH THE INTERNATIONAL MONETARY FUND (IMF)

	31 Dec. 2017		31 Dec. 2016	
	SDR thousands	EUR thousands	SDR thousands	EUR thousands
IMF quota	2,060,100	2,446,575	2,060,100	2,625,803
IMF's holdings	(1,594,428)	(1,893,542)	(1,594,602)	(2,032,480)
Reserve tranche position in the IMF	465,672	553,032	465,498	593,323
SDR holdings	536,117	636,693	535,384	682,400
Claims on the IMF	1,001,790	1,189,726	1,000,881	1,275,723
Counterpart of special drawing rights allocated by the IMF	(806,477)	(957,772)	(806,477)	(1,027,936)
Liabilities to the IMF	(806,477)	(957,772)	(806,477)	(1,027,936)

The positions in the IMF are denominated in Special Drawing Rights (SDRs), which are treated as a foreign currency, as described in Section 1.2 (e) of Note 1.

The Reserve tranche position in the IMF reflects the equivalent in euro, on 31 December 2017, of Portugal's quota in the IMF, corresponding to the initial participation and subsequent payments, less the IMF's holdings with Banco de Portugal. In 2017 Portugal's quota in the IMF remained unchanged and the change in its value denominated in euro resulted exclusively from changes in the SDR quotation compared with December 2016.

The liability position corresponds to the item Counterpart of special drawing rights allocated by the IMF, which showed a €957,772 thousand (SDR 806,477 thousand) liability to the IMF on 31 December 2017.

The changes in the different claim and liability items also include the effect of the euro appreciation against SDR (7.33%), from 1.2746 on 31 December 2016 to 1.1876 on 31 December 2017.

## NOTE 4 • BALANCES WITH BANKS AND SECURITY INVESTMENTS, LOANS AND OTHER ASSETS DENOMINATED IN FOREIGN CURRENCY

	31 Dec. 2017	31 Dec. 2016
Claims on non-euro area residents denominated in foreign currency		
Securities	2,483,424	5,295,414
Balances with banks, deposits and other money markets	4,778,448	3,802,765
	7,261,872	9,098,179
Claims on euro area residents denominated in foreign currency		
Securities	527,139	344,949
Balances with banks, deposits and other money markets	25,015	37,948
	552,154	382,896
Liabilities to non-euro area residents denominated in foreign currency		
Deposits, balances and other liabilities	(4,221,095)	(3,397,681)
Total security investments denominated in foreign currency	3,010,563	5,640,363
Total balances with banks, deposits and other money markets in foreign currency (net)	582,367	443,031
	3,592,931	6,083,395

In 2017 there was a decrease in the trading portfolio of claims denominated in foreign currency arising from Banco de Portugal's strategic investment options, in a context of appreciation of the euro. The fall resulted essentially from the volume decrease in the portfolio of securities of non-euro area residents, valued at market prices. On 31 December 2017, the securities portfolio accounted for 84% of total claims denominated in foreign currency (2016: 93%), broken down as follows:

	31 Dec. 2017	31 Dec. 2016
<b>Securities of non-euro area residents denominated in foreign currency</b>		
Government debt	1,693,037	4,203,140
Paragovernmental and supranational	790,387	1,092,274
	2,483,424	5,295,414
<b>Securities of euro area residents denominated in foreign currency</b>		
Paragovernmental and supranational	527,139	344,949
	527,139	344,949
	<b>3,010,563</b>	<b>5,640,363</b>

Gold swaps for foreign currency were also entered into in 2017 (Note 2), resulting in an increase in the balances with banks, deposits and other money markets item (under Claims on non-euro area residents denominated in euro) and an accompanying increase of the same amount in Liabilities to non-euro area residents denominated in foreign currency, as described in Section 1.2 (g) of Note 1.

As at 31 December 2017 the portfolio denominated in foreign currency was mainly composed of US dollars (around 84% of total foreign currency) as had been the case in 2016 (90% of total foreign currency corresponded to US dollars).

## NOTE 5 • BALANCES WITH BANKS AND SECURITY INVESTMENTS, LOANS AND OTHER ASSETS DENOMINATED IN EURO

	31 Dec. 2017	31 Dec. 2016
<b>Claims on non-euro area residents denominated in euro</b>		
Securities	57,288	386,178
Balances with banks, deposits and other money markets	6,777	1,559
	64,066	387,737
<b>Claims on euro area residents denominated in euro</b>		
Securities	11,875,619	13,164,773
Balances with banks, deposits and other money markets	239,140	27,526
	12,114,759	13,192,299
<b>Total security investments denominated in euro</b>	<b>11,932,907</b>	<b>13,550,951</b>
<b>Total balances with banks, deposits and other money markets denominated in euro</b>	<b>245,917</b>	<b>29,085</b>
	<b>12,178,824</b>	<b>13,580,036</b>

The volume of the trading portfolio denominated in euro (securities and balances with banks, deposits and other money markets) fell from December 2016, retaining the same structure in terms of composition by financial instrument and origin of issuer. In accordance with Banco de

Portugal's strategic decisions, the domestic securities component continues to account for the largest share in this portfolio (98% of total claims in 2017 and 97% in 2016).

The securities trading portfolio denominated in euro, valued at market prices, is broken down as follows:

	31 Dec. 2017	31 Dec. 2016
<b>Securities of non-euro area residents denominated in euro</b>		
Paragovernmental and supranational	25,464	353,734
Companies/financial institutions	31,825	32,444
	57,288	386,178
<b>Securities of euro area residents denominated in euro</b>		
Government debt	11,541,728	12,468,115
Paragovernmental and supranational	313,196	675,582
Companies/financial institutions	20,695	21,076
	11,875,619	13,164,773
	11,932,907	13,550,951

## NOTE 6 • LENDING TO EURO AREA CREDIT INSTITUTIONS RELATED TO MONETARY POLICY OPERATIONS DENOMINATED IN EURO

On 31 December 2017 the euro value of the refinancing operations to euro area credit institutions relating to monetary policy operations denominated in euro at Eurosystem level reached €764,310,316 thousand (2016: €595,874,145 thousand), of which Banco de Portugal held €22,131,400 thousand (2016: €22,372,120 thousand). The breakdown of these operations on the balance sheet of Banco de Portugal as at 31 December 2017 is as follows:

	31 Dec. 2017	31 Dec. 2016
Main refinancing operations	100,000	1,339,000
Longer-term refinancing operations	22,011,400	21,033,120
Marginal lending facility	20,000	0
	22,131,400	22,372,120

The main refinancing operations (MROs) are liquidity-providing reverse transactions usually with a frequency and a maturity of one week. Since October 2008 these operations have been conducted as fixed rate tender procedures, set at 0% since 16 March 2016. On 31 December 2017 the total amount placed by Banco de Portugal amounted to €100,000 thousand (2016: €1,339,000 thousand). Despite the total amount having fallen since 31 December 2016, these operations continue to play a key role in achieving the aims of steering interest rate, managing market liquidity and signalling the monetary policy stance.

The longer-term refinancing operations (LTROs) are liquidity-providing reverse transactions with maturity of between three and 48 months. These operations were conducted at fixed rate with allotment of the total amount bid.

In 2016, the Governing Council of the ECB introduced a new series of four targeted longer-term refinancing operations (denoted TLTRO II). These operations have a four-year maturity, with a possibility of repayment after two years. The applicable interest rate for TLTRO-II operations will be between the rate on the main refinancing operations (MRO) and the rate on the deposit

facility at the time of allotment. Within this interval, the rate will be lower the more the net eligible financing achieved by each institution, between the date of each TLTRO-II allotment and January 2018, exceeds its lending benchmark. Therefore, given that the actual rate will only be known in 2018 and a reliable estimate is not possible at this juncture, the deposit facility rate has been used for calculating the TLTRO-II accrued interest for the year, in a harmonised way at Eurosystem level, as this is deemed a prudent approach, set at -0.40% since 16 March 2016.

On 31 December 2017 the combined LTRO balance outstanding of the amount placed by Banco de Portugal reached €22,011,400 thousand (2016: €21,033,120 thousand).

The Eurosystem also provides the marginal lending facility, corresponding to overnight loans at the specified rate for these operations (0.25% since 16 March 2016). On 31 December 2017, the balance of these operations was €20,000 thousand (on 31 December 2016, Banco de Portugal's recourse to this facility was nil).

All financing operations related to monetary policy are fully collateralised by eligible assets (Note 31).

In accordance with Article 32.4 of the Statute of the ESCB, any risks from monetary policy operations, if they materialise, may be shared in part or in full by all Eurosystem NCBs, in proportion to the prevailing ECB capital key shares, on the date they materialise. Losses on these operations will only materialise if both the counterparty fails and the recovery of funds received from the resolution of the collateral provided is not sufficient to cover the respective losses. The Governing Council of the ECB has excluded a specific part of the collateral from risk-sharing, including assets that may be accepted by NCBs at their own discretion.

## NOTE 7 • SECURITIES HELD FOR MONETARY POLICY PURPOSES

On 31 December 2017, the portfolio of Securities held for monetary policy purposes contains public sector securities and covered bonds, acquired by Banco de Portugal under the securities markets programme (SMP),<sup>10</sup> the covered bond purchase programmes (CBPP, CBPP2 and CBPP3),<sup>11</sup> and the public sector purchase programme (PSPP),<sup>12</sup> in its governmental and supranational components (Section 1.2 (f) of Note 1).

	31 Dec. 2017		31 Dec. 2016	
	Amortised cost	Market value	Amortised cost	Market value
<b>Securities held for monetary policy purposes</b>				
Eurosystem's securities markets programme (SMP)	2,479,596	2,740,591	2,714,662	3,055,645
Covered bond purchase programme (CBPP)	99,909	109,119	121,849	134,329
Covered bond purchase programme 2 (CBPP2)	58,089	68,098	58,037	70,195
Covered bond purchase programme 3 (CBPP3)	3,407,710	3,446,652	2,945,142	2,961,463
Public sector purchase programme (PSPP)	25,847,533	27,938,738	21,356,768	20,264,946
– Government securities				
Public sector purchase programme (PSPP)	15,075,738	14,968,216	5,057,214	4,934,412
– Supranational securities				
	<b>46,968,576</b>	<b>49,271,414</b>	<b>32,253,673</b>	<b>31,420,990</b>

10. Decision of the ECB of 14 May 2010 establishing a securities markets programme (ECB/2010/5), OJ L 124, 20.5.2010, p. 8.

11. Decision of the ECB of 2 July 2009 on the implementation of the covered bond purchase programme (ECB/2009/16), OJ L 175, 4.7.2009, p. 18 and Decision of the ECB of 3 November 2011 on the implementation of the second covered bond purchase programme (ECB/2011/17), OJ L 297, 16.11.2011, p. 70 and Decision of the ECB of 15 October 2014 on the implementation of the third covered bond purchase programme (ECB/2014/40), OJ L 335, 22.10.2014, p. 22.

12. Decision of the ECB of 4 March 2015 on the implementation of the secondary markets public sector asset purchase programme (ECB/2015/10), OJ L 121, 14.5.2015, p. 20.

The following table presents the movements in these programmes during the year 2017:

	31 Dec. 2016	Purchases	Maturing securities	Accrual of premiums and discounts	31 Dec. 2017
<b>Securities held for monetary policy purposes</b>					
Eurosystem's securities markets programme (SMP)	2,714,662	–	259,000	23,934	2,479,596
Covered bond purchase programme (CBPP)	121,849	–	22,000	60	99,909
Covered bond purchase programme 2 (CBPP2)	58,037	–	–	52	58,089
Covered bond purchase programme 3 (CBPP3)	2,945,142	1,336,898	839,050	(35,280)	3,407,710
Public sector purchase programme (PSPP) – Government securities	21,356,768	4,763,195	–	(272,430)	25,847,533
Public sector purchase programme (PSPP) – Supranational securities	5,057,214	10,093,153	–	(74,629)	15,075,738
	<b>32,253,673</b>	<b>16,193,245</b>	<b>1,120,050</b>	<b>(358,292)</b>	<b>46,968,576</b>

Under the SMP, the ECB and the NCBs purchased securities in order to correct the malfunctioning in certain segments of the euro area debt securities markets and restore the proper functioning of the monetary policy transmission mechanism. The Governing Council of the ECB decided on 6 September 2012 to terminate this programme for new purchases. Therefore, in 2016 and 2017 no purchases were made for this portfolio. The reduction in this item, in 2017, was solely due to securities that matured.

Under the covered bond purchase programmes (CBPP and CBPP2), the ECB and the NCBs purchased covered bonds of euro area residents denominated in euro with the objective of improving funding conditions for credit institutions and enterprises as well as encouraging credit institutions to maintain or expand lending to their customers. Purchases under these programmes were fully implemented by 30 June 2010 (CBPP) and by 31 October 2012 (CBPP2). The reduction in these items in 2017 was due to bonds that matured.

Under the asset-backed securities purchase programme (ABSPP),<sup>13</sup> the ECB and the NCBs may purchase senior and guaranteed mezzanine tranches of asset-backed securities in both primary and secondary markets, to improve credit provision to the euro area economy. The ECB exclusively is purchasing these securities.

In 2017, the Eurosystem continued to purchase securities under the expanded asset purchase programme (APP), which includes the third covered bond purchase programme (CBPP3), the ABSPP, the PSPP and the CSPP. Under the CSPP, NCBs may purchase euro-denominated bonds issued by eligible corporations established in the euro area. In 2017 Banco de Portugal did not make any purchases under this programme.

The pace of net purchases of securities under the APP by NCBs and the ECB was €80 billion per month on average up to March 2017 and €60 billion per month from April to the end of the year. Based on the October 2017 decision by the Governing Council, these purchases are to continue at a pace of €30 billion per month from January to September 2018, or beyond, if necessary, until the Governing Council sees a sustained adjustment in the path of inflation compatible with its

13. Decision of the ECB of 19 November 2014 on the implementation of the asset-backed securities purchase programme (ECB/2014/45).

inflation aim. The net purchases will be made alongside reinvestments of the principal payments from maturing securities purchased under the APP.

The securities purchased under these non-standard monetary policy programmes are valued at amortised cost subject to impairment tests (Section 1.2 (f) of Note 1).

Within the monetary policy programmes, the total Eurosystem NCBs' holding of securities amounts to €82,490,038 in the SMP portfolio (2016: €94,802,907 thousand), €5,446,721 thousand in the CBPP portfolio (2016: €11,756,253 thousand), €4,367,919 thousand in the CBPP2 portfolio (2016: €6,222,063 thousand), €220,954,586 thousand in the CBPP3 portfolio (2016: €186,965,412 thousand), €1,508,841,676 thousand in the PSPP – Governmental securities portfolio (2016: €1,002,725,278 thousand), €203,931,996 thousand in the PSPP – Supranational securities portfolio (2016: €139,638,955 thousand), and €131,593,122 thousand in the CSPP portfolio (2016: €51,069,303 thousand).

