

Annual Report

Activities and Financial
Statements 2018



BANCO DE
PORTUGAL
EUROSYSTEM

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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;
- 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

In 2018, amid major challenges to monetary policy and the financial system and against a backdrop of fast technological change, Banco de Portugal focused on always doing better in complying with its mission, by promoting best practice, reaping the benefits of innovative methodologies and systems, and investing in developing its human resources, its most precious asset.



Banco de Portugal has remained true to its commitment to rigour, development and self-improvement, present across all the priorities set out in its Strategic Plan for 2017-20, in order to ensure effective, efficient and transparent action in carrying out all missions entrusted to it.

In 2018 Banco de Portugal's activities were carried out against a background of multiple challenges, among which I would like to highlight four:

- developments in the Eurosystem's monetary policy – especially non-standard measures – while preserving favourable financing conditions for the euro area economy;
- the steering of supervisory action towards the sustainability and strengthening of the Portuguese banking system, with a special focus on internal governance and control mechanisms, credit risk, capital and liquidity positions, and business models;
- the safeguarding of the Portuguese financial system's stability, including ongoing analysis of systemic risks and vulnerabilities and the adoption of a macroprudential measure aimed at mitigating the risks associated with new credit agreements with consumers;
- the impact of technological change and digital transformation on financial intermediation and payment systems and the necessary adjustment of Banco de Portugal's powers and organisational structure.

In 2018 Banco de Portugal continued to enhance its governance model, organisation and processes, using Eurosystem best practice as a benchmark. The changes introduced also aimed at responding to the new requirements arising from the widening of the missions entrusted to it and from digital transformation. By way of illustration, the changes included the strengthening of the legal framework and of compliance with professional ethics and rules of conduct, the drawing-up of a data protection action plan, and the introduction of changes to the organisational structure of a number of departments.

In 2018 Banco de Portugal also continued to invest strongly in the development of its staff members'

technical, behavioural and management skills. Human resources development and the commitment from all staff members in the performance of their tasks will continue to be instrumental for Banco de Portugal to consolidate the reputation and trust it has achieved at both national and international level.

Banco de Portugal continued to produce analyses and research on the Portuguese economy, the euro area economy and the financial system, for it considers it essential to know, understand and anticipate economic and financial developments. In its capacity as national statistical authority, Banco de Portugal produced and released monetary, financial, foreign exchange and balance of payments statistics. Research and statistics have played a key role in monetary, economic and prudential policy advice, and publishing them helps disseminate knowledge and promote public debate.

A decade after the international financial crisis, the European Union financial system, including the Portuguese banking system, is more capitalised and under greater scrutiny in the wake of the deep post-crisis regulatory and institutional reforms (some of which are still incomplete, such as the Banking Union), and new supervisory models and practices. These reforms are key to reinforcing economic agents' confidence.

However, there are still numerous, diverse challenges and uncertainties (of an economic and financial nature, as well as political, geopolitical and technological, inter alia) for which euro area decision-makers, including Eurosystem central banks, must be vigilant and prepared.

Banco de Portugal will continue to be alert and committed to addressing the challenges faced by the Portuguese financial system. Its influence on decisions with an impact on the Portuguese and euro area economies will depend on its assigned mandate and its ability to anticipate and address the ensuing challenges at both domestic and European level.



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 Laginha de Sousa

6 Director Ana Paula de Sousa Freitas Madureira Serra

* As at 31 December 2018. The composition of the Board of Directors remained unchanged throughout the year.



1

3

5

Board of Auditors*

Chair

Nuno Gonçalves Gracias Fernandes**

Members

Member – Statutory Auditor

António Gonçalves Monteiro**

Member

Margarida Paula Calado Neca Vieira de Abreu**

* As at 31 December 2018. João António Morais da Costa Pinto ceased functions as Chair on 30 April 2018.

** Appointed by Decision of the Secretary of State Assistant and of Finance No 4392/2018 of 27 April 2018, published in the Official Gazette No 86, Series II, of 4 May 2018. António Gonçalves Monteiro was appointed to a second term.



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

Nuno Gonçalves Gracias Fernandes**

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 2018.

** From 1 May 2018 onwards, after taking office as Chair of the Board of Auditors, João António Morais da Costa Pinto performed this role until 30 April 2018.





Heads of departments, regional delegations and district agencies*

Heads of departments

General Secretariat (SEC) José Gabriel Cortez Rodrigues Queiró
Compliance Office (GdC) Sofia Corte Real Lencart e Silva Pimentel
Data Protection Office (GPD) Maria Fernanda dos Santos Maças
Strategy and Organisation Development Division (SECEO) Dinora Maria Costa Fernandes Alvim Barroso
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) Nuno Jorge Teixeira Marques Afonso Alves
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 Seródio 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 João Ramos Rente
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 2018.

Specialised Committees*

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

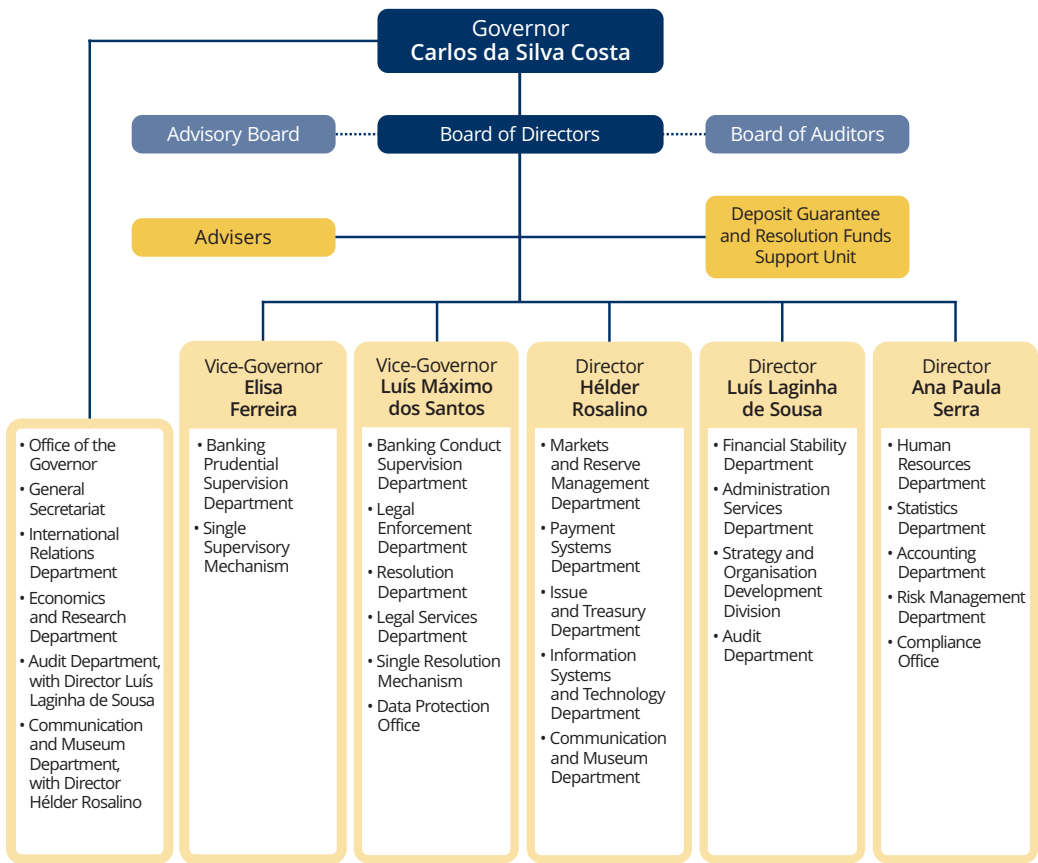
Committee for Risk and Internal Control (CR)
Chair Carlos da Silva Costa

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

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

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

Figure 1 • Organisational chart of Banco de Portugal as at 31 December 2018

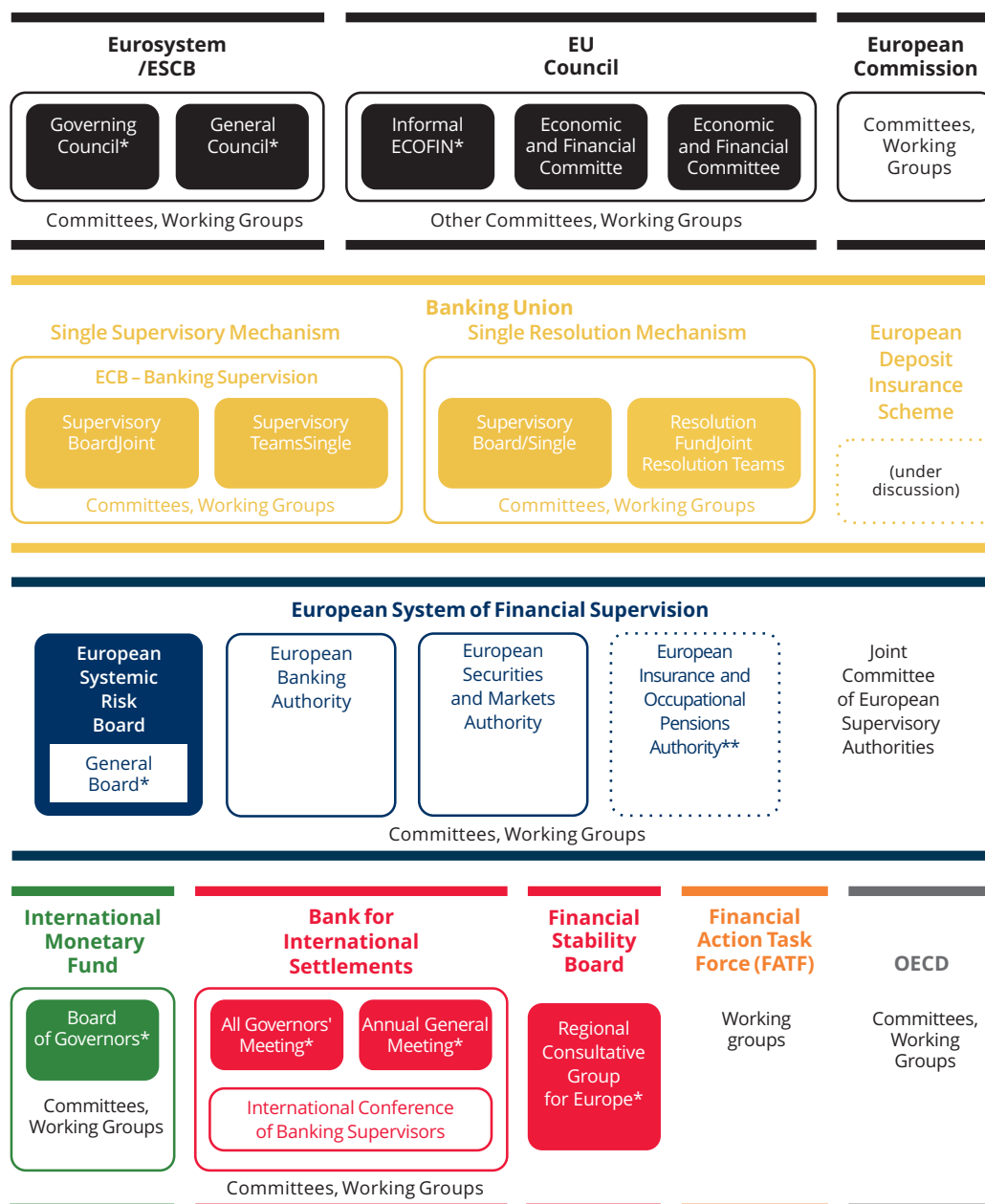


Source: Banco de Portugal.

* As at 31 December 2018.

** As at 31 December 2018.

Figure 2 • Main international bodies: representation of Banco de Portugal



Source: Banco de Portugal | * Governor's participation. ** Without Banco de Portugal's participation.

Chart 1 • Evolution of the international activity of Banco de Portugal

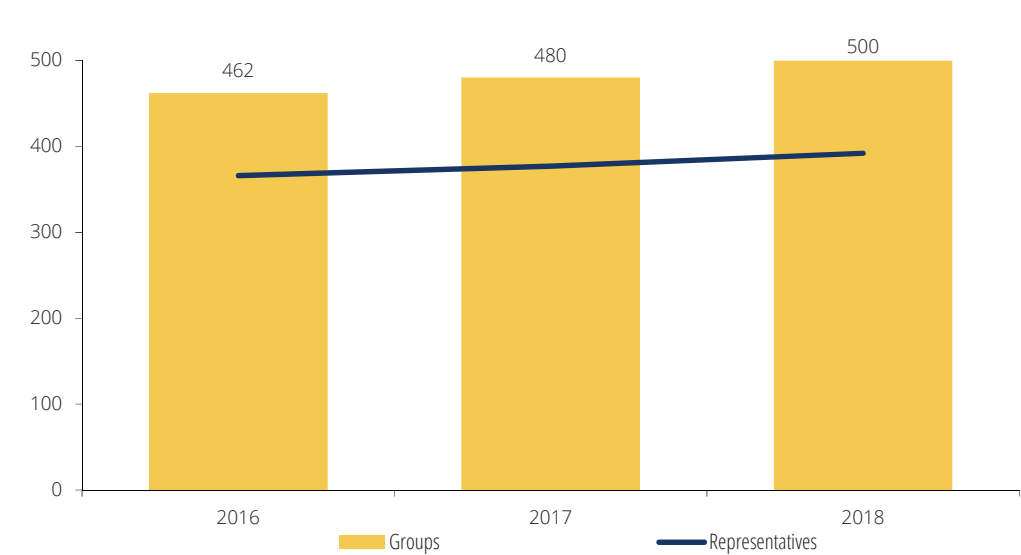
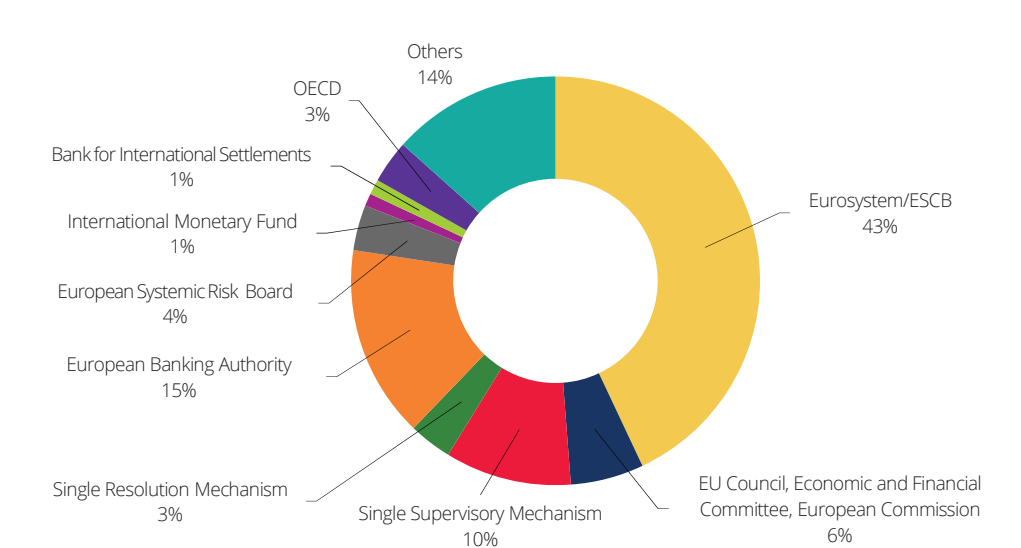


Chart 2 • International representation structure in 2018 | In group percentage





I Activity

- 1 Monetary authority
- 2 Financial stability
- 3 Knowledge creation
and sharing
- 4 Internal management

Executive summary

In 2018 Banco de Portugal carried out its mission to maintain price stability and safeguard financial stability in accordance with the priorities set out in the Strategic Plan for the four-year period 2017-20. At the European level, Banco de Portugal participated in activities related to the standardisation process of the Eurosystem's monetary policy and the reinforcement of the legal framework applicable to credit institutions and investment firms, in prudential and banking conduct and resolution terms, and also in regard to money laundering and terrorist financing prevention. At the national level, 2018 was marked by the response to the challenges of banking system sustainability and the expansion of Banco de Portugal's responsibilities in retail banking market supervision.

Monetary authority

In its capacity as a Eurosystem national central bank, Banco de Portugal shares responsibilities in the design and implementation of the euro area monetary policy. In 2018 the Governing Council of the European Central Bank (ECB) maintained its accommodative monetary policy, keeping favourable financing conditions for the euro area economy. In December it decided to end monthly net purchases under the asset purchase programme, but announced that it will continue to reinvest the principal payments from maturing securities for an extended period of time after it starts raising the key ECB interest rates.

Banco de Portugal ensured implementation of monetary policy operations with resident credit institutions and the purchase of financial assets under the asset purchase programmes. The average balance of monetary policy portfolios and of purchases under the asset purchase programme on Banco de Portugal's balance sheet recorded an increase, even if less significant than in 2017, to €49,319 million.

Banco de Portugal managed its own investment asset portfolio, composed of assets denominated in euro and in foreign currency and gold, as well as part of the ECB's foreign exchange reserves. As at 31 December 2018, Banco de Portugal's own investment asset portfolio amounted to €33,688 million, i.e. 2.5% less than in 2017, mainly due to the decision to reduce assets amid very low or even negative interest rates in the euro area. The ECB's foreign reserve portfolio, managed with Lietuvos bankas, amounted to USD 1,764 million on the same date (€1,541 million).

In 2018 the new Legal Framework for Payment Services and Electronic Money entered into force, approved by Decree-Law No 91/2018 of 12 November 2018, which transposed into the Portuguese law the revised Payments Service Directive (PSD2). Among other changes, this Decree-Law acknowledges and regulates two new types of payment services, establishes more demanding security conditions for the execution of electronic payment transactions and sets forth new reporting obligations for payment service providers. Having been appointed the competent authority responsible for implementing this framework, Banco de Portugal encouraged payment service providers to adopt the new requirements on a timely basis, which required, inter alia, renewal of the authorisations granted to payment institutions and electronic money institutions that started operating prior to the entry into force of the directive.

In September 2018 the Interbank Clearing System (SICOI) – which processes most payment transactions by private individuals and enterprises in Portugal – started allowing instant transfers. With instant transfers, funds are provided to the beneficiaries within at most 10 seconds, irrespective of the date and time in which the transaction takes place. Banco de Portugal is connected to the

Eurosystem's instant payment settlement service, the TARGET Instant Payment Settlement (TIPS), which was launched on 30 November 2018.