In accordance with Article 32.4 of the Statute of the ESCB, losses from monetary policy operations, if they were to materialise, may be shared in full by the Eurosystem NCBs, in proportion to the prevailing ECB capital key shares.

The Governing Council assesses on a regular basis the financial risks associated with the securities held under these programmes. As referred to in Section 1.2 (f) of Note 1, at the end of the year impairment tests were conducted at Eurosystem level on the securities held for monetary policy purposes, on the basis of the information available and estimated recoverable amounts as at 31 December 2017 and were approved by the Governing Council.

With regard to the impairment tests conducted on the SMP and PSPP portfolios of securities held by the NCBs, the Governing Council decided that no impairment indicator was observed, and as a result all estimated future cash flows on these securities are expected to be received.

In the context of the impairment test conducted at the end of 2017 on securities in the CBPP, CBPP2 and CBPP3 portfolios, the Governing Council identified an impairment indicator relating to securities issued by Banco Popular Español, arising from its resolution by the Single Resolution Board (SRB). The shares and capital instruments of Banco Popular Español were transferred to Banco Santander, S. A.. Banco Popular Español is now operating as part of Banco Santander and is expected to be fully merged into Banco Santander in the near future. The Governing Council considered that, based on the information available on 31 December 2017, there was no evidence of changes to the estimated future cash flows on the securities held, and therefore no impairment losses were recorded at the year-end in respect of these securities. Banco de Portugal does not hold securities from this issuer. Furthermore, no impairment losses were recorded in respect of the other securities purchased under the CBPP, CBPP2 and CBPP3 programmes.

Based on Article 32.4 of the Statutes of the ESCB/ECB, losses from securities held under the CSPP are shared in full between the Eurosystem NCBs, in proportion to the prevailing ECB capital key shares. As a result of the impairment tests conducted on the CSPP portfolio, it was decided that there was evidence of impairment in one of the securities held by a Eurosystem NCB. In accordance with the principle of prudence, the Governing Council deemed it appropriate to establish a provision for losses on monetary policy operations (Note 19). The security in question was sold in January 2018, realising the loss.

## NOTE 8 • INTRA-EUROSISTEM CLAIMS AND LIABILITIES

- Participating interest in the ECB

Pursuant to Article 28 of the Statute of the ESCB, the NCBs of the ESCB are the sole subscribers to and holders of the capital of the ECB. The subscription of capital shall be according to the key established in accordance with Article 29, specifically with paragraph 3, under which the weightings assigned to the NCBs shall be adjusted every five years after the establishment of the ESCB.<sup>14</sup>

Banco de Portugal's share in the subscribed capital of the ECB has remained at 1.7434% since 1 January 2015, and the value of Banco de Portugal's share, including supplementary payments due to the adjustment of accumulated reserves, came to €203,700 thousand.

NCB	Country	Key for subscription of the ECB's capital
		From 1 Jan. 2015
Nationale Bank van België/Banque Nationale de Belgique	Belgium	2.4778%
Deutsche Bundesbank	Germany	17.9973%
Eesti Pank	Estonia	0.1928%
Central Bank of Ireland	Ireland	1.1607%
Bank of Greece	Greece	2.0332%
Banco de España	Spain	8.8409%
Banque de France	France	14.1792%
Banca d'Italia	Italy	12.3108%
Central Bank of Cyprus	Cyprus	0.1513%
Latvijas Banka	Latvia	0.2821%
Lietuvos bankas	Lithuania	0.4132%
Banque centrale du Luxembourg	Luxembourg	0.2030%
Central Bank of Malta	Malta	0.0648%
De Nederlandsche Bank	The Netherlands	4.0035%
Oesterreichische Nationalbank	Austria	1.9631%
Banco de Portugal	Portugal	1.7434%
Banka Slovenije	Slovenia	0.3455%
Národná banka Slovenska	Slovakia	0.7725%
Suomen Pankki – Finlands Bank	Finland	1.2564%
<b>Euro area NCBs</b>		<b>70.3915%</b>
Българска народна банка /Bulgarian National Bank	Bulgaria	0.8590%
Česká národní banka	Czech Republic	1.6075%
Danmarks Nationalbank	Denmark	1.4873%
Hrvatska narodna banka	Croatia	0.6023%
Magyar Nemzeti Bank	Hungary	1.3798%
Narodowy Bank Polski	Poland	5.1230%
Banca Națională a României	Romania	2.6024%
Sveriges Riksbank	Sweden	2.2729%
Bank of England	United Kingdom	13.6743%
<b>Non-euro area NCBs</b>		<b>29.6085%</b>
		<b>100.0000%</b>

14. The capital key is also adjusted as a result of the accession of new Member States to the EU.

Banco de Portugal's share of the ECB's capital, subscribed and paid up by the NCBs of the Eurosystem, has remained at 2.4767% since 1 January 2015.

- Claims equivalent to the transfer of foreign reserves to the ECB

This item represents claims arising from the transfer of foreign reserve assets from Eurosystem participating NCBs to the ECB. These claims were translated into euro at the exchange rate prevailing on the transfer date and are remunerated daily at the latest available marginal interest rate for the Eurosystem's MROs, adjusted to reflect a zero return on the gold component.

As there were no changes to the ECB's capital key in 2017, the position of Banco de Portugal in claims equivalent to the transfer of foreign reserves to the ECB remained at €1,010,318 thousand as at 31 December 2017.

- Net claims related to the allocation of euro banknotes within the Eurosystem

The item Net claims related to the allocation of euro banknotes within the Eurosystem consists of Banco de Portugal's claims related to the allocation of euro banknotes within the Eurosystem (Section 1.2 (i) and (j) of Note 1). Since 1 January 2015, Banco de Portugal's share in the banknote allocation key has remained at 2.2785%.

The increase in this asset position compared with 31 December 2016 (from €37,636,454 thousand to €41,160,392 thousand) is due to the combination of a rise in overall circulation in the Eurosystem (4% up from 2016) and a rise in Banco de Portugal's asset position relating to the difference between banknotes put into circulation and banknotes withdrawn from circulation (Note 13). The asset position of the adjustment to circulation is remunerated at the marginal interest rate used by the Eurosystem for MROs.

- Other intra-Eurosystem claims/liabilities

On 31 December 2017 the balance of the item Other intra-Eurosystem claims, to the amount of €153,130 thousand, referred to: (i) the calculation method of the monetary income of 2017, totalling €128,666 thousand, settled on 31 January 2018 (Note 26); and (ii) an amount receivable of €24,463 thousand in respect of the early distribution of 2017 ECB income relating to the securities purchased by the ECB under the SMP, CBPP3, ABSPP and PSPP portfolios, also settled on 31 January 2018, following a decision of the Governing Council (Note 26).

On 31 December 2017, the balance of the item Other intra-Eurosystem liabilities, to the amount of €74 thousand, referred to Eurosystem adjustments to the calculation method of the monetary income relating to previous years, settled on 31 January 2018 (Note 26).

- Net liabilities arising from balances of TARGET accounts

On 31 December 2017, Net liabilities arising from balances of TARGET accounts to the ECB (net) (Section 1.2 (h) of Note 1) showed a credit position of €81,246,162 thousand (on 31 December 2016: €71,588,283 thousand). This position is remunerated at the marginal interest rate used by the Eurosystem for MROs.

## NOTE 9 • TANGIBLE FIXED ASSETS AND INTANGIBLE ASSETS

	31 Dec. 2017	31 Dec. 2016
<b>Tangible fixed assets</b>		
Land	8,840	8,888
Buildings and other constructions	108,047	107,923
Facilities	83,402	82,467
Equipment	98,817	93,450
Museum and art collections	9,396	9,280
	<b>308,502</b>	<b>302,007</b>
<b>Intangible assets</b>		
Computer software	63,857	60,509
Other intangible assets	132	9
	<b>63,989</b>	<b>60,518</b>
<b>Tangible fixed assets and intangible assets under construction</b>	<b>3,921</b>	<b>6,096</b>
<b>Total gross tangible fixed assets and intangible assets</b>	<b>376,412</b>	<b>368,621</b>
<b>Accumulated depreciation and amortisation</b>		
Depreciation of tangible fixed assets	(207,999)	(199,972)
Amortisation of intangible assets	(52,292)	(46,905)
	<b>(260,290)</b>	<b>(246,877)</b>
<b>Total net tangible fixed assets and intangible assets</b>	<b>116,121</b>	<b>121,744</b>

In 2016 and 2017 movements in this item were as follows:

	31 Dec. 2015 Net balance	Additions	Disposals	Depreciation and amortisation for the year	31 Dec. 2016 Net balance
<b>Tangible fixed assets</b>					
Land	8,888	–	–	–	8,888
Buildings and other constructions	56,245	35	–	1,625	54,655
Facilities	19,406	1,269	6	3,015	17,655
Equipment	9,202	6,119	193	3,571	11,558
Museum and art collections	9,178	104	2	–	9,280
	<b>102,918</b>	<b>7,528</b>	<b>201</b>	<b>8,211</b>	<b>102,035</b>
<b>Intangible assets</b>					
Computer software	13,346	4,678	–	4,417	13,606
Other intangible assets	8	1	–	2	7
	<b>13,354</b>	<b>4,678</b>	<b>–</b>	<b>4,419</b>	<b>13,613</b>
<b>Accumulated depreciation and amortisation</b>					
Depreciation of tangible fixed assets	3,857	7,699	5,459	–	6,096
Amortisation of intangible assets	2	–	2	–	–
	<b>3,859</b>	<b>7,699</b>	<b>5,461</b>	<b>–</b>	<b>6,096</b>
	<b>120,131</b>	<b>19,905</b>	<b>5,662</b>	<b>12,630</b>	<b>121,744</b>

	31 Dec. 2016 Net balance	Additions	Disposals	Depreciation and amortisation for the year	31 Dec. 2017 Net balance
<b>Tangible fixed assets</b>					
Land	8,888	–	48	–	8,840
Buildings and other constructions	54,655	301	115	1,629	53,212
Facilities	17,655	1,053	1	2,932	15,775
Equipment	11,558	7,009	176	5,110	13,281
Museum and art collections	9,280	116	–	–	9,396
	102,035	8,479	339	9,671	100,504
<b>Intangible assets</b>					
Computer software	13,606	3,348	–	5,384	11,570
Other intangible assets	7	123	–	3	127
	13,613	3,471	–	5,387	11,697
<b>Tangible fixed assets and intangible assets under construction</b>					
Fixed assets under construction – Projects	6,096	4,246	6,422	–	3,921
Advances	–	–	–	–	–
	6,096	4,246	6,422	–	3,921
	121,744	16,196	6,761	15,058	116,121

The increase in Equipment was mainly driven by acquisitions of cash handling equipment, IT material and systems infrastructure.

The acquisitions in 2017 relating to intangible assets were essentially associated with server software licensing and the go-live of IT systems, namely the Risk Datawarehouse (RDW), as well as various systems supporting the areas of statistics and supervision.

Finally, the high level of tangible fixed assets and intangible assets under construction, on 31 December 2017 is chiefly due to projects related to the IT systems, cash handling equipment and equipment and facilities in various buildings of Banco de Portugal.

## NOTE 10 • OTHER FINANCIAL ASSETS

	31 Dec. 2017	31 Dec. 2016
Participating interest in non-euro area resident entities	21,650	21,650
Participating interest in euro area resident entities	32,488	30,770
Medium-term investment portfolio	5,328,925	4,942,611
Other assets	202	129
	5,383,265	4,995,158

The item Other financial assets essentially records participating interests of Banco de Portugal and the medium-term investment portfolio.

Banco de Portugal's participating interests are broken down as follows:

	31 Dec. 2017		31 Dec. 2016	
	% Share	Value	% Share	Value
<b>Participating interest in non-euro area resident entities</b>				
In the Bank for International Settlements (BIS)	1.57%	21,650	1.57%	21,650
<b>Participating interest in euro area resident entities</b>				
In SGFPBP, S. A.	97.85%	3,290	97.85%	3,244
In Valora, S. A.	100.00%	28,848	100.00%	27,524
In EUROPAFI	0.25%	349	–	–
In Swift	0.01%	1	0.01%	1
		<b>32,488</b>		<b>30,770</b>

Changes in the value of the participating interests in SGFPBP and Valora result chiefly from the use of the Net Asset Value valuation method, in which the valuation differences are directly recognised in Profit/loss for the year (Note 27). Banco de Portugal used provisional financial statements from the entities in which it has a participating interest to value these interests with reference to 31 December 2017 and 2016, which according to the entities gave values fairly close to the final values.

This procedure was not applied to participating interests in BIS, SWIFT and EUROPAFI, as the respective shares are residual (1.57%, 0.01% and 0.25%), being valued at acquisition cost, in accordance with the accounting policy described in Section 1.2 (e) of Note 1.

Within the scope of Banco de Portugal's own fund management, the medium-term investment portfolio, given its characteristics, is included in Other financial assets. This portfolio is exclusively composed of securities denominated in euro and is valued at amortised cost less potential impairment losses. In December 2017, the medium-term investment portfolio showed an increase of €386,315 thousand from 2016, essentially as a result of inflows from the trading portfolio denominated in euro. As mentioned above, these assets are subject to impairment tests and no evidence was found of changes to the estimated future cash flows, and no impairment loss was therefore recorded. The breakdown of this portfolio by type of financial instrument is as follows:

	31 Dec. 2017	31 Dec. 2016
<b>Medium-term investment portfolio</b>		
Government debt	5,268,484	4,841,697
Paragovernmental and supranational	60,441	100,914
	<b>5,328,925</b>	<b>4,942,611</b>

The market value of this portfolio is presented in Note 33 for information purposes.

## NOTE 11 • ACCRUALS AND PREPAID EXPENSES

	31 Dec. 2017	31 Dec. 2016
<b>Accruals</b>		
Interest and other income receivable from central bank operations	803,883	659,561
Other accruals	1,108	1,008
	<b>804,991</b>	<b>660,568</b>
<b>Prepaid expenses</b>		
Prepaid expenses from central bank operations	63,162	106,417
Other prepaid expenses	11,772	13,448
Deferred tax assets	38,465	42,311
	<b>113,398</b>	<b>162,176</b>
	<b>918,389</b>	<b>822,745</b>

On 31 December 2017 accruals relating to Income receivable from central bank operations include essentially outstanding accrued interest receivable as follows: (i) €693,082 thousand of securities held for monetary policy purposes (2016: €513,210 thousand), (ii) €97,964 thousand of securities and other assets of trading portfolios denominated in euro and in foreign currency and of the medium-term investment portfolio denominated in euro (2016: €138,024 thousand), (iii) €10,063 thousand of gold swaps for foreign currency (2016: €4,115 thousand), (iv) €719 thousand of current accounts of credit institutions in regard to the excess reserves portion and (v) €609 thousand of deposits in Banco de Portugal from general government and the autonomous funds, remunerated at negative interest rates (2016: €1,616 thousand).

The item Prepaid expenses relating to central bank operations chiefly consists of accrued coupon interest on securities held in Banco de Portugal's portfolios (i.e. trading portfolio, medium-term investment portfolio, and portfolio of securities held for monetary policy purposes) of outstanding interest paid to the counterparty at acquisition and which will be received by Banco de Portugal on the maturity date of the respective coupon or upon the sale of the securities. Key among the values in this item is interest on the securities held for monetary policy purposes (€49,751 thousand in 2017 and €82,526 thousand in 2016).

The Other prepaid expenses item includes the updated value of the difference between cash flows related to interest receivable on Bank lending to its employees, at the interest rate applicable according to Labour Agreements (*Convenções Coletivas de Trabalho*) and market interest rates, totalling €8,754 thousand (2016: €9,848 thousand). The equivalent to this value is recorded against a deduction in the assets referring to Lending to employees (Note 12).

Note 30 presents a more detailed description of the amount of deferred tax assets in 2017 and 2016.

## NOTE 12 • OTHER ASSETS – SUNDRY

	31 Dec. 2017	31 Dec. 2016
Lending to employees	158,949	152,861
Special credit situations – BP/Finangeste Agreement	948	1,238
Other special credit situations	409	439
Claims related to reorganisation of credit institutions	2,211	5,899
Pension Fund – Defined-benefit plan	40,977	56,998
Pension Fund – Defined-contribution plan – Reserve account	23,806	23,503
Sundry debtors	1,419	514
Corporate Income Tax – Payments on account and additional payment on account	155,794	80,993
Billing to third parties	778	15,754
Other reduced value accounts	6,736	5,997
	392,027	344,197
Impairment of recoverable amounts	(3,581)	(7,583)
	<b>388,446</b>	<b>336,613</b>

Lending to employees corresponds mostly to mortgage loans to employees.

The value recorded under Special credit situations – BP/Finangeste Arrangement relates to amounts under the BP/Finangeste Arrangement of 9 January 1995, to which an annex was added in 2016, representing an asset on 31 December 2017 to the amount of €948 thousand (2016: €1,238 thousand). An impairment for the total value of this asset is recognised (Notes 19 and 30). The decrease in 2017 was related to the nominal amount of credit recovered by this entity and delivered to Banco de Portugal through the calculation of the annual instalments of 2016 and 2017, within the aforementioned Arrangement, as the aforementioned renewal of this Arrangement the previous year led to a delay in the calculation of the annual instalment of that year.

The item Claims related to reorganisation of credit institutions includes credit whose recovery is the responsibility of the judicial liquidator designated by Banco de Portugal itself. This credit was subtracted in 2016 from the overall value of the BP/Finangeste Arrangement under the aforementioned annex to the initial contract. The change in 2017 relates to the partial payment of credit by Banco de Portugal as part of the closure of the winding-up of Caixa Económica Açoreana and the pro rata distribution of credit to the respective creditors. The recoverable amounts remaining on the balance sheet continue to have a corresponding impairment at their full value, for reasons of prudence (Notes 19 and 30).

The amounts paid as payments on account, in 2016 and in 2017, under Corporate Income Tax comply with the provisions of Articles 104 and 104-A of the Corporate Income Tax Code.

The item Pension Fund – Defined-benefit plan relates to this Fund's surplus on 31 December 2017, resulting from the fact that this Fund on that date had a funding ratio above 100% (Note 32).

The position concerning the Pension Fund – Defined-contribution plan – Reserve account reflects the value of the participation units of this Fund earmarked for Banco de Portugal on 31 December 2017, valued at market price, on that date (Note 32).

As at 31 December 2016, the item Billing to third parties essentially related to costs that on that date were deemed chargeable to the Resolution Fund under the contracts for legal and financial advice relating to the sale process of Novo Banco, S. A., following the resolution of Banco Espírito Santo, S. A.. In 2017, in accordance with the October 2017 decision of the Ministry of Finance, these expenses were borne in full by Banco de Portugal (Note 27).

## NOTE 13 • BANKNOTES IN CIRCULATION

Euro banknotes in circulation on 31 December 2017 consist of Banco de Portugal's share in total euro banknotes in circulation in the Eurosystem (Section 1.2 (i) of Note 1).

	31 Dec. 2017	31 Dec. 2016
<b>Banknotes in circulation</b>		
Banknotes put into circulation (net)	(14,485,627)	(11,975,623)
Adjustments to circulation in the Eurosystem	41,160,392	37,636,454
	<b>26,674,764</b>	<b>25,660,832</b>

In 2017 the total value of euro banknotes in circulation in the Eurosystem increased by 4%. In accordance with the banknote allocation key, on 31 December 2017 Banco de Portugal recorded an aggregate value of banknotes in circulation of €26,674,764 thousand, compared with €25,660,832 thousand on 31 December 2016. The difference between banknotes put into circulation and banknotes withdrawn from circulation recorded again on 31 December 2017 a debtor balance, rising from 2016. These two effects combined account for the increase in the adjustment to circulation in the Eurosystem, which is recognised against an asset recorded in Other intra-Eurosystem claims (Note 8).

## NOTE 14 • LIABILITIES TO EURO AREA CREDIT INSTITUTIONS – MONETARY POLICY OPERATIONS DENOMINATED IN EURO

As at 31 December 2017, the item Liabilities to euro area credit institutions related to monetary policy operations denominated in euro, amounting to €13,864,548 thousand, relates almost exclusively to the current accounts of credit institutions with Banco de Portugal (2017: €13,859,548 thousand as against 2016: €5,498,141 thousand). Current accounts of credit institutions with Banco de Portugal serve a two-fold purpose: they are current/settlement accounts and accounts where funds are deposited for compliance with minimum reserve requirements.

The amount in minimum reserves is remunerated in accordance with Articles 1 and 2 of the Decision of the ECB of 5 June 2014 on the remuneration of deposits, balances and holdings of excess reserves (ECB/2014/23).

As at December 2017, this item also includes the balance on deposit facility operations outstanding on this date (€5,000 thousand), corresponding to the overnight deposits of domestic credit institutions with Banco de Portugal, used as a means to access the liquidity-absorbing operations of the Eurosystem at the pre-specified rates for these operations (2016: €150,000 thousand).

## NOTE 15 • LIABILITIES TO OTHER EURO AREA RESIDENTS DENOMINATED IN EURO

	31 Dec. 2017	31 Dec. 2016
<b>Liabilities to other euro area residents denominated in euro</b>		
General government		
Current accounts in the Portuguese Treasury and Debt Management Agency (IGCP)		
European Financial Stabilisation Mechanism (EFSM)	8,139,512	10,996,366
European Financial Stability Facility (EFSF)	813,399	848,868
	8,952,911	11,845,234
Other liabilities		
Current accounts of the autonomous funds	361,621	1,084,316
Current accounts of other entities	55,297	81,010
	416,918	1,165,325
	9,369,829	13,010,559

The deposits from the Portuguese Treasury and Debt Management Agency (Agência de Gestão da Tesouraria e da Dívida Pública – IGCP) essentially relate to the management of funds from the European Union (EU) under the Economic and Financial Assistance Programme to Portugal (Programa de Assistência Económica e Financeira a Portugal – PAEF). The remuneration of these balances is subject to Article 4 (3) of the Decision of the ECB of 5 June 2014 on the remuneration of deposits, balances and holdings of excess reserves (ECB/2014/23).

The current accounts of autonomous funds in 2017 relate to balances held at Banco de Portugal, from the Mutual Agricultural Credit Guarantee Fund and the Deposit Guarantee Fund.

## NOTE 16 • LIABILITIES TO NON-EURO AREA RESIDENTS DENOMINATED IN EURO

The balance on the item Liabilities to non-euro area residents denominated in euro on 31 December 2017 and 31 December 2016 corresponds to the balances of current accounts of several central banks and of international organisations (excluding the IMF).

## NOTE 17 • ACCRUALS AND INCOME COLLECTED IN ADVANCE

	31 Dec. 2017	31 Dec. 2016
<b>Income collected in advance</b>		
Income collected in advance	3	3
Income collected in advance	338	328
	341	331
<b>Accruals</b>		
Accruals from central bank operations	117,516	35,596
Other accruals	24,691	20,311
	142,207	55,907
	142,548	56,237

The amount recorded in Accruals from central bank operations includes the accrued interest payable on lending to credit institutions (€116,107 thousand), which relates to operations under the new series of targeted longer-term refinancing operations (TLTRO II). For prudence, the

Eurosystem accrues interest at the deposit facility rate as the actual rate is only known in 2018, as explained in Note 6 and Note 22.

Other accruals reflects essentially the above-mentioned accrued staff costs (€18,409 thousand) and accrued supplies and services from third parties payable (€6,282 thousand).

## NOTE 18 • OTHER LIABILITIES – SUNDRY

	31 Dec. 2017	31 Dec. 2016
Banknotes withdrawn from circulation	152,654	154,674
Third parties	21,344	17,943
Liabilities relating to the payment to employees of seniority bonuses	13,583	13,200
Estimate for income taxes	242,271	174,367
Other central bank liabilities	130,377	8,670
Other accounts of reduced individual value	1,782	587
	<b>562,010</b>	<b>369,441</b>

The item Banknotes withdrawn from circulation represents Banco de Portugal's liability to the holders of banknotes denominated in Portuguese escudos (legacy currency), for as long as these can be exchanged. No banknote exchange period expired in 2017 and 2016, therefore the reductions recorded in this item were exclusively due to the delivery to Banco de Portugal of banknotes denominated in escudos still within the exchange period.

The item Liabilities relating to the payment to employees of seniority bonuses as at 31 December 2017 reflects the present value of liabilities for years of service, computed in an actuarial valuation carried out by SGFPBP. Actuarial gains/losses associated with these liabilities, calculated at the end of the period under review, are recorded in Profit/loss, as described in Section 1.2 (m) of Note 1. In 2017 actuarial gains/losses were negative and were recognised under Other expenses (Notes 27 and 32).

The estimate for income tax is set out in Note 30.

## NOTE 19 • IMPAIRMENT, PROVISIONS AND GENERAL RISK PROVISION

Accounting movements in the items Impairment and Provisions in the years 2016 and 2017 may be summarised as follows:

	Balance as at 31 Dec. 2015	2016				Balance as at 31 Dec. 2016
		Increase	Transfer	Decrease	Valor líquido	
<b>Impairment of assets</b>						
Adjustments for Special credit situations – BP/Finangeste Arrangement	69,653	–	(5,899)	(62,516)	(68,415)	1,238
Adjustments for claims related to reorganisation of credit institutions	–	–	5,899	–	5,899	5,899
Adjustments for other special credit situations	439	–	–	–	–	439
Adjustments for other recoverable amounts	13	–	–	(5)	(5)	8
	<b>70,105</b>	<b>–</b>	<b>–</b>	<b>(62,522)</b>	<b>(62,522)</b>	<b>7,583</b>

	Balance as at 31 Dec. 2016	2017				Balance as at 31 Dec. 2017
		Increase	Transfer	Decrease	Net value	
<b>Impairment of assets</b>						
Adjustments for Special credit situations – BP/Finangeste Arrangement	1,238	-	-	(290)	(290)	948
Adjustments for claims related to reorganisation of credit institutions	5,899	-	-	(3,688)	(3,688)	2,211
Adjustments for other special credit situations	439	-	-	(30)	(30)	409
Adjustments for other recoverable amounts	8	6	-	-	6	14
	<b>7,583</b>	<b>6</b>	<b>-</b>	<b>(4,008)</b>	<b>(4,002)</b>	<b>3,581</b>
<b>Provisions</b>						
Provision for Eurosystem monetary policy operations	-	1,706	-	-	1,706	1,706

In regard to impairment of assets, there was significant movement in the item Adjustments for claims related to reorganisation of credit institutions (decrease of €3,688 thousand), in relation to the credit recovery following the closure of the winding-up of Caixa Económica Açoreana, under the responsibility of the judicial liquidator designated by Banco de Portugal itself (Note 12).

The decrease in 2017 in Adjustments for Special credit situations regarding the BP/Finangeste Arrangement was related to the nominal amount of credit recovered by this entity and delivered to Banco de Portugal through the calculation of the annual instalments of 2016 and 2017, under the aforementioned Arrangement (Note 12).

Furthermore, as a result of the impairment tests conducted on the CSPP portfolio, the Governing Council of the ECB decided to establish a provision of €68.9 million for losses on monetary policy operations, related to a security held by a Eurosystem NCB. The amount of the provision was calculated based on the sale information in January 2018. This treatment is in accordance with the accounting and financial reporting framework of the European System of Central Banks for post-balance sheet events,<sup>15</sup> made against the item Net result of pooling of monetary income (Note 26).

The goal of the General risk provision is to cover potential medium-term risks and in each period its use takes into consideration, among other factors, estimated future income and the risk projection for subsequent periods.

The establishment of provisions such as Banco de Portugal's General risk provision has been followed at Eurosystem level, in line with developments in the risks associated with the need for central bank intervention following developments in the euro area economies since the financial crisis was triggered in 2008. This provision policy is formally recommended by the Governing Council, in Article 8 of the ECB Accounting Guideline (as amended).

Movements in this provision in 2016 and 2017 were as follows:

	Balance as at 31 Dec. 2015	2016		Balance as at 31 Dec. 2016
		Increase	Decrease	
General risk provision	4,046,622	200,000	-	4,246,622

	Balance as at 31 Dec. 2016	2017		Balance as at 31 Dec. 2017
		Increase	Decrease	
General risk provision	4,246,622	-	(520,000)	3,726,622

15. Article 4(3) of the ECB Accounting Guideline (ECB/2016/34).

In 2017, Banco de Portugal decided to reduce the General risk provision by €520,000 thousand. Movements in this provision take into consideration, among other factors, the medium-term income projection and risk assessment, calculated according to the methodology adopted by the Eurosystem. These are used to define a strategic risk coverage goal for a set time horizon, deemed satisfactory for holding the capital ratio at levels allowing the coverage, if necessary, of potential losses, including those resulting from decisions taken by the Governing Council with an impact on Banco de Portugal's accounts (Section 1.2 (q) of Note 1).

In 2017, the Portuguese Republic's rating was increased, with the result that, in accordance with the risk assessment methodology applied by Banco de Portugal, the risk from the PSPP decreased from the end of 2016, despite its increase in volume. However, according to the latest decisions by the Governing Council on developments in this programme, the volume of this portfolio is expected to continue to grow, which will offset the aforementioned risk reduction effect over the medium term. Furthermore, there were extraordinary events not directly related to the monetary policy programmes which influenced the developments of Banco de Portugal's balance sheet risks, namely (i) the materialisation of risk associated with own assets that led to the recognition of financial losses; (ii) the reduction in volume of foreign reserves and euro assets, as well as their foreign exchange component; and (iii) the reduction in risk from securities that matured over the course of the year. Taking these factors into consideration, the Board of Directors of Banco de Portugal, maintaining the prudence perspective that it has adopted consistently in regard to movements in the General risk provision, decided to reduce it by €520,000 thousand.