In addition, it participated in the preparatory work for the issue of the last two denominations of the Europa series – the €100 and €200 banknotes – that will enter into circulation on 28 May 2019. It also entered into an agreement on the swap and delivery of excess euro circulation coins with Národná banka Slovenska, which caused 10 million €2 coins that were in excess in Portugal to be sent to Slovakia, in exchange for 20 million €1 coins, in excess in Slovakia.

Financial stability

Safeguarding the stability of the Portuguese financial system is one of Banco de Portugal's tasks. To accomplish this task, the Bank has regulatory and supervisory powers, as well as legal enforcement and resolution powers. Banco de Portugal shares responsibilities in the prudential supervision of credit institutions in the euro area, within the scope of the Single Supervisory Mechanism, and in the field of resolution, under the Single Resolution Mechanism. Simultaneously, it is represented in various national and international fora in financial regulation and supervision, in particular the National Council of Financial Supervisors, the European Systemic Risk Board and the European Banking Authority.

In 2018 Banco de Portugal participated in the development of new European Union legislation and regulations aiming to reinforce the legal framework applicable to credit institutions and investment firms, in prudential and banking conduct and resolution terms, and also in regard to money laundering and terrorist financing prevention. It took part in the work for completion of the Banking Union and revision of the functioning of the European System of Financial Supervision. It drafted a significant body of legislation and opinions requested by the Government on legislative proposals, including a preliminary draft of a "Banking Activity Code".

In the performance of its national macroprudential authority functions, throughout the year the Bank promoted a continuous analysis of systemic vulnerabilities and risks. With the purpose of ensuring that credit institutions and financial companies adopt prudent criteria when granting new credit, Banco de Portugal adopted a macroprudential measure in the form of a recommendation, introducing limits to some of the criteria used by credit institutions in the consumers' creditworthiness assessment within the scope of credit relating to residential immovable property, credit secured by a mortgage or equivalent guarantee, and consumer credit.

Banco de Portugal acted on the sustainability challenges posed to the Portuguese banking system, promoting a strong scrutiny of institutions' internal governance and control mechanisms, the reinforcement of capital and liquidity positions, the strengthening of business models and the reduction of non-performing loans and other problem assets, based on a bank-to-bank intervention. In this context, there were positive developments in the capital position, liquidity ratios, profitability indicators – that reached peaks since the financial crisis to values comparable to the average of euro area institutions – and asset quality indicators – in particular the stock of non-performing loans, which have fallen from a record high of €50.5 billion in June 2016 to €25.9 billion in December 2018.

Banco de Portugal monitored developments in terms of financial products and services innovation in the national and international fora in which it participates, hosted meetings with fintechs, created a dedicated contact channel (Fintech+) and, jointly with the Insurance and Pension Funds Supervisory Authority (*Autoridade de Supervisão de Seguros e Fundos de Pensões*), the Portuguese Securities Market

Commission (*Comissão do Mercado de Valores Mobiliários*) and Portugal Fintech, it launched Portugal FinLab, a communication platform linking financial sector innovators to Portuguese regulators.

With the entry into force of the legal framework for credit intermediaries and the new legal framework for mortgage credit, Banco de Portugal's tasks now involve the authorisation, registration and supervision of the activity of credit intermediaries, as well as the certification and monitoring of training entities of credit intermediaries and of employees of the institutions involved in marketing loans for house purchase. The scope of Banco de Portugal's banking conduct supervision was also widened to include the supervision of the activity of payment initiation service and account information service providers, by virtue of the entry into force of the new framework governing payment services and electronic money.

Over the course of the year, Banco de Portugal oversaw the conduct of the supervised entities in the marketing of retail banking products and services, monitoring the entry into force of new regulations in the areas of mortgage credit, payment accounts, structured deposits and payment services. Amid growing marketing of retail banking products and services through digital channels, the Bank sought to ensure that supervised institutions comply with the duties of transparency of the information and assistance also in these channels. On the Bank Customer Website, Banco de Portugal launched a tool – the Fees Comparator – that allows users to compare 93 maximum fees charged by all the institutions offering services linked to payment accounts in Portugal.

So as to prevent and repress illicit financial activity, Banco de Portugal conducted inquiries in 218 proceedings and issued public warnings to 19 entities not authorised to conduct financial activity. It also examined 10 proceedings for a possible withdrawal of the authorisation of credit institutions, financial companies and payment institutions.

In terms of money laundering and terrorist financing prevention, Banco de Portugal carried out 20 inspections, issued 198 supervisory measures, and assessed the implementation of 354 measures issued following inspections carried out in previous years.

In 2018, following its supervisory action, the Bank initiated 113 administrative offence proceedings and concluded 195 proceedings.

Under the Single Resolution Mechanism, Banco de Portugal participated in the development of policies and methodologies to be adopted in the planning, implementation and enforcement of resolution measures. It also contributed to the approval of resolution plans for the Portuguese groups and credit institutions for which the Single Resolution Board is directly responsible, including for determining the Minimum Requirement for own funds and Eligible Liabilities (MREL). The Bank prepared the first resolution plans for institutions for which it is directly responsible as the national resolution authority, and worked further on the development of methodologies for the implementation of a simplified system of obligations with a view to accommodate the heterogeneity of the Portuguese banking system.

It also continued its work on the resolution measures applied to BES and BANIF. In this respect, the Bank provided support to the Resolution Fund in the follow-up of the agreements related to the sale of Novo Banco and in the monitoring of Oitante's activities. In addition, it delivered its opinion on several consultations and requests related to the perimeters for the transfer of rights and obligations set in the context of BANIF's resolution, and collaborated with the ECB in the proceedings that led to the withdrawal of BANIF's authorisation to conduct business.

Banco de Portugal upheld the legality of the resolution and sanctioning measures within the scope of a high number of proceedings resulting especially from the resolution measures applied to BES and BANIF. In the litigation handled by Novo Banco in Portuguese courts and foreign jurisdictions

monitored by Banco de Portugal, reference should be made to the court ruling delivered by the UK's Supreme Court on the "Oak Finance" case. Therein Portuguese courts were recognised as having exclusive jurisdiction to decide on the dispute, the matter of which was related to the fulfilment of obligations that Banco de Portugal had asserted to be BES's responsibility. This judgement is expected to have repercussions on litigation in other jurisdictions.

Knowledge creation and sharing

Banco de Portugal produces analyses and studies on the Portuguese economy, the euro area and financial system, and, in its capacity as national statistical authority, gathers and draws up monetary, financial, foreign exchange and balance of payments statistics.

In 2018 Banco de Portugal published macroeconomic analyses and projections through the Economic Bulletin and the assessment of vulnerabilities and risks for financial stability through the *Financial Stability Report*, complemented by an analysis of relevant topics for understanding developments as described in each issue of these publications. Research focused on three priority areas defined in the research agenda for 2017-20: new challenges for monetary policy and financial stability; Portuguese economic growth in the euro area context; and the future of public institutions and policies in Portugal and the European Union. 47 studies were completed and 97 were in progress at the end of 2018; another 16 studies were in a final phase of revision. There were 135 external co-authors involved in the preparation of all these studies. As at 31 December Banco de Portugal's Microdata Research Laboratory (BPLim), located at the Porto Branch, hosted 34 scientific projects.

In its capacity as national statistical authority, the Bank released 287,000 statistical series and shared 792,000 series with international organisations. It redesigned the Central Credit Register – the database on loans granted by institutions in Portugal. This redesign allowed the Bank to comply with the first date of reporting to the AnaCredit system – the new Eurosystem database on bank loans granted to firms in the euro area – and to enhance the quality of the information it works with and provides to the financial system (for the risk assessment of customers and of those requesting credit to institutions), as well as to citizens and firms (through credit liabilities reports, which can be consulted on Banco de Portugal's website).

As a complement to the knowledge produced in its core business, Banco de Portugal organised several national and international conferences, which involved speakers of high repute in the economic and financial area. Among other relevant events, in May the Bank organised the 1st *Payment Systems Forum Conference – A new era in payments?*, which brought together in Lisbon national and European representatives of the payment systems field to discuss the impact of technological innovation and the new European legislation in this area. In September it hosted the *Conference on Banking Conduct Supervision: new challenges ten years after the financial crisis*, attended by delegations of supervisors from around the world, in which the agenda for banking conduct supervision and its growing challenges were discussed, in particular those arising from financial innovation. In November, Banco de Portugal received the Chair of the Supervisory Board of the ECB, Danièle Nouy, at the conference *Four years of the Single Supervisory Mechanism: lessons and future challenges*, which was attended by representatives of the major Portuguese banks. In the same month, the ninth *Portuguese Economic Development in the European Area* conference also took place, with John Van Reenen as keynote speaker, an economist at the Massachusetts Institute of Technology. In December, Jean-Victor Louis, Emeritus Professor at Université Libre de Bruxelles, was the keynote speaker of the first law seminar of Banco de Portugal on the reform of the Economic and Monetary Union. Banco de Portugal also welcomed the governors of Banco de España, Luis Linde, and the

Sveriges Riksbank, Stefan Ingves, as well as the president of the Standard Chartered group, José Viñals, who presented lectures on topics related to the challenges to the financial system and European integration.

The Bank reinforced its communication initiatives, including on social media, with the purpose of promoting knowledge on topics related to its core business. It published 241 press releases, 62 addresses from its Board members and 43 decoders. As a complement to accounts already opened on LinkedIn, Twitter and Youtube, it joined Instagram, pursuing the effort to diversify its contact channels with the public. It also launched a new regular publication, *Relatório da Implementação da Política Monetária* (the *Report on Monetary Policy Implementation*, available in Portuguese only).

Banco de Portugal released information on developments affecting bank customers, with emphasis on the macroprudential measure applied to new consumer credit agreements, the launch of the Fees Comparator, regulatory changes in mortgage credit and minimum banking services, and the availability of the new credit liabilities reports. It launched the financial education campaign #ficaadica to raise young people's awareness to the care needed when using digital channels, in order to prevent over-indebtedness and financial fraud. In the Money Museum, the Bank unveiled a financial education centre, which complemented its educational offering in this field. Taking advantage of the range covered by its network of branches and delegations, it organised 843 training initiatives throughout the country, with a total of 23,815 participants.

Under its social responsibility policy, Banco de Portugal developed a series of initiatives primarily aimed at promoting the inclusion of children and teenagers, namely by encouraging success at school and reading.

Banco de Portugal held 130 technical cooperation initiatives with its counterparts from emerging and developing countries, 93 of which with Portuguese-speaking countries. It also entered into two new technical cooperation agreements with the Monetary Authority of Macao and Bank Al-Maghrib (the central bank of Morocco).

Internal management

In 2018 Banco de Portugal continued to refine its organisational and internal governance model, with a view to incorporating Eurosystem best practice and to efficiently manage the resources placed at its disposal.

In response to the new requirements related to digital transformation and the widening of Banco de Portugal's tasks, changes were introduced to the organisational structure of a number of departments, covering, among others, prudential and market conduct supervision, payment systems oversight, communication, information systems and technologies management, and legal services.

Banco de Portugal's Data Protection Office performed a thorough diagnosis on the manner in which Banco de Portugal processes personal data and launched an action plan to ensure compliance with the General Data Protection Regulation, which entered into force on 25 May 2018.

The internal rules on ethics and business conduct were strengthened, by putting in place more systematic procedures to prevent conflicts of interest and to monitor the limits to private financial transactions. In parallel, the European Central Bank approved a Single Code of Conduct for members of decision-making bodies in central banks and of the authorities integrating the European System of Central Banks and the Single Supervisory Mechanism, which harmonised the applicable ethical rules and control mechanisms.

The Bank pursued an integrated management policy of the financial and operational risks to which it is exposed when carrying out its work. In this context, a statement of risk acceptance principles was approved, describing the tolerance level for the risks to which the institution is exposed.

36 internal audits were carried out, 32 of which were exclusively domestic and four related to systems and procedures that are common or shared with the European System of Central Banks, the Eurosystem and the Single Supervisory Mechanism. Banco de Portugal's internal audit function underwent a quality assessment by an accredited entity, which concluded that the audit function was compliant in all areas.

Banco de Portugal invested further in the qualification of its staff, namely with a strong emphasis on training and development of formal, technical and behavioural skills.

In 2018 the new company-level agreements were finalised between Banco de Portugal and the Portuguese Financial Sector Federation (*Federação do Setor Financeiro*), the National Union of Qualified Bank Employees (*Sindicato Nacional dos Quadros Técnicos Bancários*) and the Independent Union in Banking (*Sindicato Independente da Banca*). These agreements allowed Banco de Portugal to be in line with the new collective labour agreement for the banking sector and to adjust the internal employment framework to the new working environments and the new human resource management paradigms.

Banco de Portugal implemented a new technological platform allowing for the integrated management of information produced and compiled by the different business areas. Going forward, this solution will make it possible to streamline and standardise information requested to third parties and to enhance the quality, completeness and timeliness of its working data.

As regards innovation, Banco de Portugal carried out experimental work with new technological platforms, including a Eurosystem project in the field of monetary policy. It also participated in the Eurochain project, launched by the ECB to evaluate the possibility of implementing digital central bank money.

In 2018, seizing a market opportunity, Banco de Portugal purchased a plot of land in Alto dos Moinhos. This purchase is part of the objective of constructing a new office building in Lisbon making it possible to concentrate the services that are presently scattered across four buildings in different locations in the city. The decision on the location and future construction of the new office building has yet to be made, with all possible alternatives still being considered in order to reach the best solution for Banco de Portugal and for the city.

1 Monetary authority

This chapter describes Banco de Portugal's actions in 2018 as monetary authority of the Eurosystem / European System of Central Banks (ESCB), the first Broad Strategic Guideline established for the four-year period 2017-2020, aimed at actively contributing to the single monetary policy.

Banco de Portugal's responsibilities in the definition of euro area monetary policy are shared within the Eurosystem and their primary objective is to maintain price stability. Monetary policy decisions are taken by the Governing Council of the European Central Bank (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. The Governing Council of the ECB met 21 times in 2018. Eight of these meetings related to monetary policy.

The preparation and monitoring of the decisions taken by the ECB bodies involve the Eurosystem/ESCB Committees, and their sub-structures, where Banco de Portugal is also represented. This representation is a key part of retaining influence in interactions with the ECB, at various levels and times. In 2018, Banco de Portugal participated in over 200 committees, working groups and other structures of the Eurosystem/ESCB, on issues connected to central bank activities in general (Figure I.1.1).

Banco de Portugal also intervenes in other international economic and financial institutions worldwide, such as the International Monetary Fund (IMF), the Bank for International Settlements (BIS) and the Organisation for Economic Co-operation and Development (OECD).

Figure I.1.1 • Committees within the Eurosystem/ESCB



Source: ECB, Banco de Portugal.

The Governor of Banco de Portugal is a member of the IMF Board of Governors and Banco de Portugal is the country's representative at that institution, taking on several financial responsibilities and other responsibilities related to following the Fund's agenda and decision-making process.

The constituency of which Portugal is a member at the IMF and World Bank met in Lisbon in February 2018. The meeting was organized in collaboration with the Ministry of Finance and brought together governors of the constituency's member countries at both institutions. The debates focused on the main topics on the policy and institutional agendas of the IMF and the World Bank as well as climate change, its macroeconomic impact and the role of public policies. Banco de Portugal participated in the Spring and Annual Meetings of the IMF/World Bank, which discussed issues such as world economic performance, risks and outlook, policy recommendations and the role of international co-operation.

The IMF's agenda in 2018 included critical discussions regarding the institution's bilateral and multilateral supervision, policies for designing programmes and conditionality, and innovation in financial products and services. As part of the debate on further strengthening the global financial safety net, work continued on the IMF's 1^{5th} General Review of Quotas.

Banco de Portugal participated in the discussions with the staff teams that visited Portugal for the purposes of the IMF's Article IV Consultation, in May, and regarding the post-assistance programme surveillance by European institutions, in June and November, the latter jointly with the IMF's post-programme monitoring mission. In December 2018, Portugal completed the early repayment of its outstanding debt to the IMF pursuant to the Economic and Financial Assistance Programme, returning to the regular bilateral relationship with the institution.

The Bank for International Settlements is a privileged forum for international co-operation and discussion among central banks. Banco de Portugal participates in the Annual General Meeting and in the bimonthly governors' meetings. Throughout the year, besides taking stock of the global economic and financial performance, the following issues were debated: (i) international financial regulation and implementation of Basel III reforms; (ii) market infrastructures; (iii) macroprudential policy frameworks; and (iv) central bank governance.

As to the OECD, Banco de Portugal participated in preparatory meetings for Portugal's Economic Survey.

1.1 Monetary policy

In 2018, the ECB's agenda focused on the assessment of the euro area's economic outlook, challenges ahead, risks and their impact on price stability. Monetary policy followed an accommodative stance, with decisions on the end of net asset purchases under the asset purchase programme (APP) and on the future reinvestment policy stance.

In 2018 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 APP totalled €30 billion, between January and September, being scaled down to €15 billion in the remaining months of 2018. At its last meeting of 2018, on 13 December, the Governing Council decided that the net purchases under the asset purchase programme (APP) would end in December 2018 and announced the continuation of the policy of reinvesting, in full, the principal payments from maturing securities for an extended period of time past the date when it starts raising the key Eurosystem interest rates.¹

1. Monetary policy press releases are available for consultation on the [ECB website](#).

Under the decentralised implementation of monetary policy in the euro area, Banco de Portugal conducted the monetary policy operations with credit institutions established in the country – by carrying out open market liquidity-providing and liquidity-absorbing operations, processing lending facilities and managing the underlying collateral – and purchased financial assets under the asset purchase programmes. It also assessed the counterparty status of the institutions established in Portugal, produced the daily forecast of the liquidity needs of the domestic banking system and monitored compliance with the minimum reserve requirements.

Of the 36 institutions established in Portugal that were eligible to access the Eurosystem's open market operations and standing facilities, only 12 participated in at least one operation. The Eurosystem conducted 127 open market operations and the resident institutions participated in 58 of those operations (71 operations in 2017). Recourse to the deposit facility and marginal lending facility greatly decreased (Table I.1.1), mainly driven by a smaller use of deposit facilities. Although greater use of this facility could be expected in a context of liquidity surplus, as was the case in 2018, it did not happen largely due to lack of incentive, given that excess reserves are remunerated at the deposit facility rate (-0.40%). The average balance of open market operations and standing facilities with resident counterparties continued the downward trend of the last few years – particularly visible since the APP started – and totalled €20,621 million in 2018.