## NOTE 20 • REVALUATION ACCOUNTS

	31 Dec. 2017	31 Dec. 2016
Gold revaluation differences	10,273,653	10,472,463
Foreign currency revaluation differences	16,233	379,312
Securities revaluation differences	38,946	174,926
<b>Revaluation accounts</b>	<b>10,328,833</b>	<b>11,026,701</b>

Gold decreased €198,810 thousand, as a result of the reduction of unrealised gains resulting from the fall in the gold price in euro (Note 2).

The item Foreign currency revaluation differences increased, driven by investments denominated in SDR (€16,162 thousand) (2016: USD €327,924 thousand and SDR €33,136 thousand).

The decrease in unrealised gains resulting from fluctuations in the price of securities relates fundamentally to securities denominated in euro (€21,834 thousand in 2017 compared with €148,697 thousand in 2016) and in US dollars (€1,899 thousand in 2017 compared with €4,680 thousand in 2016).

## NOTE 21 • EQUITY

Movements in Equity for the 2016 and 2017 periods are set out in the Statement of Changes in Equity.

The capital of Banco de Portugal amounts to €1,000 thousand and it may be increased, namely by incorporation of reserves, pursuant to a decision of the Board of Directors and upon authorisation of the Minister of State and Finance.

In accordance with Article 53 (2) of the Organic Law of Banco de Portugal, the net profit for the year shall be distributed as follows: 10% to the legal reserve, 10% to other reserves to be decided by the Board of Directors and the remainder to the State, as dividends, or to other reserves, as approved by the Minister of State and Finance, on a proposal of the Board of Directors. The net profit for the year 2016 gave rise to the transfer of €44,059 thousand to the legal reserve and an equal amount to other reserves, and to the distribution of dividends to the State totalling €352,472 thousand.

Movements in 2017 in non-distributable retained earnings, recorded in the Statement of Changes in Equity, refer to actuarial gains/losses of the liabilities related to the Pension Fund, as well as to deferred taxes, recognised on 31 December 2017 (Notes 30 and 32).

## NOTE 22 • NET INTEREST INCOME

	31 Dec. 2017	31 Dec. 2016
<b>Interest income</b>		
Gold	–	48
Securities	95,979	108,630
Denominated in foreign currency	77,125	64,692
Denominated in euro	18,853	43,938
Balances with banks, deposits and other money markets	37,414	15,518
Denominated in foreign currency	26,648	7,009
Denominated in euro	10,766	8,509
International Monetary Fund	6,240	1,028
Lending to euro area credit institutions	4	803
Securities held for monetary policy purposes	803,414	588,922
Intra-ESCB claims	0	3,759
Medium-term investment portfolio	119,806	146,615
Off-balance-sheet instruments	1,231	2,153
Other claims	714	777
Current accounts of credit institutions for compliance with minimum reserve requirements	21,530	7,999
Liquidity-absorbing operations	8	7
General government	7,013	1,698
Other liabilities to euro area residents denominated in euro	3,990	3,837
	<b>1,097,343</b>	<b>881,792</b>
<b>Interest expense</b>		
Liabilities to euro area residents denominated in euro	–	0
Liabilities denominated in foreign currency	–	1,090
International Monetary Fund	5,177	853
Intra-Eurosystem liabilities	0	6,641
Off-balance-sheet instruments	1,398	705
Longer-term refinancing operations	81,018	27,205
	<b>87,593</b>	<b>36,494</b>
<b>Net interest income</b>	<b>1,009,750</b>	<b>845,298</b>

The increase in the Net interest income item in 2017 was essentially driven by the sharp rise in volume in Securities held for monetary policy purposes, as a result of the PSPP investment. Due to the nature of their assets, the securities held for monetary policy purposes have higher average yields than most of the interest-bearing assets on the portfolio. Also contributing to the increase in this item was the rise in interest from the portfolio denominated in foreign currency,

driven by income from securities and gold swaps for foreign currency, along with the rise in interest receivable from current accounts of credit institutions (minimum reserve excess), mainly due to the increase in their average balance.

These increases were partly offset by the general decline in yields on some of the main interest assets. In this regard, the Governing Council kept the main refinancing operations rate at 0% throughout 2017, similarly to 2016, when in March it reached a record low, with a direct impact on returns on monetary policy assets and liabilities.

In 2017, the asset item Longer-term refinancing operations continued to record negative interest, similarly to 2016, arising from the introduction of the new TLTRO-II operations, by decision of the Governing Council. Given that the actual rate on these operations is only known in 2018 and a reliable estimate is not possible, the deposit facility rate (which is currently -0.4%) has been used for calculating the TLTRO-II interest for the year, as this is deemed a prudent approach across the Eurosystem (Note 6).

In a standardised way across the Eurosystem, positive and negative interest on monetary policy operations is presented at its net value under either Interest income or Interest expense, depending on whether they are positive or negative in value. For reasons of consistency, this decision extends to interest on other Banco de Portugal liabilities.

## NOTE 23 • REALISED GAINS/LOSSES ARISING FROM FINANCIAL OPERATIONS

	31 Dec. 2017	31 Dec. 2016
Foreign exchange transactions	(256,544)	40,910
Other financial operations in foreign currency	19,057	(27,693)
Financial operations in euro	91,015	455,337
Interest rate futures	(117,719)	(291,798)
	<b>(264,191)</b>	<b>176,757</b>

Realised gains/losses arising from financial operations were negative in 2017, in contrast to the positive value of 2016. Contributing to this sharp fall were the losses in 2017 from spot and forward foreign exchange operations, essentially regarding sales of US dollars.

Furthermore, capital gains decreased from sale operations of securities in the trading portfolio in euro, partly offset by the decrease in realised losses from interest rate futures. These results for management purposes are analysed together with those of related assets, as these operations are undertaken from a perspective of interest rate risk hedging associated with the trading portfolios.

## NOTE 24 • UNREALISED LOSSES ON FINANCIAL ASSETS AND POSITIONS

	31 Dec. 2017	31 Dec. 2016
Unrealised exchange rate losses	230,186	1
Unrealised losses on investments in foreign currency	11,479	50,790
Unrealised losses on euro operations	18,669	26,630
	<b>260,333</b>	<b>77,421</b>

Within unrealised losses, the component related to unrealised losses on investments in foreign currency associated with US dollar-denominated assets in the portfolio increased from 2016. This increase was partly offset by the reductions in the losses in the components related to financial operations denominated in euro and in foreign currency assets.

## NOTE 25 • INCOME FROM EQUITY SHARES AND PARTICIPATING INTERESTS

The Governing Council of the ECB each year makes a decision about the distribution of (i) seigniorage income which arises from the 8% share of euro banknotes allocated to the ECB; and (ii) the ECB's income arising from securities purchased under the SMP, CBPP3, ABSPP and PSPP. The ECB distributes all of this income to the NCBs, unless otherwise decided by the Governing Council in the financial year to which they relate. This item includes the total amount of €24,463 thousand relating to this income in 2017, which only relates to the aforementioned portion of income from securities (2016: €23,931 thousand).

In 2017 this item also included dividends received for Banco de Portugal's participating interests in 2016, chiefly: (i) in the ECB, to the amount of €5,619 thousand (2016: €6,679 thousand) and (ii) in the Bank for International Settlements (BIS), to the amount of €3,151 thousand (2016: €2,320 thousand).

## NOTE 26 • NET RESULT OF POOLING OF MONETARY INCOME

This item contains the net result of pooling of monetary income, amounting to €128,592 thousand<sup>16</sup> (2016: €70,903 thousand<sup>17</sup>). The increase from 2016 was due to the decrease in the share of Banco de Portugal's net contributions in the Eurosystem's total contributions compared to the year before. Banco de Portugal's share of these contributions remains below its adjusted capital key, due to which a receivable from other Eurosystem national central banks was recorded.

This item also includes specific provision, as decided by the Governing Council of the ECB in December 2017 (to a sum of around €1,706 million), for expected losses from securities included in the CSPP, which constitute a shared risk at Eurosystem level, even though they are not in Banco de Portugal's portfolio. Therefore, the level of the provision reflects Banco de Portugal's key share of the total impairment and is offset by a loss recognised in the Profit and Loss account, in the item Net result of pooling of monetary income.

16. Includes the proceeds of the calculation of monetary income for 2017, to the amount of €128,666 thousand and adjustments from 2016, amounting to €-74 thousand.

17. Includes the proceeds of the calculation of monetary income for 2016, to the amount of €70,911 thousand and adjustments from 2015, amounting to €-9 thousand.

The amount of each Eurosystem NCB's monetary income is determined by measuring the actual annual income from a set of assets – earmarkable assets – less interest (accrued or paid) on components of a set of liabilities – the liability base.

The remuneration rate described below is applied to the items comprising these earmarkable assets and the liability base (see the following table).

Earmarkable assets	Applicable rates	Liability base	Applicable rates
Amount of gold holdings in proportion to each NCB's capital key	0%	Banknotes in circulation	Not applicable
Claims equivalent to the transfer of foreign reserves to the ECB (except gold)	Main refinancing operations rate	Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	Remuneration rate
Lending to euro area credit institutions related to monetary policy operations denominated in euro	Remuneration rate	Net liabilities arising from balances of TARGET accounts	Main refinancing operations rate
CBPP, CBPP2 and PSPP-GOV portfolio	Main refinancing operations rate		
SMP, CBPP3 and PSPP-SUPRA portfolio	Rate of return		
Net claims related to the allocation of euro banknotes within the Eurosystem	Main refinancing operations rate		
Accrued interest relating to regular monetary policy operations with a maturity of over 1 year	Not applicable		

When the value of an NCB's earmarkable assets exceeds the value of its liability base, the difference (called 'the gap'), calculated at the latest available rate for the Eurosystem's MROs, shall be deducted from the monetary income to be pooled. When the gap is negative, i.e. the value of the earmarkable assets falls short of the value of its liability base, as was the case for Banco de Portugal in 2016 and 2017, this difference is added to the monetary income to be pooled. The sum of the monetary income and the gap is termed the net contribution.

The total net contribution from all Eurosystem NCBs is allocated to all NCBs in the Eurosystem in proportion to their paid-up shares in the capital of the ECB.

The difference between Banco de Portugal's net contribution, amounting to €138,547 thousand, and its allocation under the aforementioned capital key, amounting to €267,213 thousand, less (i) the adjustments made this year regarding 2016 to the amount of negative €74 thousand, and (ii) Banco de Portugal's share of the provision for losses in monetary policy operations which was established for the security held by a Eurosystem NCB in its CSPP portfolio (Note 19), gives the net result arising from the pooling of monetary income (€126,886 thousand).

		31 Dec. 2017	31 Dec. 2016
A	Total contribution from all Eurosystem NCBs	10,788,991	9,907,797
B	Paid-up capital key	2.4767%	2.4767%
C = A x B	Total reallocation to Banco de Portugal	267,213	245,388
D	Total effective contribution from Banco de Portugal	138,547	174,477
E = C - D	Result of the method	128,666	70,911
F	Eurosystem adjustments to the result of the method relating to previous years	(74)	(9)
G	Steinhoff Europe AG Provision	(1,706)	–
H= E+ F + G	Net result of pooling of monetary income	126,886	70,903

## NOTE 27 • OTHER INCOME AND EXPENSES

	31 Dec. 2017	31 Dec. 2016
<b>Other income</b>		
Capital gains on tangible and intangible fixed assets	52	42
Previous fiscal years income	135	138
Sales and supply of services to third parties	3,277	3,664
Sundry income	5,717	1,354
	<u>9,181</u>	<u>5,198</u>
<b>Other expenses</b>		
Capital losses on tangible and intangible fixed assets	82	66
Previous fiscal years expenses	14,189	653
Sundry expenses	483	2,011
	<u>14,754</u>	<u>2,731</u>
	<u>(5,573)</u>	<u>2,467</u>

The item Sales and supply of services to third parties relates essentially to services provided by Banco de Portugal through the BpNet portal (€2,944 thousand).

The item Sundry income includes: (i) profit resulting from the adjustment of the value of Banco de Portugal's participating interests in Valora, S. A. and Sociedade Gestora dos Fundos de Pensões do Banco de Portugal (Banco de Portugal Pension Funds Management Company), due to the implementation of the Net Asset Value valuation method, as explained in Section 1.2 (e) of Note 1 and Note 10 (€3,823 thousand and €46 thousand respectively); and (ii) €876 thousand for gains in the Reserve Account, relating to the Pension Fund of Banco de Portugal – Defined-contribution plan (Note 32).

The Sundry expenses item in 2017 includes €209 thousand for negative actuarial deviations for the year-end assessment of liabilities from Seniority bonuses (Note 32).

The item Previous fiscal years expenses includes €13,987 thousand of legal and financial advice expenses from the sale process of Novo Banco, for the period from 2014 to 2016, which were borne in full by Banco de Portugal, in accordance with the decision of the Ministry of Finance in October 2017.

## NOTE 28 • STAFF COSTS

	31 Dec. 2017	31 Dec. 2016
Remuneration of the members of the Board of Directors and Board of Auditors	1,243	1,249
Employees' salaries	82,967	82,027
Compulsory social charges	34,297	32,064
Voluntary social charges	15,417	4,903
Other staff costs	1,798	1,737
	<u>135,721</u>	<u>121,980</u>

Staff costs increased €13,741 thousand in 2017. This was chiefly due to the fact that in 2017 this item began to include amounts relating to the increase in liabilities for early retirements approved in the year, under the Pension Fund – Defined-benefit plan (in previous years these amounts were recorded under Retained earnings – Note 32). If the same treatment had been used in 2016, the staff costs for that year would have totalled €133,220 thousand, giving a 2% increase in 2017 from that year.

Therefore, disregarding the effect identified above, the growth was due largely to the significant increase from 2016 in the annual charge from the Pension Fund – Defined-benefit plan. This increase (€2 million) results from the actuarial assessment made by the Sociedade Gestora dos Fundos de Pensões do Banco de Portugal (Banco de Portugal Pension Funds Management Company), and reflects above all the impact of the reduction in the discount rate used to calculate this annual charge (Note 32).

Furthermore, there was a 0.75% salary update following the revision of the collective labour agreement for the banking sector (ACT).

## NOTE 29 • SUPPLIES AND SERVICES FROM THIRD PARTIES

	31 Dec. 2017	31 Dec. 2016
Electricity, fuel and water	3,378	3,677
Travel, accommodation and other transport	2,912	2,785
Litigation and notary services	13,066	6,207
Maintenance and repairs	5,232	5,216
Rentals	2,660	2,725
Specialised work		
Surveillance and security	3,993	3,833
IT	2,173	1,779
Use of databanks	2,497	2,534
Remuneration of SGFP	2,861	2,767
Other specialised work	3,788	3,605
Software licensing and maintenance	7,272	6,886
Other supplies and services from third parties	6,039	5,510
	<b>55,871</b>	<b>47,524</b>

The increase in Litigation and notary services related mainly to the increase in the provision of services to the resolution measure on Banco Espírito Santo, S. A. (€6,925 thousand), partly resulting from the fact that Banco de Portugal in 2017 began to bear in full the expenses relating to the sale of Novo Banco, by decision of the Ministry of Finance in October 2017. Total supplies and services from third parties relating to this resolution measure came to €11,943 thousand, of which €11,936 thousand relates to litigation services.