Table I.1.1 • Monetary policy implementation – main indicators

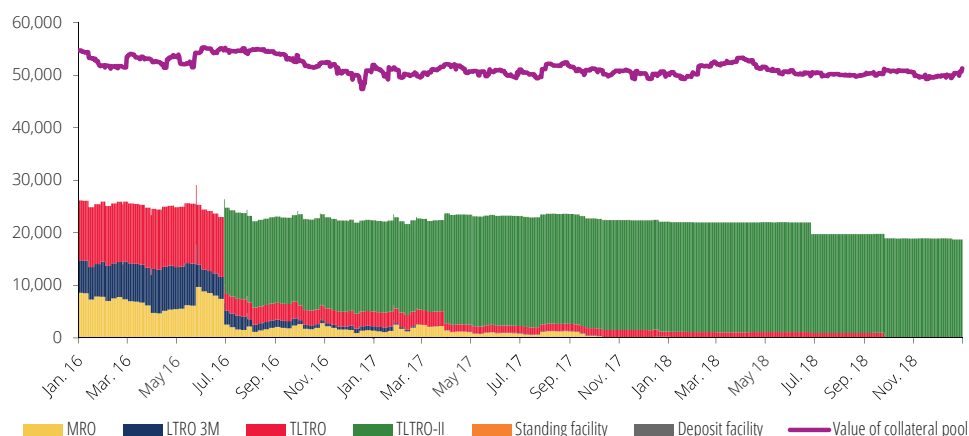
	2016	2017	2018	Δ 2018-2017
Number of Eurosystem open market operations	136	126	127	1%
Number of open market operations in which resident counterparties participated	83	71	58	-18%
Number of standing facility operations involving resident counterparties	60	52	22	-58%
Number of eligible (resident) counterparties	37	37	36	-3%
Number of (resident) counterparties participating in open market operations and standing facilities	25	14	12	-14%
Average balance of open market operations and standing facilities (resident counterparties, EUR millions)	24,023	22,862	20,621	-10%
Average balance of collateral pools (resident counterparties, EUR millions)	52,938	50,772	50,728	0%
Average balance of monetary policy portfolios / APP (EUR millions)	24,729	40,174	49,319	23%

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

Regarding the type of open market operations and standing facilities in Banco de Portugal's balance sheet (Chart I.1.1), main refinancing operations (MRO) have been replaced almost entirely with longer-term refinancing operations, particularly the second series (TLTRO-II), which were carried out between June 2016 and March 2017. By the end of 2018, TLTRO-II accounted for almost all the refinancing obtained by Portuguese counterparties with the Eurosystem. This may have to do with the conditions of these operations that include stable four-year funding at an interest rate that matches or is lower than MRO interest rates (one-week maturity).

As regards the Eurosystem's list of assets eligible as collateral, Banco de Portugal analysed the eligibility of securities traded in Portuguese markets, having identified and reported 27 new securities eligible and introducing 1,587 updates in the list. At the end of 2018, the Eurosystem's list contained 124 securities reported by Banco de Portugal as eligible, from a universe of 25,781 securities eligible in the Eurosystem.

Chart I.1.1 • Balance and type of open market operations and standing facilities and value of collateral pool | EUR millions



Source: Banco de Portugal.

Collateral used by resident counterparties are valued by Banco de Portugal at market price (if there is one) or alternatively using theoretical valuation, benefiting from risk control measures defined in the Eurosystem framework and also applied by Banco de Portugal.

The average balance of Portuguese counterparties' collateral pools totalled €50,728 million, as in 2017. Mortgage bonds and securities issued by central, regional or local governments are the asset categories with greater representation in these pools, with 60% of total assets held by Portuguese counterparties and used as collateral. The value of the assets given as collateral in excess of outstanding loans has gradually increased in the last few years, even surpassing the balance of liquidity-providing operations.

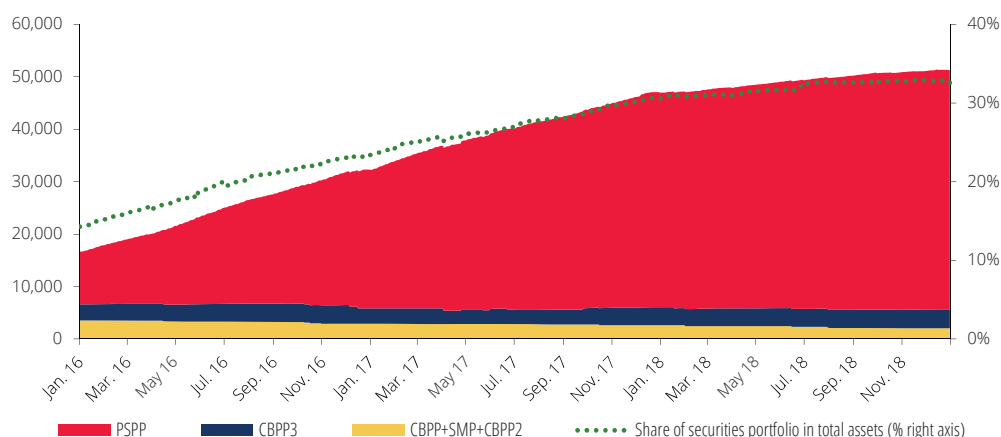
The average balance of monetary policy portfolios/APP on Banco de Portugal's balance sheet recorded a further increase, even if less significant than in 2017. In 2018, it came to €49,319 million (Chart I.1.2). As to the type of portfolios, the public sector purchase programme (PSPP) has the greatest representation, with an average share of 88% of the total volume of portfolios in 2018. The share of securities portfolios in Banco de Portugal's total assets has been increasing and was over 30% at the end of 2018.

Participating in the single monetary policy requires managing inherent risks, which are either borne by Banco de Portugal or shared by the whole Eurosystem based on each NCB's share in the ECB's capital key, depending on the programme or collateral assets provided. In purchase programmes, the issue is the direct exposure to the issuers of the assets purchased. In regard to credit granting operations, risk is associated with counterparties and indirectly with the type of assets given as collateral.

Banco de Portugal made sure that risks of monetary policy operations were controlled by applying eligibility criteria to counterparties and their respective collateral, setting evaluation margins on these assets' value and imposing limits on their use, as envisaged within the operating framework of the Eurosystem.

Overall risk developments associated with monetary policy operations were monitored within the framework of the integrated management policy for financial risks and operational risks pursued by Banco de Portugal (Chapter 4). Banco de Portugal also monitored and analysed the performance of the risk rating systems used by national credit institutions to evaluate the assets given as collateral for Eurosystem credit operations.

Chart I.1.2 • Balance and type of monetary policy portfolio/APP | EUR millions



Source: Banco de Portugal. | Notes: PSPP – Public Sector Purchase Programme. CBPP – Covered Bonds Purchase Programme. SMP – Securities Market Programme.

Also noteworthy in 2018, Banco de Portugal closely monitored the Weiss proceedings at the European Court of Justice, which ruled in favour of the validity of the ECB's secondary markets public sector asset purchase programme. Banco de Portugal took part in these proceedings by sending written observations and participating in the hearing of oral arguments.

1.2 Asset management

Banco de Portugal manages two types of asset portfolios: (i) a foreign reserve portfolio of the ECB, corresponding to the transfer of foreign reserve assets from Banco de Portugal to the ECB, at the beginning of the Economic and Monetary Union, according to its capital key; and ii) its 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.² In 2018, the average balance of net financial assets held by Banco de Portugal was €6,434 million.

ECB foreign reserve management

The management of the ECB's foreign reserves is decentralised, under an agency agreement established with the Eurosystem national central banks. Within the scope of a currency specialisation model, Banco de Portugal has been responsible for managing a portfolio denominated in US dollars (USD) since the start of 2012. Since January 2015, this portfolio has been managed in collaboration with the central bank of Lithuania and comprises the amount of the ECB reserves allocated to the two countries. As at 31 December 2018, the portfolio amounted to USD 1,764 million (€1,541 million).

Management of own investment assets

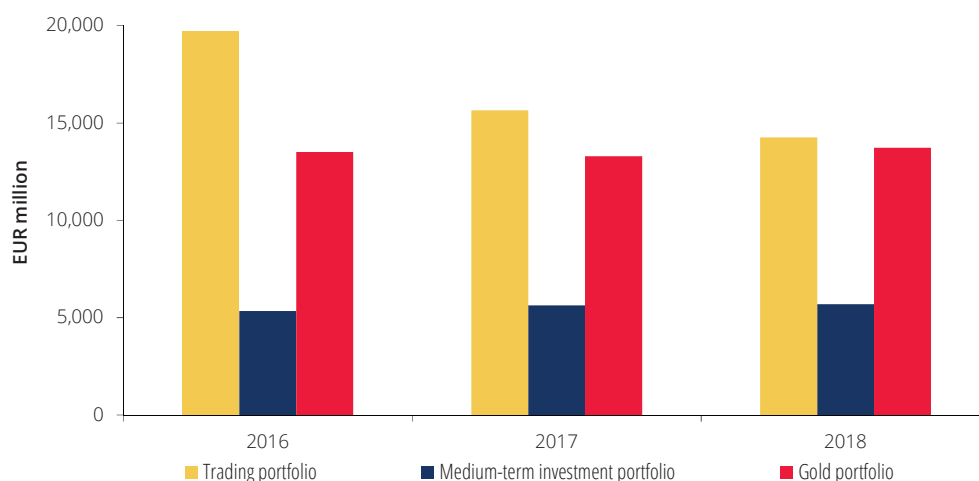
Banco de Portugal's own investment asset portfolio is composed of assets denominated in euro, assets denominated in foreign currency and gold. Assets in the trading portfolio, largely denominated in euro, are actively managed and valued at market prices. Assets in the medium-term

2. For further details, see the ECB website.

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

As at 31 December 2018, Banco de Portugal's own investment asset portfolio was valued at €33,688 million. The 2.5% decrease from the previous year was largely due to the decision to reduce assets against the reduction in TARGET account liabilities (Chart I.1.3), amid very low or even negative interest rates in the euro area.

Chart I.1.3 • Own investment asset portfolio



Source: Banco de Portugal.

The trading portfolio at market prices and year-end exchange rates was valued at €14,266 million in 2018, 9% less than at the end of 2017. Assets denominated in euros accounted for 86%.

The medium-term investment portfolio remained practically unchanged from the previous year, reinvesting the year's maturing funds in issuers and maturities that maximised future yields.

Similarly to previous years, the quantity of gold held by Banco de Portugal remained unchanged (382.5 tonnes). Its value in euro increased by 3% due to the appreciation of gold against the euro.

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

The risk arising from own investment asset management operations was controlled by imposing eligibility criteria and limits on the institutions, countries, operations and instruments involved, and taking into account the credit, exchange rate and interest rate risks of assets and operations. These criteria and limits were approved by the Board of Directors and reflect the goal of optimising yield while preserving capital and keeping risk at a level that matches the coverage provided by Banco de Portugal's equity.

In regard to the trading portfolio, the management of own investment assets is based on a strategic benchmark portfolio approved by the Board of Directors, on which a margin is set to allow the management some flexibility. This benchmark portfolio reflects the discussion of scenarios and forecasts for the main economic and financial variables and is effective for one year, although it may be revised earlier.

The valuation, return computation and control of limits and restrictions on asset management operations are performed daily through an internal information system 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 monitoring of the positions and main risk measures, enabling the risk management function to independently and systematically control the life cycle of all operations, from purchase to settlement.

1.3 Payment systems and means

On 13 November 2018, the new Legal Framework for Payment Services and Electronic Money entered into force. This legal framework is part of Decree-Law No 91/2018 of 12 November 2018, and incorporated into the Portuguese legal system the revised Payment Services Directive (PSD2).³

Among its innovative features with an impact on Portuguese users, two new types of payment services were established and regulated: account information services and payment initiation services. Such innovation brings a new paradigm to banking services, since an account opened with and managed by a bank can now be accessed by other payment service providers, upon condition that they have the customer's consent.

The establishment of increased security conditions for the execution of electronic payment transactions by adopting strong authentication mechanisms is also a noteworthy change. Strong customer authentication is based on the use of two or more elements categorised as knowledge (something only the user knows), possession (something only the user possesses) and inherence (something the user is).

In addition to PSD2, a regulation was published laying down regulatory technical standards for strong customer authentication and common and secure open standards of communication.⁴ These standards are directly applicable in all Member States from 14 September 2019 onwards.

Decree-Law No 91/2018 of 12 November 2018 establishes Banco de Portugal as the competent national authority to ensure the due implementation of this new regulatory framework (Box 1). In addition, this Decree-Law also sets forth the implementing measures for three EU regulations: (i) the Regulation on cross-border payments in the Community;⁵ (ii) the Regulation establishing technical and business requirements for credit transfers and direct debits in euro;⁶ and (iii) the Regulation on interchange fees for card-based payment transactions.⁷ Banco de Portugal is also responsible for monitoring compliance with the duties set forth in these Regulations.

Gross payment and securities settlement systems

In 2018 TARGET2-PT (the Portuguese component of the real-time gross settlement system for euro payments) maintained operational availability at 99.98% and processed more than 2.2 million transactions, to the amount of €1,724 billion (Chart I.1.4). The number of transactions settled increased by 13% from 2017, mostly due to the increase in transactions between financial institutions (customer and interbank transfers). Conversely the value settled decreased by 11% due to the lower value of the interbank transactions.

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

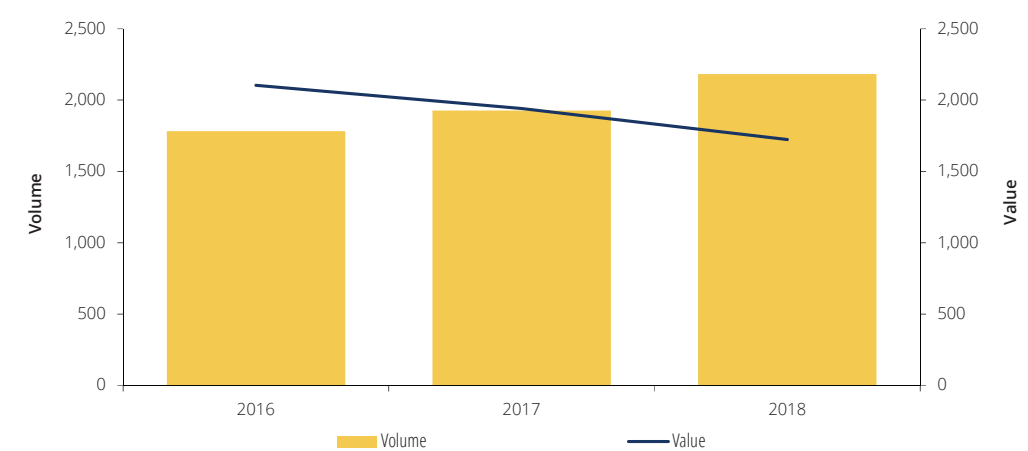
4. Delegated Regulation (EU) 2018/389 of 27 November 2017.

5. Regulation (EC) No 924/2009 of 16 September 2009.

6. Regulation (EU) No 260/2012 of 14 March 2012.

7. Regulation (EU) No 2015/751 of 29 April 2015.

Chart I.1.4 • Overall transactions through TARGET2-PT | Volume in thousands and value in EUR billions

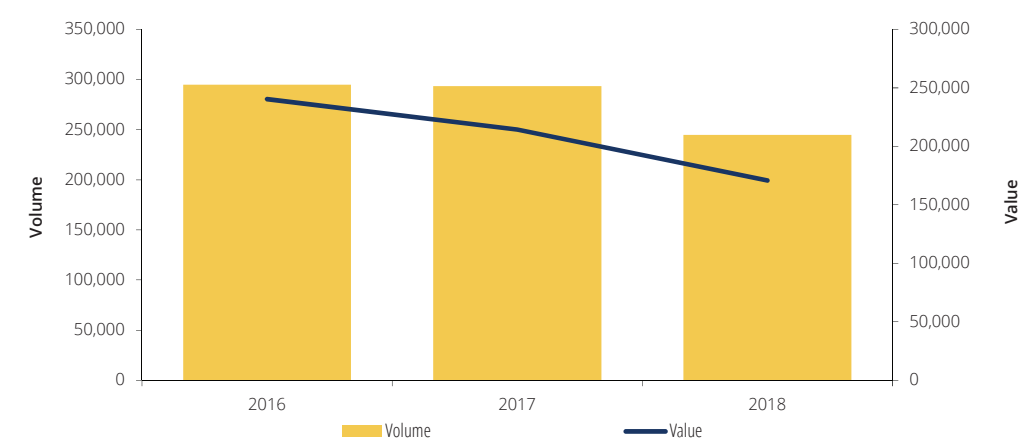


Source: Banco de Portugal.

The national community settled 244,702 securities transactions in TARGET2-Securities (T2S), worth close to €171 billion, dropping 17% in volume and 20% in value from 2017 (Chart I.1.5).

In 2018 Banco de Portugal also carried out all that was necessary to ensure its connection to the new Eurosystem’s pan-European instant payment settlement service, TARGET Instant Payment Settlement (TIPS), which went live on 30 November 2018. Banco de Portugal also followed the work on the specification of the requirements to consolidate TARGET2 and T2S, in terms of both technical and functional aspects, and the respective evolution of real-time gross settlement services.

Chart I.1.5 • Settlement of securities of the national community | Volume in units and value in EUR billions



Source: Banco de Portugal. | Note: Figures for the period until March 2016 refer to Interbolsa operations settled in TARGET2.

Retail payment system

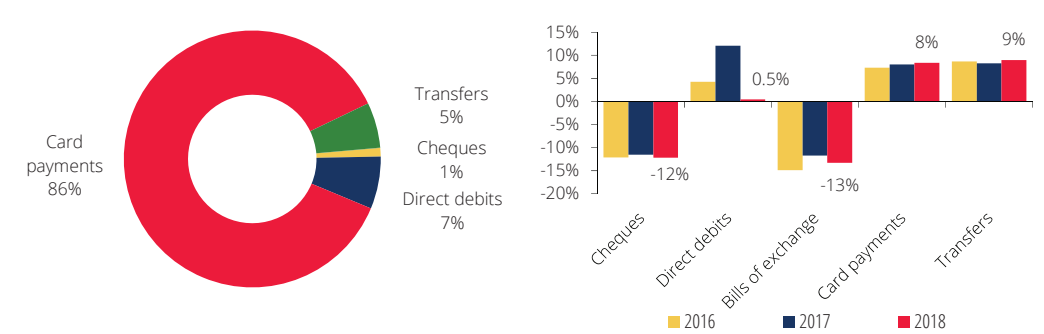
In 2018 Banco de Portugal worked on the implementation of the new risk management mechanism for the Portuguese Interbank Clearing System (SICOI), a retail payment system that clears payments by cheque, bills of exchange, direct debits, credit transfers, bank cards and instant transfers. This

new mechanism works by having each one of the direct participants in SICOI provide collateral (in cash or in collateral assets).

In 2018, SICOI processed 2.7 billion payments, worth €491 billion, accounting for an 8% volume and 7% value increase compared with 2017. This development was largely driven by the increase in card payments (8% in volume and 9% in value) and in credit transfers (9% in volume and 12% in value). Some types of payments continued to decrease, namely cheques (dropping 12% in volume and 6% in value) and bills of exchange (dropping 13% in volume and 9% in value), underlining the trend towards decreasing the use of paper-based payments and increasing take-up of electronic payments.

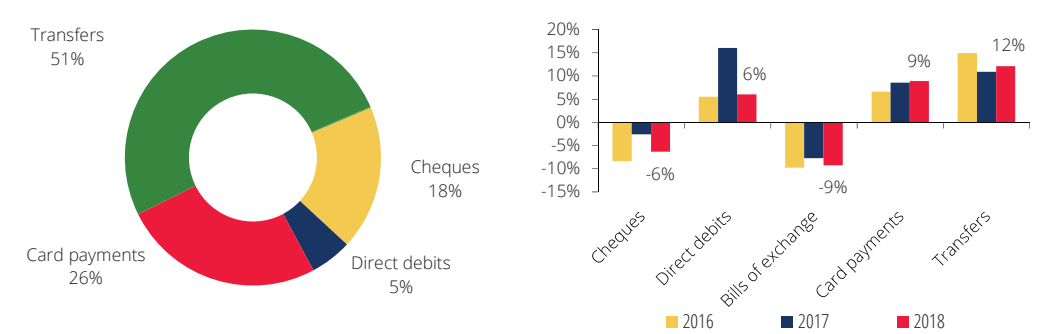
Card payments accounted for 86% of total payment volume cleared in SICOI in 2018, while credit transfers accounted for 51% of the total value processed (Charts I.1.6 and I.1.7).⁸

Chart I.1.6 • Shares of payment instruments and year-on-year growth rates, volume of transactions in SICOI in 2018



Source: Banco de Portugal.

Chart I.1.7 • Shares of payment instruments and year-on-year growth rates, value of transactions in SICOI in 2018



Source: Banco de Portugal.

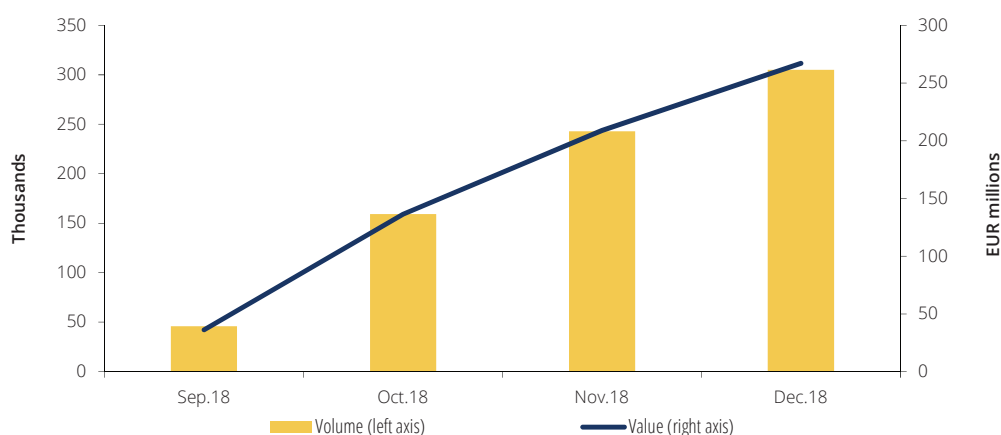
In September 2018, SICOI started allowing instant transfer processing. Instant transfers may be made 24 hours a day, seven days a week, 365 days a year. The funds arrive in the beneficiary's

8. Additional information is available in the Report on Payment Systems published on Banco de Portugal's website.

account in seconds. This new subsystem is the first to enable real-time clearing and settlement in SICOI.

Although in 2018 such transfers were only a very small part of SICOI transactions (0.03% of total volume of transactions and 0.1% of total value), individuals and companies quickly adopted this payment instrument, as the high average monthly growth rate shows (over 40% in volume and value of transactions) between September and December 2018 (Chart I.1.8).

Chart I.1.8 • Monthly developments in instant transfers processed by SICOI in 2018 | Volume of transactions in thousands and value in EUR millions



Source: Banco de Portugal.

Despite this optional solution not having full coverage from the start by retail payment service providers operating in Portugal or being available on all customer channels (branch, mobile apps, homebanking), on 31 December about 95% of all deposit accounts opened in Portugal could receive instant transfers, thus achieving widespread domestic coverage.

Instant transfers lead to important efficiency gains for both payers and payees, and are expected to take on a dominant position in the habits of Portuguese payment service users.

In order to prevent the unlawful use of cheques, Banco de Portugal manages and publishes a List of Cheque Defaulters across the banking system. In 2018, 9,143 entities were added to the list and 10,979 were removed, following a decision of Banco de Portugal or upon expiry of the applicable legal period. On 31 December 2018, the list comprised 15,427 entities, which represented an 11% decrease from 2017, consistent with the falling use of cheques in Portugal.

In 2018, 7,026 consultations of the List of Cheque Defaulters were registered by Banco de Portugal's website. In addition, Banco de Portugal answered 215 written information requests regarding this subject and provided information to 2,790 users of bank services who visited the public information desks in the head office and in the regional network.

Payment systems oversight

Banco de Portugal monitors and assesses the performance of financial market infrastructures from an operations perspective and through analysis of liquidity, concentration and credit risks, so as to ensure the smooth functioning of the infrastructures and maintain the confidence of the economic agents in the financial markets.

In 2018, Banco de Portugal assessed the Multibanco card system and concluded that it met all the oversight criteria applicable to it. As relevant authority under Article 12 of the Central Securities Depositories Regulation⁹ (i.e. as central bank issuing the currency in which settlement of the securities transactions takes place and central bank that settles the cash leg of those transactions) and representing the Eurosystem, Banco de Portugal delivered an overall positive opinion on the authorisation for Interbolsa S. A. to exercise the activity of central securities depository. Banco de Portugal also participated in TIPS' preliminary assessment by the Eurosystem, after it went live and continued to regularly monitor the retail payment system (SICOI) and the large-value payment systems (TARGET2-PT), as well as T2S. Furthermore, the cyber resilience of Portuguese market infrastructures (SICOI, OMIClear and Interbolsa) was tested using a survey standardised across the Eurosystem. This test was part of the implementation of Banco de Portugal's cyber resilience strategy,¹⁰ with satisfactory results.

Banknotes and metal coins

In 2018, Banco de Portugal started the process to issue the last two banknotes in the Europa series that will enter into circulation on 28 May 2019: the new €100 and €200 banknotes.

In terms of cash handling, 2018 saw a marked rise in operations: deposit and cash withdrawal operations in Banco de Portugal increased over 6% and Banco de Portugal checked the authenticity and fitness for circulation of 698 million banknotes received from the general public and credit institutions (51 million more than in 2017), of which 127 million were considered unfit. Although most banknotes are processed through high-speed machines, the banknotes received by Banco de Portugal that are extremely damaged or fragmented are subject to a complex manual analysis and exchange process. In 2018, Banco de Portugal exchanged 32,167 euro banknotes and 5,696 escudo banknotes in these conditions, slightly less than in 2017.

Furthermore, 18,047 counterfeit banknotes were withdrawn from circulation (corresponding to 3% 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 excess euro circulation coins with the central bank of Slovakia, under similar terms as in the agreement with the central bank of Ireland in 2017. Under the new agreement, Banco de Portugal sent to the central bank of Slovakia ten million €2 coins, in excess in Portugal, in exchange for 20 million €1 euro coins, in excess in Slovakia.

In 2018, the swap and delivery of excess collector coins in the banking system was improved substantially, resulting in the delivery of around one million coins to Banco de Portugal, worth over €6 million.

In November, the Castelo Branco Agency stopped exchanging banknotes and coins for different denominations since these operations were rarely requested and are also provided by the credit institutions.

9. Regulation (EU) No 909/2014 of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories (CSDs).

10. For further information on the Eurosystem's cyber resilience strategy see the [ECB website](#).

Box 1 • Monitoring of digital transformation in the financial system

In recent years, major changes have occurred in the financial services offering due to technological disruption, pressure on banks to reduce costs, changes in consumer behaviour, and the entry of new players into the financial system. Banco de Portugal has monitored these changes, either as a regulator and supervisor of the financial system, or as a dialogue partner with the market. In addition, the Bank has been adjusting its organisational structure to accommodate the new requirements arising from digital transformation.

As a regulator and supervisor

Digital transformation in the financial system is a central theme for the safeguarding financial stability. Therefore, Banco de Portugal has been involved in the development of new European Union legislation and regulation in this area and, as the national supervisory authority (for macroprudential, microprudential and banking conduct supervision), has been taking action to address the new regulatory requirements and the new realities in the financial sector.

The Bank has been heavily involved in the drafting of the various regulatory proposals related to digital transformation, notably at the level of the Single Supervisory Mechanism, the European Banking Authority, the ESA's Joint Committee and the European Commission.

The new Legal Framework for Payment Services and Electronic Money entered into force on 13 November 2018, as part of Decree-Law No 91/2018 of 12 November 2018, and incorporated into the Portuguese legal system the revised Payment Services Directive (PSD2). The new framework brings a number of innovations, namely:

- The establishment of increased security conditions for the execution of electronic payment transactions by adopting strong authentication mechanisms;
- The regulation of two new types of payment services: account information services and payment initiation services. Account information services allow the user to query information in an application or on a website about the user's accounts maintained by one or more banks, provided that the accounts are accessible online. Payment initiation services enable the user to initiate online payment transactions without having to interact with the bank;
- The introduction of two new reporting obligations for payment service providers to Banco de Portugal: the reporting of major incidents and the provision of statistical data on fraud relating to different means of payment.

In addition to PSD2, the European Commission has published a regulation laying down regulatory technical standards for strong customer authentication and common and secure open standards of communication.¹¹ These standards are directly applicable in all Member States from 14 September 2019 onwards.

In the Portuguese jurisdiction, Banco de Portugal is the competent authority to ensure the implementation of this new regulatory framework. In this context, the Bank is responsible for verifying compliance with the obligations binding payment service providers who manage payment accounts (as a rule, banks) with regard to the provision of interfaces enabling other service providers to access their customers' accounts, as well as the implementation of appropriate strong authentication mechanisms.

The entry into force of the Legal Framework for Payment Services and Electronic Money also required the renewal, by Banco de Portugal, of the authorisations granted to payment institutions

11. Delegated Regulation (EU) 2018/389 of 27 November 2017.

and to electronic money institutions that started operating before 13 January 2018 (13 payment institutions and 1 electronic money institution). In order for the renewal of authorisations to be completed as quickly as possible following the publication of the framework, the Bank asked the institutions concerned to submit beforehand all necessary information in order to demonstrate compliance with the authorisation requirements. In mid-December 2018, Banco de Portugal renewed the authorisation granted to all 14 institutions.

Also, in order to promote a timely adoption of the new reporting obligations, Banco de Portugal has held specific workshops on these topics targeted at payment service providers.

In the context of prudential supervision, inspections were carried out to assess the risk related to information technology (IT) in resident credit institutions. These inspections, involving specialised teams, focused on: internal governance and audit of the IT risk function; IT infrastructure to assess the alignment between the institution's needs and the support to business processes; technological security and operations management with a focus on the access management policy, segregation of duties and management of changes and incidents; and data quality management, especially related to regulatory reporting.

In the framework of preventing money laundering and terrorist financing, Banco de Portugal laid down, in Notice of Banco de Portugal No 2/2018, obligations which institutions have to comply with in outsourcing services, as well as requirements governing the use of distance communication to verify the customers' identification data. Moreover, Banco de Portugal has focused part of its inspection activity in this field on checking how supervised institutions use new technologies to comply with customer identification and customer due diligence, by conducting eight thematic inspections.

Banco de Portugal's banking conduct supervision task has also been challenged by the growing use of digital channels for contracting retail banking products and services. Such use brings benefits to bank customers, who in this way can access these products and services faster and more conveniently, but with some risks attached. Convenience and speed may lead bank customers to purchase goods and services without weighing properly their characteristics and the risks involved. For this reason, Banco de Portugal has monitored and supervised the conduct of institutions subject to supervision in this field, seeking to ensure that, in digital channels also, they comply with the obligations of providing information and assistance to customers and potential customers. The Bank has also checked whether the institutions provide adequate security mechanisms in the digital channels, including strong customer authentication.

In order to better monitor and supervise the offering of consumer credit through digital channels, Banco de Portugal required credit institutions and financial companies to report information on the sale of consumer credit products initiated and completed through digital channels (Circular Letter of Banco de Portugal No 4/2018). On the basis of the information received, the contracting processes adopted by the institutions in their applications, homebanking and IT platforms were subject to inspections, and recommendations were made to institutions on adequate compliance with information and assistance obligations, as well as contracting practices and security procedures, based on lessons learned from behavioural economics and international best practice.

In parallel with the regulation and supervision tasks, Banco de Portugal launched a financial education campaign for secondary school students, with recommendations for a safer use of digital channels (Chapter 3). Also, on the Bank Customer Website, content has been released on the safe use of digital channels and the risks associated with the collection and processing of large volumes of information (big data) by financial institutions, which is used to forecast behaviours and consumption patterns.

As a dialogue partner with the market

The Bank has been in contact and cooperated with market participants in order to create conditions that allow for innovation in the Portuguese financial market. This approach also enables the Bank to build up knowledge and experience, strengthening its role as regulator and policymaker.

In 2018, inspired by European best practice and the recommendations of the European Commission, Banco de Portugal, the Portuguese Securities Market Commission and the Insurance and Pension Funds Supervisory Authority, in partnership with Portugal Fintech, launched Portugal FinLab.¹² Portugal FinLab is a communication channel between regulators and firms, designed for innovative projects in the Portuguese financial sector. In addition to providing a competitive advantage to attract international companies, this initiative has enabled new projects and their promoters to be monitored in a controlled environment, by increasing the knowledge about the dynamics of innovation.

Banco de Portugal prepared and implemented an activity plan on digital innovation, leading to, inter alia, two meetings with Fintechs (Fintech Meetings) in Lisbon and Braga on the opportunities and challenges of the revised Payment Services Directive, as well as the launch of the Fintech+ channel on Banco de Portugal's website, dedicated to clarifying issues related to innovation in financial products and services.

In 2018, a market analysis study was also carried out based on a bank survey on their Fintech plans and projects, as well as a financial stability analysis on Fintechs published in the December issue of Banco de Portugal's *Financial Stability Report*.¹³

The dialogue with the market also took place through the Payment Systems Forum, an advisory structure of Banco de Portugal bringing together the main national stakeholders involved in payment services' supply and demand, with the mission to contribute to the implementation of safe, efficient and innovative payment solutions in the Portuguese market, and with a particular focus on aspects related to digital transformation.

Impact on organisational and governance structure

In order to ensure the timely monitoring of technological developments in the financial sector, Banco de Portugal set up, within the Specialised Committee for Financial Supervision and Stability, a permanent working group dedicated to the themes of digital innovation and Fintech, coordinated by a member of the Board of Directors. This multidisciplinary group – involving the supervisory, payment systems, markets, information systems and technology departments, and the strategy and organisational development area – monitored the implementation of the initiatives above and fostered internally an analysis of the impact Fintechs have on the financial sector and the regulators' activity.

In response to the new requirements related to digital transformation: within the Prudential Supervision Department, a dedicated team was set up to assess the technological risk profile and the impact of digitalisation on the business model of institutions, and to participate in inspections in this field; within the Banking Conduct Supervision Department, a functional team was set up to monitor the development of new technological solutions and carry out specific inspections to check compliance with the obligations of providing information and assistance to customers when marketing and contracting banking products and services through digital channels; within the Payment Services Department, a new unit was created to monitor digital transformation initiatives and their impact on payment systems and instruments; within the Information Systems and Technologies Department, the cybersecurity team was reinforced and an innovation laboratory was created, where new technologies are being tested through proofs of concept with reference to national and international cases.

12. <https://www.portugalfinlab.org/>

13. The *Financial Stability Report* is available for consultation on Banco de Portugal's website.

2 Financial stability

This chapter describes Banco de Portugal's work in 2018 to ensure the robustness and stability of the domestic financial system, the second Broad Strategic Guideline established for the four-year period 2017-2020.

Safeguarding the stability of the Portuguese financial system is part of Banco de Portugal's mission. To fulfil this task, the Bank has regulatory and supervisory powers (macroprudential, microprudential and banking conduct), as well as legal enforcement and resolution powers.

Banco de Portugal is part of the Single Supervisory Mechanism and the Single Resolution Mechanism, and participates actively in various national and international fora in financial regulation and supervision, in particular the National Council of Financial Supervisors, the European Systemic Risk Board and the European Banking Authority.

Participation in the decision-making structures of these bodies enables the Bank to actively contribute to the construction and operation of the Banking Union, influence the financial supervisory architecture and ensure an adequate regulatory framework. It also allows for a balanced treatment of national institutions and ensures an actual contribution to the decision-making process for other significant institutions.

Under the Single Supervisory Mechanism (SSM), which is the Banking Union's system for prudential supervision, Banco de Portugal intervenes at several levels: (i) it is represented on the Supervisory Board, the body responsible for planning and performing the supervisory tasks of the SSM; (ii) it collaborates in the supervision of significant institutions¹⁴ by participating in joint supervisory teams assigned to Portuguese significant institutions and other institutions with parent companies abroad; (iii) it directly supervises less significant institutions; (iv) it authorises the exercise of the functions of the members of the management and supervisory bodies and key function holders in institutions subject to its direct supervision, and participates in the assessment of suitability for the exercise of functions in significant institutions; and (v) it participates in the procedures for granting and withdrawing authorisation to credit institutions and for assessing the acquisition of qualifying holdings. Banco de Portugal also participates in a number of technical working groups responsible for the development of methodologies and supervisory tools, as well as the promotion of the supervisory best practice, which is consequently incorporated by the Bank.