The increase in Software licensing and maintenance (€386 thousand) is largely due to information technology and systems within the scope of the Eurosystem (increasing by €249 thousand) and the strategic innovation in Banco de Portugal's information technology and systems (increasing by €76 thousand). This strategy also has an impact on the item Specialised work – IT (increasing by €266 thousand).

These increases were offset by (i) effective savings, essentially relating to electricity expenses (€352 thousand) and maintenance and repairs of Banco de Portugal premises (€165 thousand) and (ii) the reduction in rent paid on buildings that were no longer used by Banco de Portugal (€65 thousand). These reductions are in line with the strategic objective of efficient resource management and cost containment.

## NOTE 30 • INCOME TAX

Banco de Portugal is subject to corporate income tax and to the corresponding municipal corporate and autonomous taxes.

Tax authorities are allowed a four-year period during which they can review Banco de Portugal's tax situation. Therefore, as a result of different interpretations of tax legislation, there may be additional payments. However, the Board of Directors of Banco de Portugal firmly believes that there will be no additional significant payments regarding previous financial periods.

On 31 December 2017 and 2016, income tax assets and liabilities were broken down as follows:

	2017	2016
Estimated income tax on profit for the year	271,964	190,977
Estimated income tax on retained earnings	(29,694)	(16,610)
Withholdings at source	(7)	(9)
Payments on account and additional payments on account	(155,794)	(80,993)
	<b>86,469</b>	<b>93,365</b>

In 2017, income tax on retained earnings was the result of (i) the 2011 change to the accounting treatment of actuarial gains and losses from the Pension Fund – Defined-benefit plan<sup>18</sup> and (ii) the portion of the extraordinary contribution to the Pension Fund relating to coverage of the increase in liabilities for current retired employees and pensioners resulting from negative actuarial gains and losses (Note 32).

Presented below are the expenses/income items comprising income tax on profit for the year, as well as the tax burden, measured through the ratio of total income tax to income before taxes.

	2017	2016
Current tax		
For the year	202,662	141,315
Municipal corporate tax and state surtax	69,041	49,524
Autonomous taxation	262	138
	271,964	190,977
Deferred tax	(727)	17,939
<b>Total income tax</b>	<b>271,237</b>	<b>208,916</b>
<b>Income before taxes</b>	<b>927,721</b>	<b>649,506</b>
<b>Tax burden</b>	<b>29.24%</b>	<b>32.17%</b>

18. Law No 64-B/2011 was published on 30 December 2011 approving the State Budget for 2012, and lays down in Article 183 that the negative balance sheet variations recorded in the 2011 tax year arising from the change in accounting treatment of actuarial gains and losses resulting from the recognition of liabilities from pensions and other defined-benefit post-employment benefits, in relation to contributions made in that year or in prior tax years, are not included in the deductibility limits established in Article 43 of the Corporate Income Tax Code, rather, they are included in equal parts in the formation of taxable profit for the 2012 tax year and the next nine tax years. Thus, the current and deferred tax relating to the pension fund's transitional regime should be recognised against equity.

The reconciliation between the nominal and effective tax rates, presented above, is as follows:

	2017		2016	
	Rate	Tax	Rate	Tax
<b>Profit/loss before taxes</b>		<b>927,721</b>		<b>649,506</b>
Tax calculated at nominal rate	29.40%	272,783	29.55%	191,907
<b>Definitive differences to be deducted</b>				
Net Asset Value	(0.12%)	(1,141)	(0.02%)	(105)
Payment or placement at disposal of beneficiaries of severance benefits, retirement benefits and other post-employment or long-term benefits	(0.25%)	(2,363)	(0.19%)	(1,204)
Impairment losses	(0.01%)	(75)	2.82%	18,311
Restoration of non-deductible tax and tax estimate surplus	(0.01%)	(120)	0.00%	(19)
Tax gains/losses	0.00%	(44)	0.00%	(10)
<b>Definitive differences to be added</b>				
Adjustments from previous periods	0.01%	58	0.03%	189
Expenses from severance benefits, retirement benefits and other post-employment or long-term benefits	0.15%	1,355	0.00%	(7)
Depreciation and amortisation not deductible as costs	0.01%	64	0.01%	36
Pension Fund	0.14%	1,255	0.07%	450
Accounting capital gains/losses	0.00%	9	0.00%	7
Charges not fully documented	0.00%	28	0.01%	52
Other	0.01%	48	0.01%	44
<b>Tax benefits</b>				
Net job creation	(0.09%)	(799)	(0.13%)	(815)
Other	0.00%	(7)	0.00%	(3)
<b>Autonomous taxation</b>	0.03%	262	0.02%	138
<b>Deferred tax assets and liabilities – Effect of rate change</b>	(0.01%)	(75)	(0.01%)	(57)
	<b>29.24%</b>	<b>271,237</b>	<b>32.17%</b>	<b>208,916</b>

In 2017 and 2016, the movements in deferred tax assets and liabilities can be broken down as follows:

	2017			
	31 Dec. 2016	Change in		31 Dec. 2017
		Equity	Profit/loss	
<b>Assets</b>				
Temporarily non-deductible provisions and impairment	2,222	–	(1,107)	1,115
Staff benefits				
Pension fund – transitional regime	31,299	(4,584)	–	26,715
Seniority bonus	3,876	–	379	4,255
Early retirements	4,915	–	1,466	6,380
	<b>42,311</b>	<b>(4,584)</b>	<b>738</b>	<b>38,465</b>
<b>Liabilities</b>				
Depreciation surplus (reinvestment of capital gains)	(328)	–	(11)	(338)
	<b>(328)</b>	<b>–</b>	<b>(11)</b>	<b>(338)</b>
	<b>41,983</b>	<b>(4,584)</b>	<b>727</b>	<b>38,127</b>

	31 Dec. 2015	2016 Change in		31 Dec. 2016
		Equity	Profit/loss	
<b>Assets</b>				
Temporarily non-deductible provisions and impairment	20,533	–	(18,311)	2,222
Staff benefits				
Pension fund – transitional regime	37,470	(6,171)	–	31,299
Seniority bonus	3,510	–	366	3,876
Early retirements	–	4,915	–	4,915
Interest rate subsidies	4	–	(4)	–
	<b>61,517</b>	<b>(1,257)</b>	<b>(17,949)</b>	<b>42,311</b>
<b>Liabilities</b>				
Depreciation surplus (reinvestment of capital gains)	(338)	–	10	(328)
	<b>(338)</b>	<b>–</b>	<b>10</b>	<b>(328)</b>
	<b>61,179</b>	<b>(1,257)</b>	<b>(17,939)</b>	<b>41,983</b>

Deferred tax is the impact on tax receivable/payable in future periods, resulting from temporary deductible/taxable differences between the balance sheet value of assets and liabilities and their taxable basis, used in the taxable profit calculation.

They are calculated based on tax rates expected to be in force on the date the temporary differences are to be reversed, and are approved or substantially decreed rates as at the balance sheet date.

In 2017, deferred tax associated with early retirements began to be recorded against profit for the year, as the transaction originating the deferred tax began to be recognised as income (Staff costs – Note 28).

The rate used to calculate deferred tax in 2017 was 31.33% (2016: 29.36%). The increase in this rate from 2016 was the result of changes laid down in Law No 114/2017, of 29 December 2017 (State Budget Law for 2018), which lays down an increase to 9% (from 7%) in the state surtax for the top tax band.

Also with respect to deferred taxes, it should be noted that temporary differences have no time limits.

## NOTE 31 • OFF-BALANCE-SHEET INSTRUMENTS

	31 Dec. 2017	31 Dec. 2016
Contracted financial operations	(1,707,890)	(4,686,739)
Collateral given	(1,464,598)	(1,464,598)
Collateral received	59,378,744	61,499,576
Items held in custody	32,374,746	46,679,976
Irrevocable credit lines	(3,188,085)	(3,454,849)

## Contracted financial operations

This item records open positions in financial operations that are under contract but still outstanding at the year-end. As at 31 December 2017 and 31 December 2016, these positions relate only to derivative financial instruments designed essentially to manage risks associated with their assets and liabilities, as follows:

	31 Dec. 2017					31 Dec. 2016	
	Contract value <sup>(a)</sup>		Market value <sup>(b)</sup>	Profit/loss <sup>(c)</sup>	Accrued interest <sup>(d)</sup>	Contract value <sup>(a)</sup>	
	Purchases	Sales	Net	Net	Net	Purchases	Sales
Currency forwards	15,848	(15,848)	1,326	1,338	(12)	11,445	(11,445)
Currency swaps	25,336	(25,336)	305	318	(13)	184,927	(184,927)
Interest rate futures	290,169	(1,998,059)	–	–	–	1,159,767	(5,846,506)

(a) Theoretical or notional value of the contract. (b) The market value corresponds to income or expenses associated with the potential closing of open positions, taking into account current market conditions and the valuation models commonly used. (c) The effect on profit/loss corresponds to the impact on the Profit and Loss Account of the potential closing of open positions, taking into account current market conditions and the valuation models commonly used. (d) The value of accrued interest corresponds to interest income and expense plus open positions until the balance sheet date.

## Collateral given, collateral received, items held in custody and other commitments to third parties

Collateral given includes the promissory note issued by Banco de Portugal in favour of the IMF, under Article III, Section 4 of the IMF's Articles of Agreement.

Collateral received principally includes collateral related to the monetary policy operations of the Eurosystem (€59,372,079 thousand on 31 December 2017), including collateral used via the Correspondent Central Banking Model (CCBM). This collateral is valued at market rates, less respective haircuts.

Items held in custody essentially comprises (i) securities owned by the Portuguese State (€14,958,551 thousand); (ii) securities held in custody by Banco de Portugal as collateral in monetary policy operations with other NCBs, under the CCBM (€11,193,580 thousand); and (iii) the value of the promissory note in favour of the IMF issued by the Portuguese Republic, under the Extended Fund Facility, to the amount of €6,060,673 thousand (Note 15).

The item Irrevocable credit lines records the limit on the credit lines of the Portuguese financial system to the amount of €2,257,600 thousand and a credit line granted to the IMF to the amount of SDR 783,500 thousand under the New Arrangements to Borrow (NAB) (€930,485 thousand).

## NOTE 32 • LIABILITIES RELATED TO RETIREMENT PENSIONS AND OTHER BENEFITS

### Pension Fund of Banco de Portugal – Defined-benefit plan

#### • Overview

Until 31 December 2010 Banco de Portugal was the sole entity responsible for the payment of the retirement and survivors pensions of staff (and their dependents) hired by the Bank before 3 March 2009, who were covered by a substitutive social security scheme for bank employees, enshrined in the collective labour regulations for the banking sector. Decree-Law No 1-A/2011 of 3 January 2011 laid down that, from 1 January 2011, the active employees of Banco de Portugal, who were registered

in Caixa de Abono de Família dos Empregados Bancários – CAFEB<sup>19</sup> (family allowance fund of bank employees) and covered by the Pension Fund – Defined-benefit plan, are now integrated in the general social security scheme with respect to statutory retirement pensions.

Thus, the Pension Fund – Defined-benefit plan in terms of the statutory retirement/old-age pensions maintained under its responsibility the payment of past-service liabilities until 31 December 2010 and after 1 January 2011 the Pension Fund only covers the payment of the supplement intended to make up for the difference between the benefits calculated under the general social security scheme and the benefits defined in the respective pension plans, which are based on the applicable labour agreements for the banking sector and on the Bank's internal regulations. The payment of disability and death grants remained totally under the Fund's responsibility as well.

In 2014 new liabilities were transferred to the Pension Fund – Defined-benefit plan, among which healthcare costs and funeral expenses for the retired employees and pensioners. With this transfer of liabilities from Banco de Portugal to the Pension Fund, the contract establishing the Pension Fund – Defined-benefit plan was amended to include the existing two benefit plans: the Pension Plan, operating three benefit schemes and the Healthcare Plan, operating only one benefit scheme for the payment of healthcare costs and funeral expenses for the retired employees and pensioners. The three schemes of the Pension Plan are closed to staff that started working in the banking sector after 2 March 2009 (Decree-Law No 54/2009 of 2 March 2009). The Healthcare Plan is open for all staff of Banco de Portugal.

The benefits associated with the above-mentioned schemes of the Pension Fund include old-age pensions of members / statutory retirement (as a supplement to those paid by the social security), disability pensions, early retirement pensions, survivors pensions, including the payment of supplementary benefits and death grants, as well as the settlement by the sponsor of charges, including inherent charges to SAMS (social health assistance service for banking sector employees) related to pensions in payment.

As the revision process of the company-level agreements (Acordos de Empresa) has not been concluded yet, implementation of the changes to the collective labour agreement for the banking sector (ACT) made in 2016 remains suspended, with the exception of the increases in wages and other pecuniary payments.<sup>20</sup>

The table below shows the most relevant risks among those arising from the Pension Plan and the Healthcare Plan:

Risk Sub-category	Risk definition
Longevity risk	Potential risk attached to increasing life expectancy of the population, compared with that assumed in actuarial valuations, resulting in an increase of the liabilities of the Pension Fund – Defined benefit plan.
Disability risk	Risk attached to potential deviation in the disability rate, compared with that assumed in actuarial valuations, resulting in an increase of the liabilities of the Pension Fund – Defined benefit plan.
Health risk	Risk of an increase in medical services costs and higher inflation than assumed in actuarial valuations, resulting in an increase of liabilities of the Pension Fund – Defined benefit plan.
Risk of regulatory changes to the general social security scheme	Risk attached to the occurrence of regulatory changes to the general social security scheme, impacting on the Pension Fund – Defined benefit plan.
Medical services inflation risk	Risk of an increase in medical services costs and higher inflation than assumed in actuarial valuations, resulting in an increase of liabilities of the Pension Fund – Defined benefit plan.
Risk of inflation implied in assumed wages and pensions growth rates	Risk of a reduction in the funding ratio arising from the materialisation of adverse movements in historical and / or expected inflation rates.
Interest rate risk	Risk of reduction of the funding ratio arising from adverse interest rate movements.

19. Dissolved by this Decree-Law.

20. Note that this Instrument of the Collective Labour Agreement applies to a reduced number of the Bank's employees; besides, overall, the changes are less favourable for employees than those currently recognised in the valuation model adopted.

In 2017 the mortality assumption used to calculate the liabilities of the Pension Fund – Defined-benefit plan was revised, translating into a significant rise in liabilities, as illustrated in the table on actuarial gains and losses for the period. The revision of this assumption aims to mitigate the longevity risk.

- Pension Fund Plans

- Pension plan

- a) Scheme members

The number of members covered by the pension plan is the following:

Number of scheme members	31 Dec. 2017	31 Dec. 2016
Active members	1,054	1,146
Retired members	1,978	1,935
Pensioners	589	585
	<b>3,621</b>	<b>3,666</b>

The assumed average life expectancy for scheme members and beneficiaries of the Fund's pension plan is the following:

Average life expectancy (years)	31 Dec. 2017	31 Dec. 2016
Active members	34	32
Retired members	15	13
Pensioners	13	11

- b) Methodology, assumptions and accounting policy

Liabilities arising from the pension plan funded through the Pension Fund – Defined-benefit plan were calculated on an actuarial basis by Sociedade Gestora dos Fundos de Pensões do Banco de Portugal – SGFPBP, using the Projected Unit Credit Method, in accordance with the principles laid down in IAS 19.

The main actuarial and financial assumptions adopted are the following:

	Actuarial and financial assumptions used			
	31 Dec. 2017	1 Jan. 2017	31 Dec. 2016	1 Jan. 2016
Discount rate	1.803%	1.619%	1.619%	2.170%
Expected return rate on the Fund's assets	n/a	1.619%	n/a	2.170%
Wage growth rate				
1st year	1.750%	1.750%	1.750%	1.000%
Subsequent years	2.786%	2.682%	2.682%	2.466%
Pensions growth rate				
1st year	0.750%	0.750%	0.750%	0.000%
Subsequent years	1.786%	1.682%	1.682%	1.466%
Tables used				
- Mortality – Male population	TV 88/90 adjusted by 1 year	TV 88/90	TV 88/90	
Female population	TV 88/90 adjusted by 4 years			
- Disability	1978 – S.O.A. Trans. Male (US)		1978 – S.O.A. Trans. Male (US)	
- Turnover	T-1 Crocker Sarason (US)		T-1 Crocker Sarason (US)	
Statutory retirement age under the Pension Fund of Banco de Portugal	65 years		65 years	
Statutory retirement age under the general social security scheme (1st year)	66 years and 4 months		66 years and 3 months	
Percentage of married members	80%		80%	
Age difference between spouses	3 years		3 years	

The discount rate calculated by SGFPBP is based on the yield of a basket comprised of high-quality bonds issued, whose liquidity, denomination and maturity are adequate to the term structure of the Pension Fund's liabilities.

- Healthcare plan

**a) Scheme members**

The number of members covered by the pension plan is shown in the table below:

Number of scheme members	31 Dec. 2017	31 Dec. 2016
Active members	1,755	1,793
Retired members and pensioners	2,512	2,475
	<b>4,267</b>	<b>4,268</b>

The assumed average life expectancy for scheme members and beneficiaries is the following:

Average life expectancy (years)	31 Dec. 2017	31 Dec. 2016
Active members	41	38
Retired members	15	13
Pensioners	13	11

**b) Methodology, assumptions and accounting policy**

The actuarial and financial assumptions used in the calculation of these liabilities are established according to IAS 19. The most important are the following:

Pressupostos atuariais e financeiros utilizados				
	31 Dec. 2017	1 Jan. 2017	31 Dec. 2016	1 Jan. 2016
Discount rate	1,803%	1,619%	1,619%	2,170%
Expected return rate on the Pension Fund's assets	n/a	1,619%	n/a	2,170%
Growth rate of the average/annual expenses				
Disability pensions	5,635%	5,512%	5,512%	5,290%
Other	4,198%	4,075%	4,075%	3,853%
Tables used				
- Mortality – Male population	TV 88/90 increased by 1 year		TV 88/90	
Female population	TV 88/90 increased by 4 years		TV 88/90	
- Disability	1978 – S.O.A. Trans. Male (US)		1978 – S.O.A. Trans. Male (US)	
- Turnover	T-1 Crocker Sarason (US)		T-1 Crocker Sarason (US)	
Statutory retirement age under the Pension Fund – Defined-benefit plan	65 years		65 years	
Statutory retirement age under the general social security scheme (1st year)	66 anos e 4 meses		66 anos e 3 meses	
Percentage of married members	80%		80%	
Age difference between spouses	3 years		3 years	

- Changes in assets and liabilities of the Pension Fund

	31 Dec. 2017			31 Dec. 2016		
	Retired members and pensioners	Active members	Total	Retired members and pensioners	Active members	Total
<b>Total past service liabilities of the Pension Fund</b>						
Retirement and survivors benefits	1,042,544	671,772	<b>1,714,316</b>	929,698	664,365	<b>1,594,063</b>
Pensions' inherent charges to SAMS	60,162	37,025	<b>97,187</b>	53,455	35,671	<b>89,126</b>
Death grants	2,139	730	<b>2,870</b>	2,080	793	<b>2,873</b>
Healthcare	55,948	27,827	<b>83,774</b>	49,065	26,524	<b>75,589</b>
	<b>1,160,793</b>	<b>737,353</b>	<b>1,898,147</b>	<b>1,034,297</b>	<b>727,353</b>	<b>1,761,650</b>

The table below presents developments in past service liabilities of the Pension Fund in 2017 and 2016:

Past-service liabilities	2017	2016
Value at the beginning of the year	1,761,650	1,596,223
Current service cost	15,920	14,147
Benefits payable (expected value)	(67,498)	(66,116)
Interest cost	28,521	34,638
Actuarial gains/losses	149,091	171,090
Increase in liabilities arising from early retirements	10,463	11,240
Past-service cost	–	428
<b>Value at the end of the year</b>	<b>1,898,147</b>	<b>1,761,650</b>

In 2017 the value associated with the increase in liabilities arising from the approval of early retirements started to be recognised as staff costs, instead of being recorded in retained earnings as was the case until 2016 (Note 28).

The Fund's financial management is driven to cover the risks implied in assumed liabilities, liable of mitigation through financial instruments in order to preserve the funding ratio.

Among the several assumptions adopted in the valuation of the Fund's liabilities, the most relevant due to their impact on the value of liabilities, are those relating to longevity, the discount rate and the rate of increase of salaries and pensions.

The table below shows sensitivity of the Fund's assets and liabilities to changes in the assumption values adopted:

Sensitivity as at 31 December 2017	One-year increase in life expectancy	10 b.p. reduction in the discount rate	10 b.p increase in wages and pensions growth rates
Impact on the Pension Fund's assets	0,0%	1,0%	1,1%
Impact on the Pension Fund's liabilities	4,3%	1,6%	1,5%
Impact on the Pension Fund's funding ratio	-4,3%	-0,6%	-0,4%

Note that in terms of wages and pensions growth rate, its change only impacts the value of the Pension plan's liabilities; the impact measured in the Fund's assets is based on the assumption that said growth rate is indexed to the assumption for inflation.

On 31 December 2017 the modified duration of liabilities stood at 16.0 years (2016: 15.3 years) and the difference between the modified duration of the bond portfolio on the assets side and the modified duration of liabilities, adjusted so as to incorporate the size differences between these two aggregates, stood at -5.6 years (2016: -3.2 years).

Fund's assets	2017	2016
Value at the beginning of the year	1,818,648	1,663,425
Current contributions paid to the Fund	15,792	14,344
On account of the Bank	13,826	12,349
On account of the employees	1,966	1,995
Contributions paid on account of early retirements	10,463	11,240
Extraordinary contributions paid to the Fund	133,600	56,700
Benefits and inherent charges paid by the Fund	(71,623)	(69,523)
Net income of the Fund	32,244	142,462
<b>Value at the end of the year</b>	<b>1,939,124</b>	<b>1,818,648</b>

The Fund's assets can be broken down as follows:

Fund's investments	31 Dec. 2017	31 Dec. 2016
Land and buildings	163,926	120,831
Variable income securities	174,537	135,596
Fixed income securities	1,575,133	1,517,489
Cash and bank deposits	13,310	9,674
Other	12,217	35,058
	<b>1,939,124</b>	<b>1,818,648</b>

Land and buildings includes the Castilho Building, used by Banco de Portugal, recorded in 2017 for the value of €25,402 thousand.

Securities portfolio of the Fund	31 Dec. 2017	31 Dec. 2016
<b>Variable income securities</b>		
Participation units – Investment funds	174,537	135,596
<b>Fixed income securities</b>		
Government debt	1,575,133	1,498,477
Other	–	19,012
	<b>1,749,670</b>	<b>1,653,085</b>

At the end of 2017 the funding ratio of the Pension Fund stood at 102.2%, i.e. lower than at the end of 2016 (103.2%).

The value of actuarial gains and losses calculated in 2016 and 2017 can be broken down as follows:

	31 Dec. 2017	31 Dec. 2016
<b>Actuarial gains / losses</b>		
Population movements	(12,660)	(5,553)
Technical gains and losses	22,239	10,205
Wage growth	192	(3,850)
Increase in pensions	834	(4,745)
Change in average healthcare expenses	609	537
Adjustments to the model	2,837	1,485
Other gains and losses	(205,011)	6,353
Indexation of assumptions:		
Wage growth	(11,058)	(23,815)
Increase in pensions	(2,602)	(13,018)
Discount rate	55,530	(138,689)
	<b>(149,091)</b>	<b>(171,090)</b>
<b>Financial gains and losses</b>		
Gains and losses in paid pensions	(4,125)	(3,407)
Gains and losses in expected income of the Fund	2,799	106,366
	<b>(1,326)</b>	<b>102,959</b>
	<b>(150,417)</b>	<b>(68,131)</b>

As to actuarial gains and losses in 2017 there are losses in terms of the combined effect of the update of assumptions (Other gains and losses). These include the value relating to the new mortality assumption used, which resulted in actuarial losses of around €-210,937 thousand, which were partly funded through the extraordinary contribution paid by Banco de Portugal.

The change between the discount rate used at the beginning and at the end of 2017, resulting from the upward movement of interest rates, translated into gains, mirrored in a reduction of the Fund's liabilities (€55,530 thousand).

The amounts recognised in staff costs relating to the Pension Fund – Defined-benefit plan can be summarised as follows:

	2017	2016
<b>Staff costs</b>		
Current service cost <sup>(a)</sup>	13,483	11,669
Interest cost	28,521	34,638
Expected return on the Fund's assets	(29,444)	(36,096)
Increase in liabilities arising from early retirements	10,463	–
	<b>23,024</b>	<b>10,211</b>

(a) Excludes costs borne by staff and other entities

As referred to above, the value associated with the rise in liabilities arising from early retirements in 2017 started to be recognised in staff costs (Note 28).

- Seniority bonuses

The table below shows the most relevant risks:

Risk Sub-category	Risk definition
Interest rate risk	Risk of adverse interest rate movements, resulting in an increase of the liabilities arising from these benefits.
Risk of undervaluation of wage growth rate	Risk of career progress and inflation being higher than assumed in actuarial valuations, resulting in an increase of the liabilities arising from these benefits.

Changes in past service liabilities were as follows:

Past-service liabilities	2017	2016
Value at the beginning of the year	13,200	11,981
Seniority bonuses paid	(1,115)	(1,285)
Current service cost	1,120	965
Interest cost	168	199
Actuarial gains/losses	209	1,340
<b>Value at the end of the year</b>	<b>13,583</b>	<b>13,200</b>

On 31 December 2017 the modified duration of liabilities stood at 10.3 years (2016: 10.2 years). The main actuarial and financial assumptions used in the calculation of these liabilities are the following:

	Actuarial and financial assumptions used			
	31 Dec. 2017	1 Jan. 2017	31 Dec. 2016	1 Jan. 2016
Discount rate	1.354%	1.276%	1.276%	1.663%
Wage growth rate				
1st year	1.750%	1.750%	1.750%	1.000%
Subsequent years	2.575%	2.524%	2.524%	2.207%
Tables used				
- Mortality – Male population	TV 88/90 adjusted by 1 year	TV 88/90	TV 88/90	
Female population	TV 88/90 adjusted by 4 years			
- Disability	1978 – S.O.A. Trans. Male (US)		1978 – S.O.A. Trans. Male (US)	
- Turnover	T-1 Crocker Sarason (US)		T-1 Crocker Sarason (US)	
Statutory retirement age under the Pension Fund – Defined-benefit plan	65 years		65 years	
Statutory retirement age under the general social security scheme (1st year)	66 years and 4 months		66 years and 3 months	

The population considered for the calculation of these liabilities in December 2017 is 1,755 participants (2016: 1,793).

- Pension Fund of Banco de Portugal – Defined-contribution plan

The changes introduced into Banco de Portugal's company-level agreements, published on 22 June 2009 in Boletim do Trabalho e Emprego (work and labour bulletin) provided for the setting up of a supplementary defined-contribution pension plan, funded through contributions from the Bank and its staff, as regards Banco de Portugal staff who started working in the banking sector after 3 March

2009 and are covered by the general social security scheme by virtue of Decree-Law No 54/2009 of 2 March 2009 (Section 1.2 (I) of Note 1). This plan was created in 2010, backdated to 23 June 2009.

This supplementary defined-contribution pension plan, which is contributory with vested rights, is voluntary for the members and compulsory for the sponsor whenever the participant adheres to this pension plan.

Banco de Portugal set up a closed pension fund in order to create an alternative funding vehicle for its employees who wish to join it. Employees can join this Fund or another of a similar nature and are also responsible for choosing an investment profile for their contributions. The funding vehicle can be changed annually on the employees' initiative.

At the end of 2017, the supplementary pension plan funded through this Pension Fund covered 723 members (2016: 664).

When this Pension Fund was set up, Banco de Portugal made an initial contribution of €5 million, which constituted a reserve account in its name, called Reserve account of the sponsor. In 2016 the Reserve account was increased by €20 million with a view to addressing the Fund's operational and financial constraints in connection with the reduced amount under management.

As at 31 December 2017 the assets of the Fund amounted to €26,472 thousand broken down as follows:

Participation units (in value)	31 Dec. 2017	31 Dec. 2016
Reserve account (Note 12)	23,806	23,503
Members' individual accounts	2,666	2,018
	<b>26,472</b>	<b>25,522</b>

Participation units of this reserve account are transferred monthly to the individual accounts of its members by the amounts corresponding to:

- i) The contributions from Banco de Portugal; and
- ii) The contributions from the active members (by withholding each month these amounts when salaries are processed).

The table below shows movements in the Reserve account of the sponsor; the results of the annual revaluation are recognised in the Profit/loss account of Banco de Portugal:

Reserve account of the sponsor	2017	2016
Value at the beginning of the year	23,503	3,770
Transfer of rights to members – contributions of the year	(573)	(510)
Increase in the reserve account	–	20,000
Revaluation of the period (Note 27)	876	243
Value at the end of the year	<b>23,806</b>	<b>23,503</b>

## NOTE 33 • RISK MANAGEMENT

Risk management in Banco de Portugal is designed to ensure the sustainability and profitability of Banco de Portugal itself, safeguarding its independence and guaranteeing its effective participation in the Eurosystem. Therefore, Banco de Portugal has defined and pursues a strict and prudent risk management policy, taking into account the risk profile and degree of tolerance defined by the Board of Directors of Banco de Portugal.