In 2018 the ECB's Supervisory Board met 21 times. Throughout the year, 38 Banco de Portugal staff members have joined the joint supervisory teams assigned to the significant institutions of the Banking Union.

Banco de Portugal also participates in the Single Resolution Mechanism (SRM), the system established under the Banking Union for the resolution of credit institutions. Within the SRM, the powers and responsibilities for resolution are shared between the Single Resolution Board – which exercises resolution functions on significant institutions or institutions with cross-border activity – and the national resolution authorities of the Member States of the Banking Union – which are responsible for directly exercising their resolution functions in relation to less significant institutions with no cross-border activity. Regarding the Single Resolution Board, Banco de Portugal was represented

14. The assessment of the significance of credit institutions is based on a number of criteria, including size and economic relevance (e.g. the total value of their assets, importance for the economy of the country in which they are located or the EU as a whole, and the scale of their cross-border activities).

in plenary sessions, as well as in the extended executive sessions whenever issues related to Portuguese credit institutions or institutions present in Portugal were at stake, a total of 15 sessions. In addition, the Bank's staff members joined ten internal resolution teams – assigned to Portuguese significant institutions and other institutions with parent companies abroad – which are in charge of, inter alia, preparatory work for decision-making on resolution plans. Banco de Portugal has also participated in several committees and technical working groups of the SRM. In addition, it continued to monitor the operation of the Single Resolution Fund, contributing in particular to supporting tasks for the calculation, collection and payment of periodical contributions by the Portuguese institutions.

The activity of the European Banking Authority (EBA), focusing on regulation and convergence of prudential supervision in the European Union (EU), requires the regular involvement of several of Banco de Portugal's areas, namely the financial stability, prudential supervision, banking conduct supervision, resolution, prevention of money laundering and terrorist financing, and payment systems areas. Banco de Portugal participates in EBA's highest decision-making body, the Board of Supervisors, which met seven times in 2018. In addition to the regular analysis of risks and vulnerabilities in the European banking sector and of capital and liquidity matters, several other issues were addressed, such as the UK's withdrawal from the EU (Brexit), the treatment of non-performing loans, the implementation of Basel III reforms, the application of internal ratings methodologies, securitisation, the implementation of the International Financial Reporting Standards (IFRS9), the implementation of guidelines on procedures for retail banking product oversight and governance, the annual report on developments in retail banking markets (*Consumer Trends Report*), financial training and literacy, the establishment of procedures for monitoring the instruments meeting the minimum requirements for own funds and eligible liabilities (MREL), the prevention of money laundering and terrorist financing, the use of technology in the financial sector (fintech), the analysis of the impact arising from the use of virtual currencies and other elements related to the revised Payment Services Directive (PSD2).¹⁵ In November the results of the 2018 EBA EU-wide stress-test exercise were also released.

The Governor of Banco de Portugal is a member of the General Board of the European Systemic Risk Board, the entity responsible for macroprudential supervision of the EU financial system and for the prevention and mitigation of systemic risks. This body met four times in 2018. The issues discussed focused on the main risks to financial stability, macroprudential measures taken by various Member States, developments in the real estate market, macroprudential approaches to non-performing loans, macroprudential tools for the insurance sector, and a common framework for the assessment of the macroprudential stance.

The Bank also participates in the Macroprudential Forum, which regularly brings together the Governing Council of the ECB and the Supervisory Board of the Single Supervisory Mechanism to discuss topics of common interest from the micro- and macroprudential perspectives.

The work carried out under the aegis of the Joint Committee of European Supervisory Authorities includes the Bank's participation in various committees and working groups cutting across the financial system. In 2018, Banco de Portugal contributed to: the development of regulatory technical standards and guidelines in the field of preventing money laundering and terrorist financing, as well as for the assessment of supranational risks; the updating of the list of groups constituting a financial

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

conglomerate in the EU; the half-yearly reports summarising the main inter- and intra-sectoral risks in the European financial system, and highlighting the main recommendations or measures issued by the three European supervisory authorities; activities related to the implementation of the new rules for the sale of structured deposits; the analysis of risks and difficulties in cross-border supervision of the sale of financial products and monitoring of processes and automated advisory systems.

Banco de Portugal also participates in the Economic and Financial Committee of the EU and in several technical groups in the financial area, in particular at the level of the European Commission and the EU Council, as well as in global institutions such as the Bank for International Settlements, the International Monetary Fund, the Financial Stability Board's Regional Consultative Group for Europe and the Financial Action Task Force (FATF).

In 2018, Banco de Portugal joined the Central Banks and Supervisors Network for Greening the Financial System (NGFS), an international network to promote the management of environmental risks in the financial sector and support the transition to a sustainable economy through "green finance". Thereby, the Bank showed its commitment to contribute, within its mandate to preserve financial stability, to the overall effort to promote environmental objectives and in particular to combat climate change.

In the fora where it is represented, Banco de Portugal has followed the developments related to the United Kingdom's withdrawal from the European Union (Brexit) and its impact on the financial system. Among other initiatives, the Bank has published information on this process on its institutional website, primarily aimed at financial institutions, including a guide, prepared in cooperation with the *Comissão do Mercado de Valores Mobiliários* (Portuguese Securities Market Commission), which describes the authorisation and registration procedures necessary for managing entities of collective investment undertakings to carry on business in Portugal.

2.1 Regulatory framework

In 2018, Banco de Portugal participated in the development of new legislation and regulations of the European Union applicable to institutions subject to its supervision.

In conjunction with the Ministry of Finance and the Permanent Representation of Portugal to the EU, Banco de Portugal participated in the negotiation process of several European Commission legislative proposals, especially those designed to: (i) strengthen the legal framework applicable to credit institutions and investment firms, in prudential and banking conduct and resolution terms, and also in regard to money laundering and terrorist financing prevention; (ii) complete the Banking Union through the establishment of a European Deposit Insurance Scheme; and (iii) revise the European System of Financial Supervision (by updating the legal framework governing, in particular, the activities of the European Banking Authority and the European Systemic Risk Board).

Banco de Portugal has also contributed to the completion of the regulatory framework for banking activity by drafting a significant body of legislation and opinions requested by the Government on legislative proposals, either within the National Council of Financial Supervisors or as part of specific initiatives. It has adopted guidelines issued by the European Banking Authority with a view to strengthening certain prudential rules applicable to credit institutions and investment firms. It put

forward proposals for the incorporation of the provisions of the new Directive on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing.¹⁶

In addition, it sought to ensure the consistent implementation of accounting standards applicable to credit institutions and financial companies. In this area, the work related to the implementation of IFRS9 on accounting for financial instruments has culminated in the issuance of Circular Letter of Banco de Portugal No 2018/62, which set out benchmarks for the measurement of expected credit losses.

The Bank has revised the regulation on prudential rules and reporting by virtue of the entry into force of the legislative package composed of the Capital Requirements Directive and the Capital Requirements Regulation (CRD IV/CRR), and has completely overhauled the regime applicable to authorisation requests to become a member of corporate bodies.

At the regulatory level, Banco de Portugal also conducted preparatory work on the revision of the Legal Framework of Credit Institutions and Financial Companies, approved by Decree-Law No 298/92 of 31 December 1992; as a result, a preliminary draft of a “Banking Activity Code” was submitted to the Ministry of Finance.

2.2 Stability of the Portuguese financial system

In recent years, in a context of strengthened and more demanding regulatory and supervisory frameworks, the Portuguese banking sector has carried out a significant adjustment process, which improved solvency, enhanced the liquidity position, reduced non-performing assets, and increased operational efficiency, with visible effects on profitability (Table I.2.1).

The various positive developments include: the recapitalisation of CGD; the capital increase by BCP and Caixa Económica Montepio Geral; in the case of BPI, the reduction of the exposure to Banco de Fomento de Angola; and the completion of the Novo Banco sale process. These developments have brought stability to the shareholder base in some of the main Portuguese banks; have led to the strengthening of the banking sector’s capital ratios; and have increased the institutions’ capacity to sharply reduce their non-performing loan (NPL) level amidst an economic recovery and rising real estate prices.

In 2018, the asset quality indicators continued to develop very positively. NPLs have fallen from a record high of €50.5 billion in June 2016 to €25.9 in December 2018: a decrease of more than €24 billion (about 50%) (Box 2). This sharp and sustained decrease in the NPL stock allowed the NPL ratio to be below 10% (9.4%) at the end of 2018. In turn, the reinforcement of the level of impairment coverage resulted in a decline in the net NPL amount to below €12.5 billion in December 2018, thus leading to an NPL ratio net of impairments of 4.5%.

In the performance of its financial stability functions, throughout the year the Bank promoted a continuous analysis of systemic vulnerabilities and risks, and took steps to mitigate these risks. It also carried out supervisory initiatives and evaluations in order to strengthen the control and internal governance mechanisms, and to stabilise and improve the quality of several institutions’ management teams. In addition, it permanently challenged the plans to reduce banks’ problem assets (NPLs, real

16. Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purpose of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU.

estate and shares in restructuring funds) and imposed alternative measures where warranted. Also in this context, the Bank monitored the implementation of the nationally designed strategy for the reduction of non-performing assets, as well as the initiatives that have been developed and adopted in Europe. These topics are further detailed in the following sections.

Table I.2.1 • Portuguese banking system indicators

	Notes	Unit	2015	2016	2017	2018
Total assets (gross)/GDP (nominal)			2.3	2.1	2.0	1.9
Profitability (*)						
Return on assets (ROA)	(1)	%	0.2	-0.6	0.3	0.7
Operating income	(2)	%	0.6	0.7	0.8	3.9
Net interest income	(3)	%	1.4	1.5	1.6	1.6
Return on equity (ROE)	(4)	%	2.2	-7.3	3.3	7.1
Cost-to-Income	(5)	%	60.9	59.4	52.8	60.3
Net profit		EUR, millions	324.3	-1,248.9	-87.8	1,084.0
Liquidity						
Central bank funding	(6)	%	7.0	6.4	6.3	5.3
Loan-to-deposit (Ltd) ratio	(7)	%	96.1	95.5	92.5	88.9
Liquidity coverage ratio (LCR)	(8)	%	n.d.	150.8	173.5	196.5
Asset quality						
NPL Ratio	(9)	%	17.5	17.2	13.3	9.4
Households, house purchase	(9)	%	7.2	7.0	5.7	3.7
Households, consumption and other purposes	(9)	%	19.2	16.2	13.1	10.6
Non-financial corporations	(9)	%	28.3	29.5	25.2	18.5
NPL impairment coverage ratio	(10)	%	40.8	45.3	49.4	51.9
Households, house purchase	(10)	%	23.5	21.0	22.8	27.1
Households, consumption and other purposes	(10)	%	57.6	63.2	62.6	60.4
Non-financial corporations	(10)	%	44.4	48.9	53.9	56.3
Total non-performing loans		EUR, millions	49,818	46,361	37,001	25,850
Solvency						
Capital ratio	(11)	%	13.3	12.3	15.1	15.1
Common Equity Tier 1 (CET 1) ratio	(12)	%	12.4	11.4	13.9	13.2
Leverage ratio	(13)	%	n.d.	6.6	7.8	7.3

Source: Banco de Portugal | Notes: (*) Profitability indicators calculated with cumulative flows in the year, annualised. (1) Profit and loss before taxes as a percentage of average assets. (2) Net interest income and net fees and commissions less operational costs; as a percentage of average assets. (3) Difference between interest income and expenses on financial assets and liabilities; as a percentage of average assets. (4) Profit and loss before taxes as a percentage of average equity. (5) Ratio between operational costs and total operating income. (6) Central bank funding as a percentage of total assets. It corresponds almost entirely to Eurosystem funding. (7) Ratio of loan to deposits from customers. (8) Ratio of available liquid assets and net cash outflows calculated under a 30-day stress scenario. (9) Ratio between the gross value of the non-performing loans and the total gross value of the loans. (10) Ratio between impairments recorded for non-performing loans and their gross value. (11) Ratio between total own funds and risk-weighted assets. (12) Ratio between Common Equity Tier 1 capital and risk-weighted assets. (13) Ratio between Tier 1 capital and total exposure (including on- and off-balance-sheet assets, derivatives).

Macroprudential policy

In the exercise of its powers as the national macroprudential authority, Banco de Portugal has developed the conceptual framework of this policy and activated macroprudential tools it deems ex-ante suited to address the build-up of systemic risk.

In early 2018, Banco de Portugal announced a macroprudential measure aimed at mitigating the risks associated with new credit agreements with consumers. This measure, which came into force in July 2018 as a Recommendation, consisted of the introduction of limits to the maturity of loans and to the loan-to-value (LTV) and debt-service-to-income (DSTI) ratios (Box 3). To monitor the implementation of this measure, Banco de Portugal continued to interact closely with the

institutions for the preparation and collection of information, and provided clarifications on issues raised by these institutions and their customers.

On a quarterly basis, Banco de Portugal continued to reassess the countercyclical capital buffer, and kept it at 0%.

In 2018, the period for the phased implementation of the capital conservation buffer – designed to absorb losses in a potentially adverse macroeconomic and financial scenario – came to an end. As of 1 January 2019, this buffer has been increased to 2.5% of total exposures.

The Other Systemically Important Institutions (O-SII) capital buffer, imposed on banking groups considered systemically important at national level, started to be phased in as of January 2018. This buffer, included in a harmonised set of tools at European level, seeks to mitigate the build-up of risks stemming from misaligned incentives and moral hazard associated with institutions deemed too big to fail. It is specific to each institution¹⁷ and should be fully implemented as of January 2021.

The annual exercise to identify third countries relevant to the Portuguese banking system was carried out and there was no change in relation to the countries identified in the previous year. Banco de Portugal has also decided to voluntarily reciprocate the macroprudential measures taken in Belgium and Finland, which are related to exposures secured by residential property located in those countries.

Prudential supervision

After several years in which the prudential supervision activity was constrained by the management of specific situations in the banking system, in 2018, in the context of a more normal environment, prudential supervision was directed to strengthen supervised banks in three key areas: governance and internal control, credit risk and business model.

At the level of internal governance structures, the Bank scrutinised the requirements to act as member of corporate bodies, determined the increase of independent members, requested the exclusion of members with potential reputational risk and the mitigation or remedy of potential conflicts of interest. In this context, 666 individuals were granted authorisation (Table I.2.2) and 210 recommendations were issued, with a view to enhancing qualifications for the performance of duties.

Regarding internal control systems, the Bank requested the implementation of the conditions required for an effective and independent performance of risk management, compliance and internal audit functions, including the replacement of those in charge, where necessary. The Bank also requested development or revision of policies on risk management, prevention of conflict of interests, reporting of irregularities, remuneration, selection of auditors and assignment of non-prohibited services. Independent audits were also requested, whenever a behaviour of repeated situations was observed.

Also in 2018, institutions' business models were strengthened by assessing their viability and sustainability, and by questioning and monitoring their strategic plans. In 2018, several of the system's profitability indicators have reached peaks since the financial crisis, with the return on equity and return on assets ratios and the net interest income rate standing at 7.1%, 0.7% and 1.6% respectively, levels comparable to the average within the Single Supervisory Mechanism (Table I.2.1).

17. For further information on the O-SII buffer, refer to the information published on Banco de Portugal's website.

Table I.2.2 • Registration acts

	2016	2017	2018	Δ 2018-2017
Members of corporate bodies registered:				
– Management bodies	603	336	324	-12
– Supervisory bodies	480	210	228	18
– Board of the general meeting	317	146	114	-32
	1,400	692	666	-26
National institutions registered:				
– Credit institutions	173	170	165	-5
– Financial companies	96	95	90	-5
– Payment institutions	44	45	46	1
– Electronic money institutions	5	6	8	2
– Holding companies	32	31	29	-2
Branches of subsidiaries of EU-based credit institutions		1	2	1
Branches of EU-based financial companies		1	1	
Registered representative offices of credit institutions and financial companies based abroad	20	20	20	
	370	369	361	-8
Credit institutions based in EEA States, providing services	513	535	537	2
Payment institutions based in EEA States, providing services	306	348	360	12
Electronic money institutions based in EEA States, providing services	93	134	172	38
Registration acts with regard to qualifying holdings	182	212	228	16
Statutory changes	89	75	56	-19
Total	2,953	2,365	2,380	15

Source: Banco de Portugal.

In 2018, there was also an increase in capital and liquidity positions, following the issuance of decisions aiming at ensuring levels consistent with the risk profiles and the regulatory requirements. As regards the capital position, the decisions issued in the supervisory process have led to the strengthening of the institutions' solvency, with about €900 million increase in Tier 2 capital up to December 2018. Total capital ratio remained unchanged at 15.1%.

Liquidity ratios have also improved significantly, with an increase in the liquidity coverage ratio (LCR) by 23 percentage points and in deposits taken by €8,3 billion up to December 2018, which enabled recourse to Eurosystem financing to be reduced by €3,5 billion (-15%) during 2018.

In terms of overall results, these measures have helped to enhance the quality of the internal governance and internal control systems, and have led to very positive developments in asset quality indicators, to the strengthening of the institutions' business models, and to improvements in capital and liquidity positions. These results were achieved on the basis of a bank-to-bank intervention.

In addition, 2380 registrations were made in relation to: members of corporate bodies (666); credit institutions, financial companies and payment institutions (1430), qualifying holdings (228) and statutory changes (56). There were no significant changes compared to 2017.

Banking conduct supervision

In 2018, banking conduct supervision by Banco de Portugal was extended to other entities. New functions were assigned to the Bank with regard to the authorisation and registration of credit intermediaries and the certification of training entities of credit intermediaries and of employees of the institutions involved marketing loans for house purchase (Box 4). At the same time,

the rights of bank customers have been strengthened by the entry into force of important legal acts and their regulatory implementation in the areas of mortgage credit, payment accounts, structured deposits and payment services.

In parallel, the increasing offering of retail banking products and services through digital channels has required Banco de Portugal to monitor and supervise the conduct of the institutions. The Bank has also sought to ensure that the duties of transparency of information and assistance were fulfilled in these channels, by guaranteeing the same rights to customers regardless of the channel used (technological neutrality) (Box 1).