The integrated management of the financial and operational risks is the responsibility of the Risk Management Department in articulation with the Risk Committee and Banco de Portugal's other departments, being monitored by the Board of Auditors and the Board of Directors of Banco de Portugal.

Banco de Portugal also has a Compliance Officer position, responsible for advising and monitoring ethics and conduct, and managing coordination, identification, monitoring, control and mitigation of compliance risk, in Banco de Portugal.

- Financial risk management
  - Risk management policies

Financial risks primarily arise in the management of own investment assets and from the participation in the monetary policy of the Eurosystem and comprise the losses resulting from default by counterparties and issuers, and the fluctuations of financial asset prices, exchange rates and the price of gold.

Monitoring and control of these risks is made through Value at Risk (VaR) and expected shortfall indicators, among others, which are produced and released on a daily basis, as well as through regular sensitivity analysis and stress testing exercises.

Banco de Portugal's own investment assets are managed by the Markets and Reserve Management Department based on a strategic benchmark, reflecting the preferences of the Board of Directors of Banco de Portugal in terms of risk-profitability. This benchmark reflects the discussion of scenarios and forecasts for the main economic and financial variables and the undertaking of various optimisation exercises to determine efficient portfolios. The benchmark – which remains in force for the period of one year and may be reviewed at mid-term – plays an important role in guiding asset management and serves as a basis in setting the allowed asset management deviation margin.

The control of risk in asset management operations is based on the imposition of a number of eligibility criteria and limits which are set out in the Guidelines relating to the management of Banco de Portugal's own investment assets endorsed by the Board of Directors of Banco de Portugal. In the case of credit risk, the said criteria and limits are based on risk ratings assigned by rating agencies and incorporate a qualitative assessment of all information available, including the use of market indicators. Market risk is controlled through the application of limits to VaR, as well as by setting limits to foreign currency positions, and monitoring developments in interest rate risk-sensitivity measures, such as the modified duration. The valuation, assessment, performance allocation and control of limits and restrictions of asset management operations is performed through an information system for the management of reserves and assets, similar to the one used by the ECB and by most NCBs of the Eurosystem. This system also executes the financial settlement of the operations and the monitoring of the positions and main risk measures. Complementing the calculation of VaR/expected shortfall and credit VaR (CVaR)/expected shortfall is state-of-the-art commercial software and the integrated financial risk model developed by the Eurosystem.

The exposure to credit risk arising from monetary policy operations results from the share of the Eurosystem's global exposure imputable to Banco de Portugal, according to its capital key, and from the operations whose risk is directly assumed by Banco de Portugal.

The risk of these operations is controlled by applying rules and procedures defined at Eurosystem level. Follow-up and monitoring is made through a series of aggregate risk indicators produced by the ECB, supplemented by internal measures for the intervention portfolios, created within the framework of the non-standard monetary policy measures.

Banco de Portugal runs a projection exercise of the financial statements and balance sheet risks for the medium term, which enables not only the monitoring of these risks against expected developments in assets and liabilities, but also the constant assessment of the risk coverage levels by Banco de Portugal's financial buffers. This exercise is also used in the assessment of annual movements in the General risk provision (Note 19).

— Fair value

The comparison between the market value and the balance sheet value of the main financial assets measured at amortised cost on 31 December 2017 and 2016 is as follows:

	31 Dec. 2017		31 Dec. 2016	
	Amortised cost	Market value	Amortised cost	Market value
Securities held for monetary policy purposes (Note 7)	46,968,576	49,271,414	32,253,673	31,420,990
Medium-term investment portfolio (Note 10)	5,328,925	5,560,151	4,942,611	5,230,079
	52,297,501	54,831,565	37,196,283	36,651,069

Quotations from active markets were used to assess the market value of the securities, as presented previously.

Quotations from active markets are also used to assess the market value of the financial assets recognised on the financial statements (Section 1.2 (f) of Note 1).

- Operational risk management

Operational risk is related to losses arising from weaknesses, inadequate performance of internal business processes, staff, systems, or third-party actions.

The scope of the operational risk management process includes all processes, activities, functions, tasks, operations and projects that may jeopardise the pursuance of Banco de Portugal's mission and goals arising from legislation, from its participation in the Eurosystem/ESCB/Single Supervisory Mechanism and from other requirements that may have a material negative impact on Banco de Portugal's activity and assets.

Banco de Portugal's operational risk management policy and methodology broadly follow the framework for operational risk management endorsed at Eurosystem/ESCB level, adjusted for the specific aspects of Banco de Portugal, and take into account the international standards as well as the policies and practices followed by the community of central banks.

Banco de Portugal is equipped with tools that provide a comprehensive and consistent outlook of financial and non-financial risks, specialising in the identification and assessment of the main risks facing financial activity. The results of that assessment suggest that the main risks identified are in zones compatible with the tolerance level in force, reflecting the effectiveness of the controls implemented.

## NOTE 34 • LEGAL PROCEEDINGS IN PROGRESS

As at 31 December 2017, various legal proceedings were in progress against Banco de Portugal.

Developments in these proceedings are monitored regularly by the Board of Directors of Banco de Portugal, with technical and legal work undertaken by its Legal Services Department and, in certain cases, external lawyers.

The litigation currently pending falls into the following categories: common lawsuits, administrative lawsuits, precautionary measures, administrative offence proceedings (judicial phase), monitoring of winding up of and monitoring of proceedings related to labour disputes.

Although the Board of Directors of Banco de Portugal regularly monitors administrative offence proceedings and the winding up proceedings of, these do not have a direct impact on the financial statements of Banco de Portugal, and result from the exercise of their legal powers.

The Board of Directors' assessment of Banco de Portugal's current position in the most important lawsuits, considering both the quantity and subject of proceedings in question, is presented below:

- Resolution measure applied to Banco Espírito Santo, S. A. (BES)

By its nature, the resolution process of Banco Espírito Santo, S. A. (hereinafter "BES"), in the form of the transfer of most of that institution's activity and assets to a bridge bank, Novo Banco, S. A. (hereinafter "Novo Banco"), led to a significant increase in litigation, with proceedings brought against Banco de Portugal in (civil and administrative) national courts specifically in virtue of its activity as national resolution authority, under the terms of its Organic Law and the Legal Framework of (*Regime Geral das Instituições de Crédito e Sociedades Financeiras* – hereinafter "RGICSF").

Within Banco de Portugal's competences as resolution authority of the Portuguese financial sector, by deliberation of the Board of Directors of Banco de Portugal of 3 August 2014, under Article 145-G(5) of RGICSF, approved by Decree-Law No 298/92 of 31 December 1992, Novo Banco was established following Banco de Portugal's application of a resolution measure to BES, under the terms of Article 145-C(1) and (3)(c) of RGICSF.

In this regard, as determined by the second point of the deliberation of the Board of Directors of Banco de Portugal of 3 August 2014 (8pm), as amended by the deliberation of the same Board of Directors of 11 August 2014 (5pm), the assets, liabilities, off-balance-sheet items and assets under management of BES were transferred to Novo Banco, under the terms and for the purposes of the provisions of Article 145-H(1) of RGICSF, in accordance with the criteria defined in Annex 2 to the deliberation.

Following the application of this measure, various proceedings were filed in court, as described below.

- i) Court order proceedings for the provision of information and issuance of certificates

Pending at the Administrative Court of the Lisbon District are court order proceedings for the provision of information and issuance of certificates. Most of these proceedings relate to the sale process of Novo Banco to Lone Star, requesting that Banco de Portugal make available that process, in the form of the Share Purchase Agreement and the documents related to the Liability Management Exercise.

Banco de Portugal contested all these lawsuits, both through invocation of supervisory secrecy under Article 80 of RGICSF and on the grounds that disclosure of certain material and information was impossible, as it is reserved under Article 6(6) of the Law for Access to Administrative Documents (*Lei de Acesso aos Documentos Administrativos*).

In certain proceedings, the courts have already delivered judgements. Even those judgements sentencing Banco de Portugal to supply the documents recognise Banco de Portugal's right to redact the documents, in regard to material deemed confidential. In the isolated cases in which Banco de Portugal was sentenced to supply the requested documents without redaction, Banco de Portugal appealed against those decisions, reaffirming the grounds invoked before the Administrative Court of the Lisbon District. These proceedings thus are awaiting their final developments.

Banco de Portugal has not disclosed any document deemed confidential.

In these types of proceedings, if Banco de Portugal is sentenced by a final decision, it will only have to provide information and issue certificates, which will not involve at any time the payment of cash sums, due to which there is no financial risk from these types of proceedings.

#### **ii) Requests for cancellation of the resolution measure applied**

Pending at the Administrative and Fiscal Courts are proceedings requesting the cancellation of the deliberations of the Board of Directors of Banco de Portugal regarding the BES resolution measure, chiefly the deliberations of 3 and 11 August 2014 and 29 December 2015. These lawsuits were mostly brought within the three-month limit following publication of the deliberations of the Board of Directors of Banco de Portugal, in compliance with Article 58(1)(b) of the Administrative Courts Procedure Code (which sets this limit for requesting the cancellation of administrative deeds).

The aforementioned lawsuits do not carry any financial risk for Banco de Portugal, as it would not be sentenced to pay any amount, aside possibly from legal costs, should the lawsuits be judged to be well-founded. In those lawsuits where the cancellation of the applied resolution measure exclusively was requested, Banco de Portugal believes, supported by the opinion of its internal and external legal counsel, that those proceedings do not present financial risks for Banco de Portugal at present, since the legal framework in force at the time of the resolution awards responsibility for any compensation claims to the Resolution Fund.

Indeed, in order to analyse the risk of these lawsuits, the purpose of the Resolution Fund must be taken into consideration, which is, under Article 153-C of RGICSF, to provide financial assistance to the application of the resolution measures adopted by the resolution authority. The rationale behind the resolution regime, both in the version prior to publication of Law No 23-A/2015 and in the current version, is that the Resolution Fund is the entity that provides financial support to the resolution measure and to its implementation. On grounds of consistency, if a resolution measure were to be cancelled by a final decision and the resolution authority deems that, for public interest and financial stability reasons, the effects of the resolution measure should continue, then it shall be the Resolution Fund that supports any compensation payable for the continuation of the resolution measure subject to the judicial decision. However, this compensation is distinct, naturally, from others that may arise from any civil responsibility lawsuits against Banco de Portugal on any other grounds, in relation to which, given the legal and procedural information available at present, we believe success to be more probable than failure.

Most of the proceedings are still in the initial exchange of information phase (filing of the lawsuit through the initial petition and corresponding objection from Banco de Portugal in which the irregularities attributed to the deliberations are always contested, sometimes presenting defence based on grounds of exception) or the curative phase.

Furthermore, in regard to the proceedings contesting the BES resolution measure (i.e. contesting the deliberations of the Board of Directors of Banco de Portugal of 3, 11 and 14 August 2014), the discussion essentially focuses on whether the framework laid down in Article 48 of the Administrative Courts Procedure Code should be applied to these lawsuits (selection of proceedings to be treated with priority).

Finally, the Administrative and Fiscal Court of Porto ruled in favour of Banco de Portugal in case number 2842/14.OBEPT, absolving it and finding proven all the facts alleged by it, including those relating to the recitals of the Deliberation of 3 August 2014 and those contained in the Decision of the European Commission on the authorisation of the resolution on BES. The Court considered as unfounded all the illegalities alleged by the complainant, particularly in regard to the sections of the judgement finding that Banco de Portugal's position was compliant with the Law in regard to the alleged violation of the ownership right of BES shareholders and the alleged violation of the principle of trust in the press releases and statements of Banco de Portugal and the Governor of July 2014. This judgement was appealed and Banco de Portugal presented its respective counter-allegations in June 2017. On 16 October 2017, the Court deemed the appeal inadmissible, and as a result the case was ruled in favour of Banco de Portugal with regard to these issues. In relation to the other proceedings, Banco de Portugal is waiting for their final phases.

As these matters have no doctrinal precedent and only one case-law precedent, which was ruled in favour of Banco de Portugal, it is impossible at present for Banco de Portugal to predict the tendency of the decisions to be delivered by the Courts. However, cancellation of the deliberations in question does not carry any type of financial risk for Banco de Portugal, as in the aforementioned lawsuits payment by Banco de Portugal of a specified cash amount is not sought. In the other cases, given the legal and procedural information available at present, there is no evidence to refute our belief that success is more probable than failure.

### iii) Requests for reimbursement of sums transferred and/or compensation

Pending at the Civil Courts and also the Administrative and Fiscal Courts are proceedings requesting a sentence for Banco de Portugal and/or the Resolution Fund to pay compensation for physical and non-physical damages arising from deposits in BES.

These suits are for the most part in the prior hearing phase. Following defence based on grounds of exception presented by Banco de Portugal and/or the Resolution Fund, a considerable number of favourable decisions have already been handed down, absolving the Resolution Fund and also Banco de Portugal.

In certain cases, the Court was deemed to have no jurisdiction and proceedings were remitted to the Administrative Courts (where, to date, charges have only been brought against the Resolution Fund). There has been a case of the Administrative Courts receiving remitted proceedings and deeming themselves without jurisdiction also, by reason of the subject matter – which led to the further remission of those proceedings (brought against the Resolution Fund) to the Conflicts Court. It should be noted that to date, no civil court has deemed that it has material jurisdiction over the disputes regarding Banco de Portugal.

Regarding the decisions that reached conclusions in regard to the Resolution Fund, around 90% absolved through lack of jurisdiction and around 10% dismissed the request.

As the contentious matters subject to these proceedings have no doctrinal or case-law precedent and involve considerable legal complexity, it is impossible at present for Banco de Portugal to predict the

tendency of the decisions to be delivered by the Courts. However, given the favourable developments to date in these legal proceedings, and the legal and procedural information available at present, there is no evidence to refute our belief that success is more probable than failure.

**iv) Oak Finance (including the proceedings filed by Goldman Sachs, Oak Finance, Guardians of the New Zealand Superannuation Fund and others)**

Pending at the Administrative Court of the Lisbon District are lawsuits brought by Goldman Sachs, Oak Finance and the Guardians of the New Zealand Superannuation Fund, which request the contesting of the deliberations of the Board of Directors of Banco de Portugal of 22 December 2014, 15 September and 29 December 2015.

The lawsuits are at the initial exchange of information phase, with the courts having delivered no formal judgement or judgement on the substance yet.

The fact that these proceedings have no legal precedent and involve considerable legal complexity precludes any prediction of the courts' decisions, or even the decisions' tendency. Therefore an adequate reassessment of these circumstances must be put back until the final developments of the proceedings. However, cancellation of the deliberations in question does not carry any type of financial risk for Banco de Portugal, as payment by Banco de Portugal of a specified cash amount is not sought.

**v) Other requests related to the resolution measure applied to BES**

During 2017, six injunction proceedings were filed, relating to the sale process of Novo Banco to Lone Star. These precautionary measures chiefly requested the suspension of the act of adjudication to that entity and the consequent prohibition from concluding the definitive contract.