The transposition into the Portuguese legal framework of the provisions of the Payment Accounts Directive¹⁸ extended the rights of bank customers by laying down new rules on transparency and comparability of fees and commissions charged to consumers in relation to the payment accounts held by the same. After establishing a standardised designation of the main payment account services, Banco de Portugal launched a free comparison tool for payment accounts' fees and commissions. This Fees Comparator, available on the Bank Customer Website, allows a simple and quick comparison by service or institution of 93 maximum fees charged by all the institutions offering services linked to payment accounts (about 200 institutions). The information provided takes into account the distribution channels available for each service; thus, user search results can be sorted or filtered by type of service and channel used. This comparator contains information reported by the institutions and is thus constantly updated. It is also one of the measures included in the programme SIMPLEX+2017 entitled "*Consumo financeiro + informado*" ("More informed financial consumption"), which has played a pioneering role at European level. In order to support consumers in the use of the Fees Comparator, Banco de Portugal has released, on the Bank Customer Website, a video tutorial, a glossary, FAQs and boxes containing additional information on the services included in the comparator.

In the context of supervising the advertising of banking products and services, Banco de Portugal inspected 9,739 advertisements in order to check compliance with the information and transparency obligations of the institutions, an increase of 2.5% compared to 2017. 117 of these advertisements are related to structured deposits, subject by law to prior approval by Banco de Portugal (Table I.2.3).

In 2018, after the changes made to the regulatory framework applicable to structured deposits, institutions became required to provide their customers with a new pre-contractual information document, the Key Information Document ('KID'). Banco de Portugal checked compliance of the information provided in the KID for 91 structured deposits offered in 2018, representing a decrease of 37% compared to 2017, which is in line with the trend of previous years. Banco de Portugal also checked the remuneration rates set by the institutions for the 162 deposits of this type that matured in 2018.

In turn, banking conduct supervision inspectors monitored the significant extension of the regulatory framework in 2018. In this context, according to the priorities laid down based on a risk assessment, Banco de Portugal checked compliance with the obligation for the institutions to submit to their customers the 'invoice-receipt', at the beginning of each year and free of charge,

18. Directive 2014/92/EU of 23 July 2014, incorporated by Decree-Law No 107/2017 of 30 August 2017.

detailing all fees and commissions charged in the previous year linked to their current account. A total of 123 inspections were carried out on all institutions maintaining current accounts, and no non-compliance was detected.

Compliance with the regulatory framework on minimum banking services remained a priority in 2018, especially with the entry into force of two major amendments to this scheme throughout the year. Institutions' compliance with the submission of information by the institutions on the convertibility of current accounts into minimum banking services accounts was checked and all 106 institutions offering such accounts were questioned on this requirement. Due to the change in the method for calculating the maximum annual costs linked to this account, which now cannot exceed 1% of the amount of the social support index, a thorough assessment of the price lists and standardised information sheets was carried out.

In the context of the minimum banking services, Banco de Portugal also monitored the implementation of new parameters for debit cards, the provision of information on access conditions and new services available, and assessed, at branch level, the provision of information and compliance by the institutions' employees with the duty to provide assistance, the conditions of access and the characteristics of these accounts.

Compliance with the rights granted to bank customers by the new legal framework for mortgage credit was also checked.¹⁹ The provision of pre-contractual information contained in the new European Standardised Information Sheet (ESIS) was also assessed, including information on loan characteristics, charges and interest rates, as well as the use of the APRC as a new measure of total cost of credit. At branch level, Banco de Portugal also oversaw compliance with the duty to provide assistance by the institutions' employees. These inspections were carried out in 46 branches of 24 institutions, representing a significant part of the mortgage credit market.

In 2018, Banco de Portugal continued to pay special attention to consumer credit, due to its relevance and buoyancy, with the inspections focusing mainly on credit cards. During the inspections, the Bank assessed in particular the application of the arrears regime, in particular the collection of the maximum surcharge for interest on arrears and fees for recovery of amounts owed, as well as the general default regime, analysing the practices adopted in the solutions for settling non-compliance with credit agreements.

Similarly to the year before, 15,254 complaints were received from bank customers. Deposit accounts were the product type with the highest number of complaints, followed by consumer credit and mortgage credit, together accounting for about 70% of the total. In 44% of the cases, the analysis of complaints by Banco de Portugal led to the resolution of the situation by the credit institution. 56% of the complaints showed no evidence of infringement by the institution in question.

The inspections, the supervision of advertising and the complaint analysis led to the issuance of 907 specific instructions from Banco de Portugal demanding the irregularities detected to be corrected. It also initiated 47 administrative offence proceedings.

Banco de Portugal continued to promote financial information and training for bank customers, in particular through the Bank Customer Website, paying special attention to minimum banking services. This was also the year in which Banco de Portugal launched its digital plan for financial

19. Entry into force of Decree-Law No 74-A/2017 of 23 June 2017, which incorporated into the Portuguese legal system the Mortgage Credit Directive, and the supplementary regulations, specially Notice of Banco de Portugal No 5/2017.

education, designed to raise bank customers' awareness of the benefits and risks associated with banking products offered through the internet and mobile applications, and thus promote the safe use of these channels. Banco de Portugal continued to participate and collaborate actively with other financial supervisors in the initiatives of the National Plan for Financial Education (Chapter 3).

In the context of representation in the main international fora for banking conduct supervision, in addition to that outlined in the beginning of this chapter, the Bank participated in the International Financial Consumer Protection Organisation (FinCoNet) and in OECD working groups focused on bank customer protection and the development and promotion of financial education principles and best practice. Banco de Portugal also followed the work of the G20/Global Partnership for Financial Inclusion platform, which it joined in 2017 with the status of participating non-G20 member country; in this context, the Bank contributed to the preparation of a policy guide on digitalisation for financial inclusion.

Table I.2.3 • Key indicators for banking conduct supervision | 2016–2018

	2016		2017		2018	
	Number	Entities covered	Number	Entities covered	Number	Entities covered
Systematic supervision						
Price lists (fees and interest rates leaflets) reported	1,222	102	1,090	96	1,150	93
Advertisements inspected	8,572	59	9,501	55	9,739	56
Pre-contractual information on structured deposits ⁽¹⁾	197	12	145	12	91	8
Remuneration rates on structured deposits ⁽²⁾	233	13	187	15	162	12
Consumer credit agreements concluded	1,582,788	56	1,601,050	56	1,627,313	55
Inspections⁽³⁾	810	105	874	126	1,335	123
Branches	132	22	147	31	400	27
Central services	66	12	95	16	85	24
Off-site	612	105	632	126	850	123
Complaints	14,141	84	15,282	77	15,254	74
Requests for information						
Specific recommendations and instructions	1,020	73	753	59	922	66
Administrative offence proceedings initiated	155	29	55	21	47	19
Financial education						
Training initiatives ⁽³⁾	350		375		449	
No of trainees	12,122		12,577		14,364	

Source: Banco de Portugal. | Notes: (1) Since early 2018 the term 'indexed deposits' has been replaced with 'structured deposits'. In the same year, pre-contractual information on such deposits started to be provided to customers on a new document, the Key Information Document ('KID'), replacing the prospectus. (2) Depending on what is being inspected. (3) Banco de Portugal's initiatives.

Legal enforcement

In 2018, the Bank made significant progress in several administrative offence proceedings of considerable size and complexity, and in some cases it was possible to complete the investigation and deliver the corresponding final decision.

In the course of the year, 195 administrative offence proceedings were concluded, which, together with a decrease in the number of new proceedings initiated, led to a significant reduction in the total number of proceedings pending at the end of 2018, particularly affecting those brought longer ago (Table I.2.4).

Table I.2.4 • Administrative offence proceedings

Overall indicators	2016	2017	2018	Δ 2018-2017
Proceedings carried forward from previous year	382	441	326*	-115
Proceedings initiated	276	154	113	-41
Proceedings concluded	217	271	195	-76
Proceedings pending at the end of the year	441	325	244	-81

Source: Banco de Portugal. | Note: * The difference between the number of proceedings pending at the end of 2017 and the number of proceedings carried forward to 2018 arises from a decision delivered in summary proceedings at the end of 2017, which was refused in 2018.

In terms of prevention and repression of illicit financial activity, Banco de Portugal conducted off-site and on-site inquiries in 218 proceedings. These led to the initiation of 12 administrative offence proceedings, 20 notifications to the Prosecutor General of the Portuguese Republic for signs of criminal offence, and public warnings to 19 entities not authorised to conduct financial activity. Furthermore, Banco de Portugal cooperated with the judiciary and police authorities, participating in investigations on matters of common competence.

Banco de Portugal's supervisory work in the prevention of money laundering and terrorist financing (ML/TF) increased significantly. The Bank carried out 20 on-site inspections, issued 198 supervisory measures, and assessed the implementation of 354 supervisory measures issued following inspections carried out in previous years. It also stepped up its action in processes for the acquisition of or increase in qualifying holdings and for the incorporation of new financial institutions, by assessing the risk associated with shareholders and, in the case of incorporation of new financial institutions, by checking the ML/TF preventive procedures. It assessed the compliance of ML/TF preventive control mechanisms in the context of the renewal of the authorisation granted to payment institutions and active electronic money institutions under PSD2. In addition, it concluded the work towards the entry into force of Notice of Banco de Portugal No 2/2018 and Instruction of Banco de Portugal No 5/2019 on the provision of information and other aspects necessary to ensure compliance with the ML/TF preventive duties.

In terms of non-sanctioning enforcement, 10 proceedings were examined for the possible withdrawal of the authorisation of credit institutions, financial companies and payment institutions, and, based on supervening facts, 31 proceedings were analysed for a possible reassessment of the suitability of the members of the management and supervisory bodies of supervised institutions, entailing several investigatory and documentation measures, as well as detailed legal analyses. In this field, Banco de Portugal maintained significant interaction with the ECB, given that, in the context of the Single Supervisory Mechanism, 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 21 winding-up proceedings – some of which were concluded in the course of 2018 – under the responsibility of State commissioners, judicial liquidators or liquidation committees appointed for that purpose, especially the somewhat complex winding-up of BES and BANIF.

Deposit guarantee funds and the Resolution Fund

In 2018 Banco de Portugal continued to provide technical and administrative services required for the smooth operation of the Deposit Guarantee Fund, the Mutual Agricultural Credit Guarantee Fund and the Resolution Fund.²⁰

With regard to the contribution schemes of each of the funds, Banco de Portugal set the parameters for calculating the contributions due by member institutions and carried out the procedures for calculating and collecting those contributions.

The Deposit Guarantee Fund and the Resolution Fund approved their respective plans for the prevention of corruption risks and related offences, and Banco de Portugal's Compliance Office was entrusted with managing the corruption risks and related offences of these Funds. In the case of the Mutual Agricultural Credit Guarantee Fund, the drafting of this plan began in 2018 and will be finalised in 2019.

As the designated authority for the Deposit Guarantee Fund and the Mutual Agricultural Credit Guarantee Fund, Banco de Portugal participated in the working group on deposit guarantee schemes, created by European Banking Authority to assist it in carrying out the tasks assigned to it under Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014.

With regard to the Resolution Fund, the Bank continued to provide the support needed for the performance of its tasks as shareholder of Novo Banco and Oitante, and more importantly, for the monitoring of the implementation of the agreements related to the sale of Novo Banco, in particular the share purchase and subscription agreement, and the contingent capitalisation agreement.

2.3 Resolution

As to the resolution function, Banco de Portugal has intensified the resolution planning work for institutions under its direct responsibility as national resolution authority, i.e. institutions considered to be less significant for the purposes of the Single Supervisory Mechanism and institutions that are not part of cross-border groups. The Bank prepared the first resolution plans for this set of institutions and worked further on the development of methodologies for the implementation of a simplified system of obligations with a view to accommodating the heterogeneity of the Portuguese banking system conveniently.

With regard specifically to the resolution planning for groups and institutions under direct responsibility of the Single Resolution Board (SRB), Banco de Portugal participated in the work of the internal resolution teams and in the preparation of decisions related to the resolution plans of those groups and institutions, including the calculation of the minimum requirement for own funds and eligible liabilities (MREL).

As part of its participation in the decision-making bodies, committees and working groups comprised in the SRB, Banco de Portugal contributed to the development of guidelines and methodologies related to the planning, implementation and enforcement of resolution measures, including: (i) the assessment of credibility and public interest in the application of resolution measures; (ii) MREL calculation; (iii) the assessment of resolvability of credit institutions and subsequent identification and removal of impediments to the resolution; (iv) the determination of an institution's status as failing or likely to fail; and (v) the planning, implementation and operation of several resolution measures.

20. For further information on the activities of each of the funds see the reports and accounts that are made available on their sites.

Also within the scope of the Single Resolution Mechanism, Banco de Portugal continued to provide all support necessary for the operation of the Single Resolution Fund, and participated in supporting tasks for the calculation, collection and payment of periodical contributions for the year 2018, and in December 2018 it organised, together with the SRB, a clarification session, addressed to the Portuguese credit institutions, on the contributions and operation of this fund.

Banco de Portugal also continued its work on the resolution measures applied to BES and BANIF. In addition to the aforementioned support to the Resolution Fund in the follow-up of the agreements related to the sale of Novo Banco and in the monitoring of the activities of Oitante, Banco de Portugal promoted the conditions required for the completion of the work of the independent valuer in charge of carrying out the evaluations provided for in the resolution regime, and continued to analyse and deliver its opinion, where applicable, on several consultations and requests related to the perimeters for the transfer of rights and obligations set by Banco de Portugal in the context of BANIF's resolution. In addition, Banco de Portugal collaborated with the ECB in the proceedings that led to the withdrawal of BANIF's authorisation to conduct business (a decision that triggered its judicial winding-up proceedings).

2.4 Upholding the legality of the resolution and enforcement measures

A considerable amount of litigation against Banco de Portugal continued to exist in 2018, and against the funds it operates, mainly due to the high number of court cases handled by the Bank's legal services as a result of the application of resolution measures in previous years. In addition to these cases, Banco de Portugal also has to monitor the litigation handled by Novo Banco in Portuguese courts and foreign jurisdictions, as a result of the obligations undertaken by the Resolution Fund as part of the sale of that institution.

In 2018, the litigation involving Banco de Portugal included a major court ruling, delivered by the UK's Supreme Court on the "Oak Finance" case (Goldman Sachs International and other investors v Novo Banco). After Banco de Portugal's intervention before the appeal courts, the British courts recognised that Portuguese courts have exclusive jurisdiction to decide on the dispute, the matter of which was related to the fulfilment of obligations that Banco de Portugal had asserted to be BES's responsibility. This judgement is a landmark decision at European level in the field of cross-border recognition of decisions taken by resolution authorities and of the jurisdiction of their national courts, and is expected to have repercussions on litigation in other jurisdictions.

Banco de Portugal has also intervened in numerous trial hearings at the Portuguese Competition, Regulation and Supervision Court, in particular the hearing leading up to the court ruling on the first administrative offence proceedings of the so-called "BES Universe". Banco de Portugal has also participated in several specific appeals related to sanctioning proceedings, as well as in trial hearings related to the application of resolution measures to BANIF.

In the cases in which Banco de Portugal, the Deposit Guarantee Fund and the Resolution Fund are prosecuted by former customers of Banco Privado Português (currently in liquidation) and following the resolution processes of BES and BANIF, there have been several rulings in favour of Banco de Portugal and the Funds, in interim injunction proceedings and main proceedings. It also continued to monitor, at the judicial stage, cases related to the winding-up of credit institutions and financial companies.

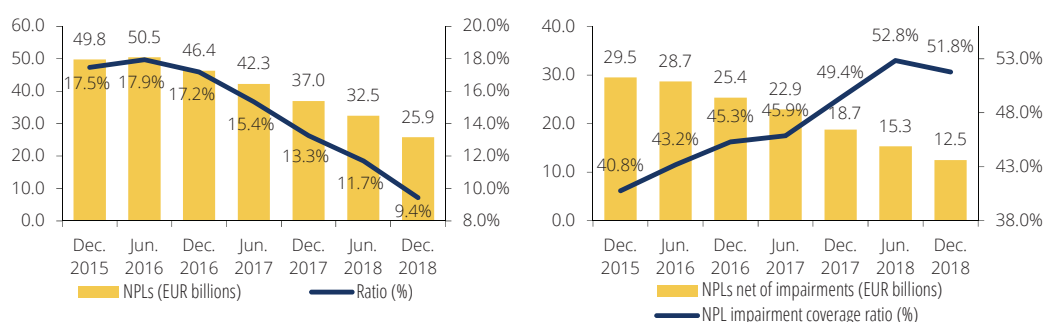
Box 2 • Developments in non-performing loans in the Portuguese banking system

In 2018 the stock of non-performing loans (NPLs), one of the key vulnerabilities of the Portuguese banking sector, decreased significantly.

In fact, one of the most significant achievements in the sector, in the past few years, was the marked reduction in NPLs by Portuguese credit institutions. From June 2016 – when it reached its highest level of €50.5 billion – to December 2018, the stock of NPLs declined by €24.7 billion to €25.9 billion. These developments were largely the result of a reduction (of almost €16 billion) in the NPLs of non-financial corporations (NFCs) and were accompanied by an increase in the impairment coverage ratio to 51.8% in December 2018, close to the European average. The ratio of NPLs accompanied the decline in the stock by decreasing from 17.9% in June 2016 to 9.4% in December 2018, thus achieving a level below 10% for the first time since this data started to be collected based on the definition of NPLs used by the European Banking Authority (EBA). The increase in the coverage level, coupled with the decrease in the NPL stock, led to a reduction of the stock of NPLs net of impairments to an amount below €12.5 billion in December 2018 and to a net NPL ratio of 4.5%.

The decline in the stock of NPLs was due not only to write-offs, but also to cures and sales of NPLs. Sales – particularly of NPLs of NFCs – have become more relevant in the most recent period.

Chart C2.1 • Developments in the stock of NPLs, ratio of NPLs and impairment coverage levels



Source: Banco de Portugal.

A number of supervisory actions conducted by Banco de Portugal made a decisive contribution to these developments, in conjunction with the Single Supervisory Mechanism (SSM) in the case of significant institutions (SIs). In particular, institutions with higher NPL ratios were required to prepare multi-year plans to reduce NPLs. These plans are regularly monitored, reviewed and updated.

In addition, the SSM issued guidance directly applicable to SIs, establishing the supervisory authority's expectations regarding banks' internal model for managing NPLs, including guidance on forbearance, on the definition and recognition of loans as non-performing, on the measurement of impairments and on collateral valuation for immovable property. In March 2018, the SSM adopted an addendum to the guidance, focusing on provisioning for new NPLs, which was an important incentive to the timely recognition of impairment losses on loans that become non-performing.

Also in this respect, the implementation of the International Financial Reporting Standard 9 (IFRS 9) in January 2018 introduced a new model for financial institutions to calculate impairments. Under this new model, impairment losses are recognised based on expected loss, as opposed to the concept of incurred loss used in the previous model.

These initiatives are part of the comprehensive strategies implemented at both domestic and European levels to reduce the stock of NPLs in the banking system. In Portugal, the strategy²¹ to reduce NPLs is based on three interlocking and complementary pillars:

- i. revision of the legal, judicial and tax framework;
- ii. microprudential supervision action;
- iii. active management of NPLs by institutions.

At European level, particularly relevant are the initiatives included in the *Action plan to tackle non-performing loans in Europe* – adopted in July 2017 by the Economic and Financial Affairs Council of the European Union (ECOFIN) – identified in the *Financial Stability Report* of June 2018. In addition to the measures identified in this Report, the main developments in the second half of 2018 are the following:

- The political agreement between the Council and the European Parliament – reached in December 2018 – on the prudential backstop, which introduces minimum loss coverage levels for new NPLs in the European Regulation on prudential requirements for credit institutions and investment firms (Capital Requirements Regulation – CRR);
- The adoption by the EBA of the above-mentioned guidance, issued by the SSM, extending its scope to cover all European Union (EU) Member States and all significant and less significant institutions;
- The publication by the EBA of guidelines on the disclosure of information by institutions related to non-performing and forborne exposures;
- The update by the EBA, in September 2018, of data templates to organise the information to be provided by credit institutions to potential investors in NPLs;
- The publication by the European Commission, in November 2018, of a document on the setting-up of NPL transaction platforms at European level;
- The approval by the European Systemic Risk Board of a report, based on the work of an expert group co-chaired by Banco de Portugal, with macroprudential initiatives to prevent a systemic increase in NPLs in the future and strengthen the resilience of institutions to increases in NPLs.

The remaining measures in the *Action plan to tackle non-performing loans in Europe* are expected to be adopted in 2019. There should be further developments with respect to the Proposal for an EU Directive on credit servicers, credit purchasers and the recovery of collateral and to the EBA guidelines on reporting of non-performing and forborne exposures to supervisory authorities, as well as on banks' loan origination, monitoring and related internal governance rules (of a more preventive nature).

These initiatives are all key to promoting the reduction of the NPL stock and preventing significant increases in these assets in the future. Nevertheless, the most important role belongs to credit institutions, which should continue their efforts to reduce NPLs at a robust pace.

21. As detailed in the *Financial Stability Report* of December 2017, published on Banco de Portugal's website.

Box 3 • The macroprudential measure applied to new credit relating to residential immovable property and consumer credit

In its capacity as national macroprudential authority, by deliberation of the Board of Directors of Banco de Portugal of 30 January 2018, Banco de Portugal has approved a **recommendation** introducing limits to some of the criteria used by institutions when granting new consumer credit.²² These limits are applicable as of 1 July 2018 to credit agreements relating to residential immovable property, credit agreements secured by a mortgage or equivalent guarantee, and consumer credit agreements concluded by credit institutions and financial companies having their head office or a branch in Portugal.

With this recommendation, Banco de Portugal seeks to ensure that credit institutions and financial companies adopt prudent criteria when granting new credit and simultaneously that borrowers have access to sustainable financing. This measure has been adopted to prevent the build-up of systemic risk in the financial system, taking into account, on the one hand, an environment of low interest rates, economic recovery and house price increases – conducive to an easing of credit standards – and, on the other hand, of high indebtedness and a low household savings rate, which make them more susceptible to adverse macroeconomic and financial developments.

The recommendation establishes three types of limit²³ to the criteria used in the consumers' creditworthiness assessment, which institutions should observe simultaneously:

- to the ratio of the loan amount to the value of the immovable property pledged as collateral (LTV – loan-to-value);
- to the ratio of the monthly instalment amount calculated with all the borrower's loans to his/her net monthly income, adjusted for the borrower's age at the expiry of the agreement and his/her employment status (DSTI – debt service-to-income);
- and to the original maturity of the loans.

The recommendation also establishes that new credit agreements should have regular principal and interest payments (Figure C3.1).

When applied simultaneously, these limits help strengthen the measure's effectiveness. In fact, the limits to the LTV may ease in a context of rising housing prices, which is why they are combined with limits to the DSTI and to the maturity. Limits to the DSTI act as automatic stabilisers, given that they tighten in the expansionary phase of the credit cycle, since housing prices tend to grow faster than the borrowers' income. On the other hand, imposing a limit on the maturity makes it possible to prevent the DSTI limit from being circumvented by an extension of the loan's original maturity.

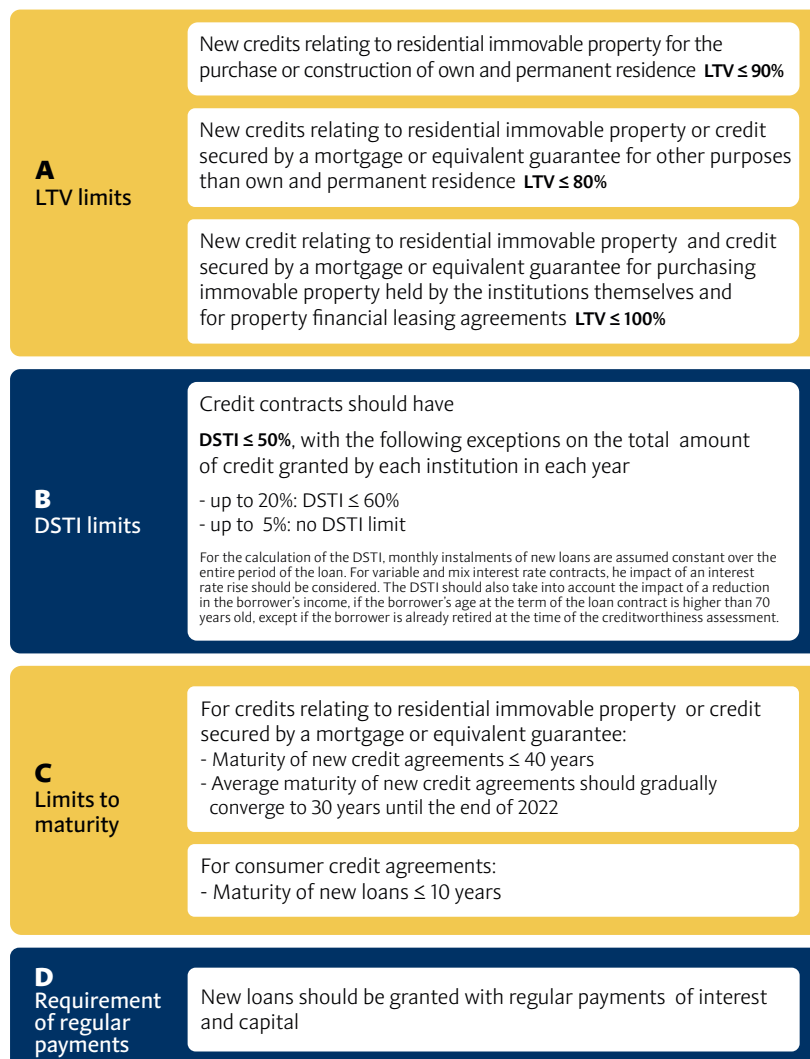
Although the DSTI is key for assessing the probability of default, there are other important factors for ascertaining credit risk, such as the borrower's level of wealth, the existence of a guarantor, or the amount of the borrower's other regular expenses. Taking into account the limitations associated with the DSTI and the wider group of indicators used by credit institutions when assessing specific risk situations, Banco de Portugal allows exceptions to DSTI limits (Table 1). Nevertheless, institutions will have to justify these exceptions, on the assumption that they are used carefully and observe strict risk analysis standards.

The limits introduced correspond to the applicable caps and as such do not replace these institutions' compulsory assessment of the adequacy of the different indicators' values and the weighing of other criteria when assessing borrowers' creditworthiness.

22. "Consumer" means a natural person who acts for purposes other than those of his or her commercial or professional activity in the credit agreements covered by the provisions of Decree-Law No 133/2009 and Decree-Law No 74-A/2017.

23. For further details on these limits, see the relevant information and documentation available on Banco de Portugal's website.

Figure C3.1 • Summary of Banco de Portugal's recommendation



These quantitative limits were defined based on impact studies conducted by Banco de Portugal and compared with relevant international benchmarks. The studies analysed the probability of default and losses to the financial system related to the different LTV and DSTI levels, as well as the impact of imposing various limits on credit and other variables relevant to financial stability. In the course of this process, Banco de Portugal also collected and analysed information on the credit standards currently applied by Portuguese institutions, and assessed expectations as to the future evolution of these criteria. Subsequently, it consulted the Associação Portuguesa de Bancos (APB), Associação de Instituições de Crédito Especializado (ASFAC), Associação Portuguesa de Leasing, Factoring e Renting (ALF) and Associação Portuguesa para a Defesa do Consumidor (DECO) with regard to a draft recommendation on new credit agreements for consumers. The National Council of Financial Supervisors (CNSF) was also consulted in accordance with the applicable law.

Similarly to other macroprudential authorities in the European Union, Banco de Portugal chose to implement the limits to credit standards as a recommendation, to avoid any market disturbances, difficult to predict given the measure's innovative nature and complexity. This notwithstanding, the

recommendation is subject to the “comply or explain” principle, which means that the institutions concerned should observe the requirements set out or justify non-compliance. In the event that the explanation is considered inadequate, Banco de Portugal may issue other measures within its competences as the national macroprudential authority.

Public announcement of the measure included a session with journalists and interviews with members of the Board of Directors of Banco de Portugal. It also involved the creation of a webpage on the macroprudential measure, summarising the set of macroprudential tools, information on the underlying legal framework, and the documents supporting the recommendation. Some frequently asked questions (FAQs) and an information video were also released.

In November 2018 an authored article on this measure was published in Banco de España’s Financial Stability Review, and various public presentations were given.

The recommendation establishes that Banco de Portugal monitors implementation of the criteria set out at least once a year, as well as the evolution of credit excluded from the scope of the measure. Hence, in the months following the entry into force of the recommendation, Banco de Portugal and the most representative institutions from the Portuguese financial system and institutions specialising in consumer credit interacted closely via telephone and bilateral meetings. The purpose of this contact with the institutions was to gauge the degree of implementation of the recommendation in the various distribution channels, clarify the information to be reported, and check the advertising campaigns’ compliance with the recommendation, as well as the involvement of said financial institutions’ boards in the monitoring of the recommendation’s implementation.

The data collected do not yet allow a comprehensive analysis of the recommendation’s impact on credit developments, mainly because there are credit operations whose borrower’s creditworthiness assessment was carried out prior to the entry into force of the recommendation, but whose funds were released after 1 July 2018. This is particularly significant in credit relating to residential immovable property, in which the period between the creditworthiness assessment and the release of funds is greater than for consumer credit. In addition, the information available for some institutions includes credit for an amount lower than the equivalent to tenfold the guaranteed monthly minimum wage, which is excluded from the scope of the measure.

However, it was possible to see that the LTV ratio generally became more demanding, insofar as total credit granted depended on the minimum between the purchase price and the appraisal value. In fact, in general, the purchase value is lower than the appraisal value. For example, as regards the maximum value of the LTV for credit relating to residential immovable property for the purchase or construction of own and permanent residence, the institutions’ usual practice prior to implementation of the measure was 80% to 90% of the appraisal value.

On the other hand, most institutions did not apply caps to the maturity of new agreements above those established in the recommendation and do not seem to record significant overrunning as far as the limits established are concerned. Prior to the entry into force of this Banco de Portugal recommendation, however, some institutions were applying maximum maturities of 50 years for credit relating to residential immovable property. With regard to the gradual convergence towards an average maturity of 30 years for this type of credit, institutions expect it to occur naturally by the end of 2020, although at present no specific measures are being adopted.

In 2019 Banco de Portugal will continue to monitor compliance with the macroprudential measure.

Box 4 • Broadening the perimeter of banking conduct supervision

In recent years, the scope of the banking conduct supervision function has been expanded in order to cover new entities.

In 2017, the Portuguese legislator regulated the activity of credit intermediaries by laying down requirements for access to and pursuit of this activity, and assigning to Banco de Portugal the responsibility for supervising the entities conducting such business. Banco de Portugal's tasks include checking compliance with the requirements for access to the activity, as well as supervising the activities of credit intermediaries and other entities authorised to carry on such activity.

In that same year, Banco de Portugal also became responsible for certifying the training entities of credit intermediaries and of employees of the institutions involved in marketing mortgage credit. In exercising this function, Banco de Portugal assesses whether these entities meet the requirements necessary to grant professional certification to credit intermediaries and employees of the institutions involved in marketing mortgage credit. Banco de Portugal is also responsible for following up, monitoring, regulating and ensuring the quality of the training activity provided by these entities.

In addition, in 2018 the perimeter of banking conduct supervision expanded in order to cover the activity carried on by payment initiation service and account information service providers.

Authorisation and registration of credit intermediaries

Credit intermediaries are natural or legal persons that, although not authorised to grant credit, are involved in marketing credit agreements. Typically, these entities present or propose credit agreements to consumers, but they may also help consumers in preparatory documentation for entering into such agreements, provide consultancy services or enter into credit agreements on behalf of lending institutions.

The activity of credit intermediation in Portugal has seen significant development in recent years, playing an important role in the operation of the credit market. In 2017, 45.4% of all consumer credit agreements were offered by credit intermediaries, constituting the main distribution channel in some segments of that market (car loans and revolving credit).²⁴

When the Mortgage Credit Directive was transposed into the Portuguese legal system, the legislator chose to regulate the activity of credit intermediaries across the board, by laying down rules that, in general terms, apply either to credit intermediaries which intend to operate in the area of mortgage credit or to those which intend to operate in the area of consumer credit.²⁵

With the entry into force of these rules on 1 January 2018, access to the credit intermediary activity is now conditional upon authorisation and registration with Banco de Portugal. Credit institutions, financial companies, payment institutions and electronic money institutions, may also act as credit intermediaries, without needing specific authorisation for the purpose. Those credit intermediaries which obtained authorisation in other Member States of the European Union and which operate in mortgage credit may also carry on this activity within Portuguese territory through a branch or under the freedom to provide services.

The party concerned must apply for authorisation to pursue the activity using the relevant form available on the Bank Customer Website. The application for authorisation must be accompanied by documents showing compliance with the requirements laid down by law, in particular with regard to

24. For further information, see the Retail Banking Markets Monitoring Report for 2017, available on Banco de Portugal's website (in Portuguese only).

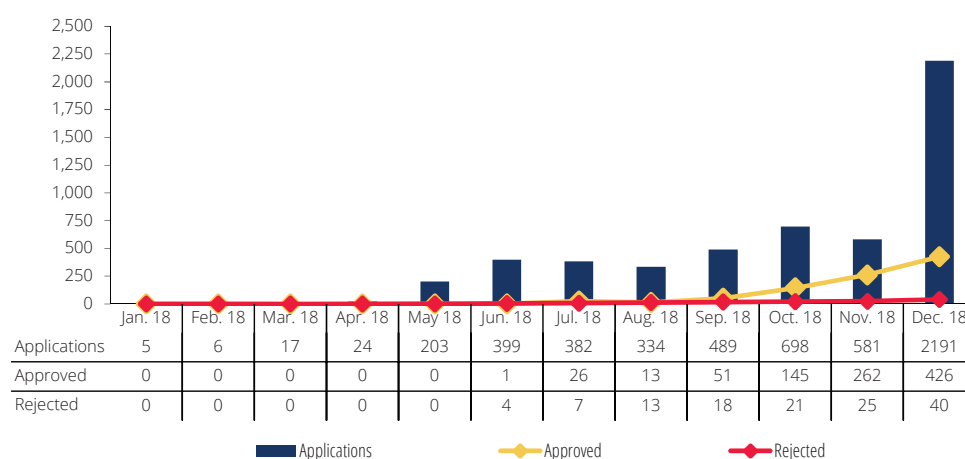
25. Decree-Law No 81-C/2017 of 7 July 2017.

adequate knowledge and skills, suitability, appropriate commercial and administrative organisation, and the possession of professional indemnity insurance or other comparable guarantee.

The legislator established a transitional period allowing those already engaged in credit intermediary activities on 1 January 2018 to continue pursuing such activities until 31 December 2018 without being authorised and registered with Banco de Portugal. In December 2018, the transitional period was extended until 31 July 2019.²⁶

In 2018, Banco de Portugal received 5,329 applications for authorisation to pursue this activity, of which 924 were approved and 128 were refused (Chart 1).

Chart C4.1 • Developments in credit intermediary authorisation applications



Source: Banco de Portugal.

Applications for authorisation were received principally from the beginning of the second half of the year onwards, with a considerable number of applications in December.

Most applications for authorisation were submitted by legal persons carrying on business in other areas and seeking to operate in the area of consumer credit, as a credit intermediary in an ancillary capacity, in order to boost the business activity they already pursue. Nevertheless, about 20% of the applications received were submitted by persons interested in pursuing the activity of credit intermediary in the area of mortgage credit.

So that the persons interested in pursuing the activity and the lending institutions are able to monitor the progress of the authorisation and registration proceedings, every week Banco de Portugal releases data on the applications submitted, approved and rejected, through the Bank Customer Website. This information is particularly important given that the number of applications submitted increased significantly at the end of the year due to the extension of the transitional period.

Banco de Portugal is also responsible for the registration of credit intermediaries and public disclosure of information on entities authorised to operate as credit intermediaries.

During 2018, 11 communications were received from the supervisory authorities of France, the United Kingdom and the Netherlands concerning credit intermediaries wishing to operate in Portugal in the area of mortgage credit. Most of these intermediaries pursue the activity under the freedom to provide services, and there is only one case where the credit intermediary has chosen to establish a branch in Portuguese territory.

26. Decree-Law No 122/2018 of 28 December 2018.

Table C4.1 • Communications received from home Member States on cross-border activity of a credit intermediary authorised in another EU Member State | 2018

EU Members state	Communications
France	5
United Kingdom	4
Netherlands	2
Total	11

Source: Banco de Portugal.

In 2018, communications were also received from 16 credit institutions wishing to operate as credit intermediaries.

Banco de Portugal publishes on the Bank Customer Website information on credit institutions, financial companies, payment institutions and electronic money institutions providing credit intermediation services or consultancy services in relation to credit agreements.

Supervision of the activity of credit intermediaries

Banco de Portugal is responsible for monitoring credit intermediaries' compliance with applicable legal and regulatory requirements, and has the power to sanction non-compliance with those rules.

In addition to the specific provisions governing the activity of credit intermediaries in the marketing of consumer credit agreements²⁷ and mortgage credit agreements,²⁸ the legal regime governing the activity of credit intermediaries also provides for a set of rules for carrying on this activity.

These include duties of conduct and provision of information to customers on credit intermediation services and the conditions under which such services are provided. The remuneration for services rendered by credit intermediaries is also regulated, in particular by establishing that non-tied credit intermediaries may only be remunerated by bank customers and that credit intermediaries acting on behalf and under the responsibility of a lending institution (tied credit intermediaries and credit intermediaries in an ancillary capacity) are remunerated only by the lending institution, and are not allowed to receive any amounts from consumers, namely as compensation, fee or expense. They also include rules governing the advertising of services provided by credit intermediaries and laying down the conditions under which credit intermediaries may advertise the credit products they market.

In the exercise of its supervisory tasks, Banco de Portugal carries out inspections and may require credit intermediaries, as well as lending institutions to which they are tied, to present the information and documentation it deems necessary to monitor compliance with applicable legal and regulatory requirements. Banco de Portugal is also responsible for reviewing the complaints submitted by customers of credit intermediaries.

Where it identifies irregularities in the activity of the intermediaries or lending institutions, Banco de Portugal may issue specific orders and, as a result of administrative offence proceedings, may impose fines and additional penalties.

Certification of training entities

The legal framework for mortgage credit obliged creditors with headquarters or branches in Portugal to ensure that their employees have and maintain an adequate level of knowledge and skills in the preparation, offering and conclusion of mortgage credit agreements.

27. Decree-Law No 133/2009 of 2 June 2009.

28. Decree-Law No 74-A/2017 of 23 June 2017.

Likewise, the legal regime of credit intermediaries provides that natural persons or members of the board of directors of legal persons wishing to engage in the activity of credit intermediary or, where they exist, those responsible for that activity and, furthermore, employees of credit intermediaries wishing to carry out their activity in the context of mortgage credit agreements, must have an adequate level of knowledge and skills in the matters relevant to the exercise of the activity in question.

Banco de Portugal examines the applications for certification submitted by the training entities wishing to provide certified training to credit intermediaries and to employees of credit institutions engaged in granting and marketing of mortgage credit agreements. Banco de Portugal is also required to disclose the list of certified training entities, which is published on the Bank Customer Website.

In 2018, Banco de Portugal received seven applications for certification, of which four were approved and one was rejected.

Follow-up and monitoring of the activity of certified training entities

As the authority responsible for certifying training entities, Banco de Portugal promotes measures necessary for following-up, monitoring, regulating and assessing the quality of the certification system. Such measures aim at confirming that the certified training entities continue to comply with the requirements of the applicable regulations and that the way in which they pursue their training activities leads the trainees to gain an adequate level of knowledge and skills.

Where Banco de Portugal finds non-compliance with the applicable requirements by the training entities, it may revoke the certification granted.

In 2018, Banco de Portugal started monitoring these entities, and, where appropriate, issued the necessary recommendations.

Supervision of the activity of payment initiation service and account information service providers

Banco de Portugal became responsible for supervising the performance of payment initiation service and account information service providers following the transposition into the Portuguese legal system of the revised Payment Services Directive.²⁹

The payment initiation service provider initiates a payment order at the request of a bank customer in respect of a payment account held by such customer with another payment service provider. In turn, the account information service provider provides consolidated information on one or more payment accounts held by the bank customer with other payment service provider(s).

Supervising the banking conduct of the providers of these services is based on the potential risks that their operations entail for bank customers, particularly in terms of security and privacy.

These entities pursue their activity only in a digital environment (internet and mobile applications), therefore requiring differentiated supervisory work by Banco de Portugal.

Banco de Portugal has also been entrusted with the assessment of the complaints submitted by bank customers in relation to the services provided.

29. Decree-Law No 91/2018 of 12 November 2018.

3 Knowledge creation and sharing

Banco de Portugal is tasked with promoting knowledge of the Portuguese economy and European integration, under the third Broad Strategic Guideline defined for 2017-2020, thereby contributing to an enlightened and well-informed society. The following sections describe the Bank's activity in 2018 in knowledge creation and sharing, including its work with the central banks of the Portuguese-speaking countries and other emerging and developing countries. It also describes the various forms of Banco de Portugal's public accountability and social responsibility policy.

3.1 Analyses, studies and statistics

Banco de Portugal produces analyses and studies on the Portuguese economy, the euro area and financial system, and, in its capacity as national statistical authority, gathers and draws up monetary, financial, foreign exchange and balance of payments statistics. The analyses, studies and statistics help give the Bank the theoretical and empirical knowledge necessary to pursue its mission, and dissemination of this work promotes public understanding of its themes.

The Bank published macroeconomic analyses and projections through the *Economic Bulletin* in 2018. Each of the four editions featured a Special issue giving insights into the evolution of the Portuguese economy: Portuguese firms' investment decisions, household consumption, total factor productivity and tourism exports.

The *Financial Stability Report* contained Banco de Portugal's assessment of the Portuguese financial system's risks and vulnerabilities, along with analysis of topics such as the adoption of macroprudential measures at European level, the treatment of non-performing loans, technological innovation in financial services (Fintech), investment funds as a source of systemic risk, the interconnectedness of the Portuguese financial system, the monitoring of systemic liquidity risk in the banking sector, the possibility of introducing a European risk-free asset in the euro area (the so-called sovereign bond-backed securities), and the changes to the legislative package comprising the Capital Requirements Directive and Regulation (CRD IV/CRR).

Research developed in the Bank focused on three priority areas defined in the research agenda for 2018-2020:³⁰ new challenges for monetary policy and financial stability; Portuguese economic growth in the euro area context; and the future of public institutions and policies in Portugal and the European Union. In 2018, 47 studies were finalised, of which 46 appeared in Banco de Portugal's publications or other specialist publications. At the end of the year, 16 were in the final phase of revision and 97 were in progress (Table I.3.1). There were 135 external co-authors involved in the preparation of all these studies, including, among others, 30 from the Eurosystem, 13 from other national central banks, 23 from Portuguese universities and 59 from foreign universities.

The journal *Banco de Portugal Economic Studies* conveyed studies by Banco de Portugal economists and researchers on distribution of wages; GDP-linked bonds; term premia in the US and euro area; debt enforcement in the Portuguese judicial system; the Phillips curve for the Portuguese economy;

30. The research agenda identifies the analysis and research topics seen as most relevant to Banco de Portugal's Strategic Plan. Available for consultation on the Bank's website (in Portuguese only).

the outlook for exports; Portuguese international traders of non-tourism services; short-term maturity and firms' myopia; financial situation indicators of Portuguese firms; borrowing constraints and firm dynamics; unconventional monetary and fiscal policy; factors explaining interest rate spreads; and the equity risk premium in the S&P500.

Table I.3.1 • Studies completed, in revision and in progress at the end of the year, by topic | 2018

Priority topics for 2017-2020	Studies completed or in a final phase of revision	Studies in progress
New challenges facing monetary policy and financial stability	28	40
Monetary policy after the crisis	14	20
Financial intermediation	11	17
Prudential policy and regulation	3	3
Portuguese economic growth within the euro area: constraints and sustainability	27	48
Diagnosing and understanding the Portuguese economy	25	41
The future of the Portuguese economy	2	7
The future of institutions and public policies in Portugal and in the European Union	6	7
Euro area and European Union institutions	4	2
Economic policies in Portugal: stocktaking and lessons for the future	2	5
Other topics not identified in the research agenda	2	2
Total	63	97

Source: Banco de Portugal.

In the *Working Papers* series, 27 articles of a more academic nature were published, and, in the *Occasional Papers* series, an article was published on the deepening of the Economic and Monetary Union. The *Financial Stability Papers* included a work on the European Central Bank's prudential supervision powers within the Single Supervisory Mechanism. Throughout the year, the Bank's researchers presented or discussed work in over one hundred international scientific meetings.

With regard to statistical activity, the Bank fulfilled its objectives and deadlines as set in the plan for 2018.³¹ It released 287,000 statistical series through the BPStat site and 7,000 in the *Statistical Bulletin*, and shared 792,000 series with international organisations (European Central Bank, EUROSTAT, the International Monetary Fund, the Organisation for Economic Co-operation and Development and the Bank for International Settlements). It also published a *Supplement to the Statistical Bulletin* containing articles on statistics presented in national and international fora.

In recent years, the Bank has focused on the integrated use of micro databases, i.e. datasets with granular information (on an entity-to-entity and transaction-by-transaction basis) on multiple aspects of economic activity in Portugal. The use of these databases has brought improvements to the quality of statistical information that it uses and discloses to the public. Through Banco de Portugal's Microdata Research Laboratory (BPLim), located in the Porto Branch, the Bank provides microdata on the Portuguese economy to in-house and external researchers. As at the end of 2018, BPLim hosted 34 scientific projects, of which 14 were exclusively undertaken by external researchers.

31. For further details on Banco de Portugal's statistical activities in 2018, see the sectoral plan and report [available on its website](#).

One of the micro databases managed by Banco de Portugal is the Central Balance Sheet Database, which contains information on non-financial corporations in Portugal based on individual accounting data. In 2018, the Bank released four studies based on information from the Central Balance Sheet Database: two analyses, one regional and one sectoral, on non-financial corporations in Portugal; an analysis of firms integrated in groups, and a study on manufacturing. Banco de Portugal also updated six studies already published: the analyses of enterprises in the wood, cork and paper sectors; enterprises in the pharmaceutical sector; manufacture of food products; manufacture of textiles and wearing apparel; manufacturing of footwear; and accommodation and food service activities. The Bank collaborated with the Portuguese Confederation of Social Solidarity Institutions (*Confederação Nacional de Instituições de Solidariedade Social*) in the preparation of a prototype for a central balance sheet system of private social solidarity institutions.

Banco de Portugal also manages the Central Credit Register (CCR), a micro database on actual or potential credits of an initial amount of €50 or more granted by institutions in Portugal to natural and legal persons. This information is mainly intended to support credit-granting institutions in assessing the risk of their customers and of those applying for credit. In 2018, the Bank completed the redesign of the CCR, which had been launched to comply with the reporting requirements set by the European Central Bank under the AnaCredit framework,³² the new Eurosystem database on bank loans granted to firms in the euro area, but which quickly turned into a more ambitious project to set up a platform capable of gathering all credit information that Banco de Portugal needs to perform its tasks, such as statistics, supervision, financial stability and monetary authority tasks.

By compiling in this database all credit information it receives from external entities, the Bank has removed redundancy, minimised the need for new reporting requirements, and enhanced the quality of the information it works with and provides to the financial system, citizens and firms (Chapter 3.3). In the long term, the project will help reduce internal data aggregation and reporting costs borne by financial institutions.

The first release of information to the financial system under the new Central Credit Register took place in October 2018, and in November the first data were reported to AnaCredit. Aside from Portugal, only five other countries reported information on the first reporting date set for this new European database.

In 2018, a satisfaction survey on the statistics produced and regularly published by Banco de Portugal was also conducted to users registered with BPStat. According to the survey, the general satisfaction rate was 4.4, on a scale of 1 to 6.

3.2 Conferences and seminars

In 2018, Banco de Portugal organised several national and international conferences to discuss developments in the Portuguese economy, the euro area and the financial system (Figure I.3.1).

In April, the Bank received the Governor of Banco de España, Luis Linde, at the conference *Future Challenges for Spain and the European Union*, and the chair of the Standard Chartered group, José Viñals, at the conference *New Challenges to the Banking Sector*.

32. The reporting requirements are set out in Regulation (EU) 2016/867 of the European Central Bank of 18 May 2016.

In May, it hosted the first *Payment Systems Forum Conference – A new era in payments?*, which brought to Lisbon representatives of the European Central Bank, the European Commission, the European Payments Council, SIBS, and the main national payment service providers and user representatives, to discuss the challenges facing Europe and from the entry into force of the revised Payment Services Directive, the implementation of immediate payment solutions, and the use of technology associated with 'digital currencies' (distributed ledger technology).³³

In June, the Bank assisted the European Central Bank in hosting the fifth *ECB Forum on Central Banking*, which brought together in Sintra central bank governors, academics, policymakers and top-level representatives of financial institutions to discuss price and wage formation in advanced economies. This is one of the most important conferences in the world on central bank topics, and the fact that it has been held in Portugal since 2014 is in part the result of Banco de Portugal's effort to bring the event to the country.

In June, the Bank also promoted in Porto the seventh *Central Balance Sheet Database Conference*, on innovation and entrepreneurship in the Portuguese business sector,³⁴ and in Ílhavo the second *Conference on New Trends and Developments in Econometrics*, exploring developments in econometric methods used in economics and finance.

In September, to mark the 10th anniversary of Banco de Portugal's responsibility to supervise the retail banking markets, it hosted the *Conference on Banking Conduct Supervision: new challenges ten years after the financial crisis*,³⁵ which was attended by delegations of supervisors from around the world, and featured speeches from the Deputy Minister, Pedro Siza Vieira and the Secretary of State for Education, João Costa. The Bank brought together in Lisbon several national and international experts to discuss the agenda for banking conduct supervision and its growing challenges, in particular those arising from financial innovation.

In October, the 28th *Lisbon Meeting between the Central Banks of Portuguese-speaking Countries*, hosted by Banco de Portugal and Banco Central de Timor-Leste, took place in Dili with a public session on the challenges facing the Portuguese-speaking financial sector (Chapter 3.4). Also in October, the Governor of the Central Bank of Sweden, Stefan Ingves, was in Lisbon at the invitation of the Bank to take stock of developments in the banking regulatory framework at the conference *Basel III: Where did we get and how far do we still need to go?*.

In November, Banco de Portugal received the Chair of the Supervisory Board at the ECB, Danièle Nouy, at the conference *Four years of the Single Supervisory Mechanism: lessons and future challenges*, which was attended by senior officials from Portuguese significant institutions. In the same month, the ninth *Portuguese Economic Development in the European Area* conference took place, with John Van Reenen as keynote speaker, an economist at the Massachusetts Institute of Technology. During this, the José da Silva Lopes Award was presented to the author of the best master's thesis on the Portuguese economy, decided by a jury of Portuguese researchers.

33. The speeches of the *Payment Systems Forum Conference* are available for consultation on Banco de Portugal's website.

34. The speeches of the *Central Balance Sheet Database Conference* are available for consultation on Banco de Portugal's website.

35. The speeches of the *Conference on Banking Conduct Supervision* are available for consultation on Banco de Portugal's website.

In December, Jean-Victor Louis, Emeritus Professor at Université Libre de Bruxelles, was the keynote speaker³⁶ of the first law seminar of Banco de Portugal on *The reform of the Economic and Monetary Union: how to achieve it in a time of dissent*, in which the Minister of Foreign Affairs, Augusto Santos Silva, and officials of the European Central Bank and the European Commission also participated as speakers.

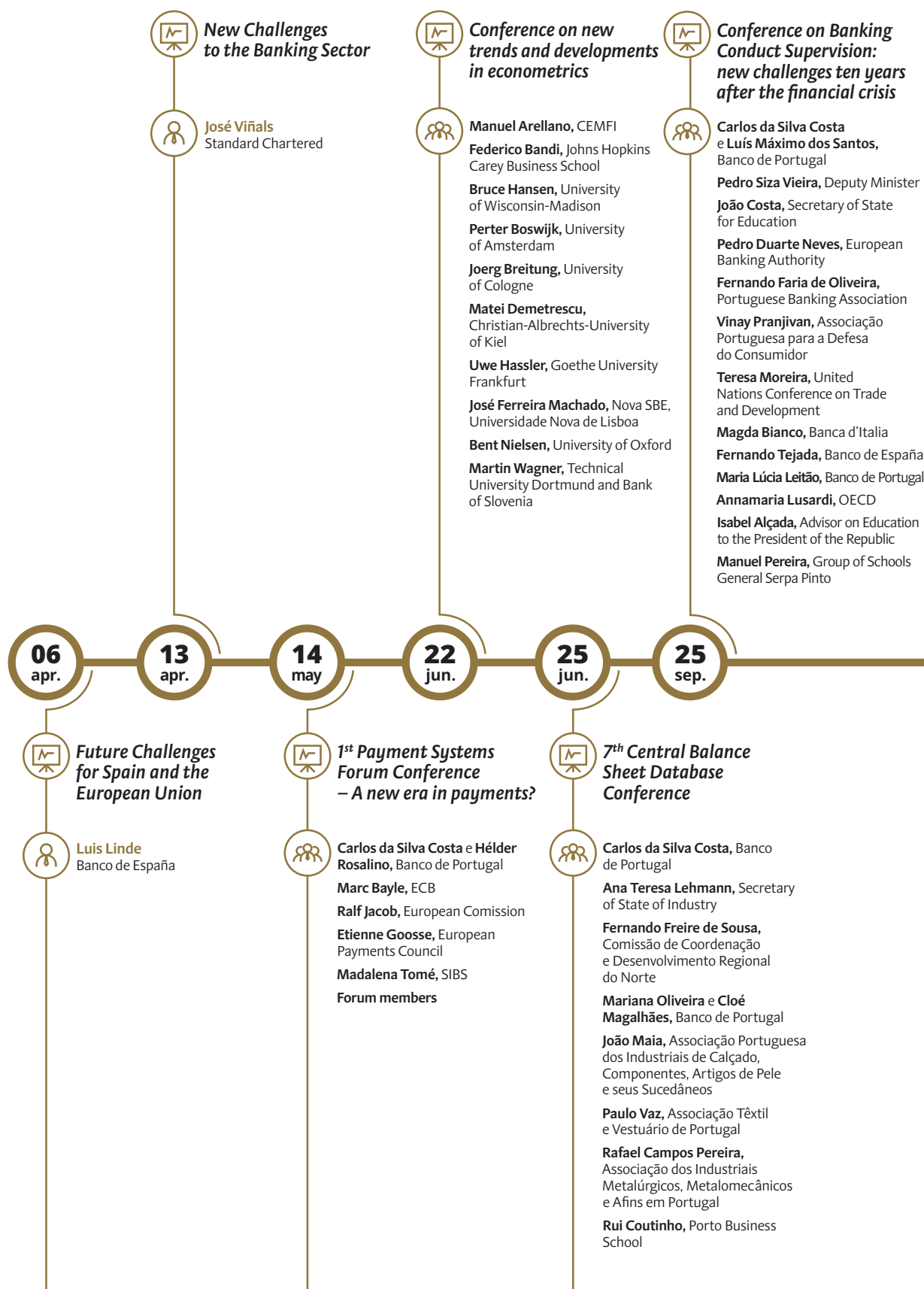
Also in December, in partnership with the