In one of these injunction proceedings, the judgement was delivered absolving Banco de Portugal and the Resolution Fund. In the other, in December 2017, Banco de Portugal and the Resolution Fund presented counter-allegations to the appeal, after the judgement delivered had been appealed, which ruled fully in favour of Banco de Portugal. In the other four pending injunction proceedings, the exchange of information phase has ended, and Banco de Portugal is waiting for its final phases.

The provisional decisions delivered to date were all ruled in favour of Banco de Portugal and/or the Resolution Fund.

As these matters have no doctrinal or case-law precedent, Banco de Portugal is unable to predict the tendency of the decisions to be delivered by the Courts. However, the following applies in this regard: (i) a decision on merit in the injunction proceedings identified has already been ruled in favour of Banco de Portugal; (ii) the provisional decisions did not grant injunctions; (iii) the sale process of Novo Banco is now at an end and (iv) the injunction proceedings are instrumental to the main lawsuits (as they only safeguard the rights of individuals for a final judgement in the main lawsuit not to be delivered). These factors indicate that there is no financial risk for Banco de Portugal.

Finally, there are also the lawsuits of the members of the Board of Directors of BES contesting the precautionary retention of the bonds that they had acquired in BES.

- **Resolution measure applied to Banif – Banco Internacional do Funchal, S. A. (Banif, S. A.)**

Within the exercise of its powers as resolution authority of the Portuguese financial sector, and supported by Article 17-A of the Organic Law of Banco de Portugal and Articles 145-E and

146 of RGICSF, on 19 and 20 December 2015, Banco de Portugal applied a resolution measure to Banif – Banco Internacional do Funchal, S. A. (hereinafter “Banif, S. A.”), as it deemed that this was “the only solution to protect depositors and to ensure continuity of the essential financial services provided by BANIF, safeguarding the stability of the financial system with fewer costs for the public purse”. The resolution measure consisted of “declaring that BANIF is failing or likely to fail, according to and for the purposes of Article 145-E(2)(a) of RGICSF” and taking “the steps required towards the sale of the business of BANIF, with Banco Popular Español, S. A., and Banco Santander Totta, S. A.”. Subsequently, Banif, S. A. was sold to Banco Santander Totta, S. A., in accordance with the deliberation of 20 December 2015.

At the end of 2017, there was an increase in lawsuits related to the resolution measure applied to Banif, S. A., since, under Article 324(2) of the Securities Code, the two-year time limit for contractual responsibility started with the subscription of the financial instrument, and was due to end at the end of 2017.

Currently there are 15 administrative lawsuits contesting these deliberations, which are all in the initial exchange of information phase (initial petition and corresponding objection by Banco de Portugal).

Recently, a decision was delivered to join four of the pending proceedings.

There are also 17 civil suits pending at the Lisbon District Court, requesting a sentence for Banco de Portugal and/or the Resolution Fund to pay compensation for physical and non-physical damages arising from investments made in Banif, S. A.. The suits are still in the exchange of information phase.

Finally, injunction proceedings are pending at the Administrative and Fiscal Court of Sintra in relation to one case, in which suspension is requested of the acquisition by PROTEUS ASSET MANAGEMENT, UNIP., Lda. of exclusive control over the business of managing credit and real estate assets of Oitante. Furthermore in these proceedings, in 2018, a judgement ruled in favour of Banco de Portugal, finding the injunction request in question unfounded. This judgement is awaiting confirmation as a final decision.

The fact that these proceedings have no legal precedent and involve considerable legal complexity precludes any prediction of the courts’ decisions, or even the decisions’ tendency. These factors, combined with the general procedural dynamic and the vicissitudes of legal proceedings, impede the determination of the risks involved for Banco de Portugal in this phase and the calculation of possible sums sentenced resulting therefrom. However, given the legal and procedural information available at present, there is no evidence to refute our belief that success is more probable than failure.

In order to analyse the risk of these lawsuits, the purpose of the Resolution Fund must be taken into consideration, which is, under Article 153-C of RGICSF, to provide financial assistance to the application of the resolution measures adopted by the resolution authority. The rationale behind the resolution regime, both in the version prior to publication of Law No 23-A/2015 and in the current version, is that the Resolution Fund is the entity that provides financial support to the resolution measure and to its implementation. On grounds of consistency, if a resolution measure were to be cancelled by a final decision and the resolution authority deems that, for public interest and financial stability reasons, the effects of the resolution measure should continue, then it shall be the Resolution Fund that supports any compensation payable for the continuation of the resolution measure subject to the judicial decision. However, this compensation is distinct, naturally, from others that may arise from any civil responsibility lawsuits against Banco

de Portugal on any other grounds, in relation to which, given the legal and procedural information available at present, we believe success to be more probable than failure.

- Winding up proceedings of Banco Privado Português, S. A. (BPP, S. A.)

There are 24 lawsuits pending in court, corresponding namely to requests to sentence Banco de Portugal or the Deposit Guarantee Fund to pay compensation for balances on accounts opened with BPP, S. A..

In most of the lawsuits, the exchange of information phase has come to an end. For example, rendition of judgement is pending on two lawsuits and in two cases sentences were delivered, one that deemed that there was no need to adjudicate and the other deemed well-founded the exception by *lis pendens* and absolved the defendants.

There is the possibility of financial risk imputable to Banco de Portugal in these proceedings. The fact that these proceedings have no legal precedent and involve considerable legal complexity precludes any prediction of the courts' decisions, or even the decisions' tendency. These factors, combined with the general procedural dynamic and the vicissitudes of legal proceedings, impede the determination of the risks involved for Banco de Portugal in this phase and the calculation of possible sums sentenced resulting therefrom.

However, given the favourable developments to date in these legal proceedings, and the legal and procedural information available at present, there is no evidence to refute our belief that success is more probable than failure.

- Overall assessment of the Board of Directors of Banco de Portugal

The aforementioned increase in litigation, compared to the number of legal proceedings in 2016, has continued to warrant the additional allocation in 2017 of specialised internal resources in the Legal Services Department and the contracting of external legal services, to respond to Banco de Portugal's needs in terms of legal representation in court. The majority of lawsuits described above are in an initial procedural phase, and are thus expected to be conducted over several years. Given their nature and complexity, they may result in additional or complementary legal proceedings.

Lastly, as the lawsuits relating to the resolution measures do not draw upon a sizeable body of case-law precedent – although, those few precedents that have even so cropped up indicate a generally favourable tendency for Banco de Portugal and the Resolution Fund – in this phase it has been deemed impossible to use the criterion of case-law precedent in the prudent assessment of any associated legal or financial risk. However, based on the facts summarised above, and given the applicable legislation and the reasoned opinion of the internal and external legal counsel, the Board of Directors of Banco de Portugal, taking as a basis the information available, firmly believes that the ruling on these lawsuits will not have an unfavourable outcome for Banco de Portugal, and therefore there is no specific provision recognised for the lawsuits in progress as at 31 December 2017.

In compliance with its Organic Law, Banco de Portugal has established a General risk provision (see Section 1.2 (q) of Note 1), movements of which are decided upon by the Board of Directors, to cover risks for Banco de Portugal which are not covered by specific provisions.

## NOTE 35 • RELATED PARTIES

On 31 December 2017, the participating interest of Banco de Portugal in the equity of its related parties was 97.85% in SGFPBP and 100% in Valora, S. A. (Note 10).

All transactions between Banco de Portugal and the related parties are contracted, accepted and conducted under terms or conditions essentially similar to those that would normally apply to independent entities in comparable operations.

Certain members of the Board of Directors of Banco de Portugal form part of the Management Committees of the Resolution Fund, the Deposit Guarantee Fund and the Mutual Agricultural Credit Guarantee Fund. The Management Committees are the bodies responsible for managing these Funds' activity.

The Portuguese State is the owner of Banco de Portugal's equity. In accordance with Article 53 (2) of the Organic Law of Banco de Portugal, the net profit for the year shall be distributed as follows:

10% to the legal reserve, 10% to other reserves to be decided by the Board of Directors and the remainder to the State, as dividends, or to other reserves, as approved by the Minister of State and Finance, on a proposal of the Board of Directors.

## NOTE 36 • NOTE ADDED FOR TRANSLATION

The accompanying financial statements are a translation of the financial statements originally issued in Portuguese. In the event of discrepancies, the Portuguese version prevails.

# 4 External Auditors' Report

## AUDIT REPORT

(Amounts expressed in thousands of Euro – t.euros)

(Free translation of a report originally issued in Portuguese language: In case of doubt the Portuguese version will always prevail – Note 36)

### **REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS**

#### **Opinion**

We have audited the accompanying financial statements of Banco de Portugal, which comprise the balance sheet as at 31 December 2017 (showing a total of 152,964,831 t.euros and equity of 1,862,858 t.euros, including a net profit of 656,484 t.euros), the profit and loss account and the statement of changes in equity for the year then ended, and the accompanying notes to the financial statements, including a summary of the significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view, in all material respects, of the financial position of Banco de Portugal as at 31 December 2017 and of its financial performance for the year then ended in accordance with the accounting principles included in the Chart of Accounts of Banco de Portugal, which are described in Note 1 of the accompanying notes to the financial statements.

#### **Basis for opinion**

We conducted our audit in accordance with International Standards on Auditing (ISAs) and further technical and ethical standards and guidelines as issued by Ordem dos Revisores Oficiais de Contas (the Portuguese Institute of Statutory Auditors). Our responsibilities under those standards are further described in the "Auditor's responsibilities for the audit of the financial statements" section below. We are independent from Banco de Portugal in accordance with the law and we have fulfilled other ethical requirements in accordance with the Ordem dos Revisores Oficiais de Contas code of ethics.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### **Other matters**

The balance sheet as at 31 December 2016, and the profit and loss account and the statement of changes in equity for the year then ended are presented in order to comply with the requirements on publication of accounts. The financial statements of Banco de Portugal for the year ended in 31 December 2016 were examined by another audit firm and the respective audit report, dated 24 march 2017, did not contain any reserves or emphasis of matter paragraphs.

#### **Responsibilities of management for the financial statements**

Management is responsible for:

- the preparation of financial statements that give a true and fair view of Banco de Portugal's financial position and financial performance in accordance with the principles included in the Chart of Accounts of Banco de Portugal;
- the preparation of the activity report of 2017 in accordance with applicable laws and regulations;
- designing and maintaining an appropriate internal control system to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error;

- the adoption of accounting policies and principles appropriate in the circumstances; and
- assessing Banco de Portugal's ability to continue as a going concern, and disclosing, as applicable, the matters that may cast significant doubt about its ability to continue as a going concern.

#### **Auditor's responsibilities for the audit of the financial statements**

Our responsibility is to obtain reasonable assurance on whether the financial statements as a whole are free from material misstatements, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISA will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment, maintain professional skepticism throughout the audit and we also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Banco de Portugal's internal control;
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management;
- conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on Banco de Portugal's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our report. However, future events or conditions may cause Banco de Portugal to cease to continue as a going concern;
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation;
- communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Our responsibility also includes the verification that the information contained in the activity report of 2017 is consistent with the financial statements.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

### **On the activity report of 2017**

It is our opinion that the information included in the activity report of 2017 is consistent with the audited financial statements and, having regard to our knowledge of Banco de Portugal, we have not identified any material misstatements.

Lisbon, 20 March 2018

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Deloitte & Associados, SROC S.A.  
Represented by João Carlos Henriques Gomes Ferreira, ROC

### **EXPLANATION ADDED FOR TRANSLATION**

*(This report is a translation of a report originally issued in Portuguese. Therefore according to Deloitte & Associados, SROC S.A. internal procedures, the report is not to be signed. In the event of discrepancies, the Portuguese language version prevails.)*

## 5 Report and Opinion of the Board of Auditors



**BANCO DE PORTUGAL**  
EUROSYSTEM

Board of Auditors

### Report and Opinion of the Board of Auditors

**2017**

In accordance with the provisions laid down in Article 43 of the Organic Law of Banco de Portugal, the Board of Auditors monitors the business of Banco de Portugal and the observance of the laws and regulations applicable thereto and, among other functions, issues its opinion on the Financial Statements presented by the Board of Directors.

During the course of 2017, the Board of Auditors, in use of the above-mentioned powers, monitored the activity of Banco de Portugal through (i) its members' participation, without voting rights, in the meetings of the Board of Directors, (ii) the review of the minutes of the Executive Committee for administrative and staff-related issues and (iii) the regular monitoring of Banco de Portugal's functions and activities, which fall within its remit under the regulatory framework in force.

The Board of Auditors monitored with particular attention the functions and activities performed by (i) risk management, internal control and compliance, (ii) financial reporting, (iii) external auditing, and (iv) internal auditing. Monitoring was essentially focused on (i) review and discussion of a number of reports and information produced by the Accounting Department, the Risk Management Department, the Audit Department and other departments and structural units in Banco de Portugal, responsible for or involved in the performance of said activities and (ii) meetings and requests for additional information on subjects being monitored, in particular, situations deemed to have significant risk, whenever necessary or convenient.

The Board of Auditors also monitored compliance with the accounting policies and practices adopted, focusing in particular on the financial information preparation and disclosure process and on the evaluation of the internal control systems' effectiveness.



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The Board of Auditors also analysed the financial information contained in the Management Report and Accounts for the fiscal year ended on 31 December 2017 – approved in the meeting of the Board of Directors held on 13 March 2018 – and discussed the conclusions of the external audit work carried out by Deloitte & Associados – Sociedade de Revisores Oficiais de Contas S. A., which issued its opinion without any qualification or emphasis of matter.

In the monitoring of annual balance sheet developments, the Board of Auditors paid particular attention to financial risks developing in the securities portfolios held for monetary policy purposes and the portfolios of euro assets and foreign reserves not directly related with monetary policy, as well as their coverage by general risk provisions and other own funds of Banco de Portugal.

The developments in Profit for the year reflect the impact of various relevant factors, including (i) the significant strengthening of the securities portfolios held for monetary policy purposes, (ii) the negative results in financial assets and positions and unrealised foreign currency losses and (iii) the reduction in general risk provisions covering risks materialising during the year, involving assessment of short and medium-term risks, as deemed prudent.

In addition, the Board of Auditors analysed the proposal for the distribution of profit for 2017, to the amount of €656,484,195.98. The Board of Directors, in accordance with Article 53 (2) of the Organic Law of Banco de Portugal, will submit to the Minister of Finance the following proposal for the distribution of profit:

– 10% to the legal reserve .....	€65,648,419.60
– 10% to other reserves .....	€65,648,419.60
– Dividends to the State .....	€525,187,356.78

In light of the above, the Board of Auditors raises no objection to the approval of the 2017 Financial Statements of Banco de Portugal, nor to the proposal for the distribution of profit mentioned above.



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The Board of Auditors wishes to express to the Governor, the Board of Directors and the entire staff of Banco de Portugal its appreciation for their cooperation.

Lisbon, 20 March 2018

**The Board of Auditors**

João Costa Pinto

António Gonçalves Monteiro



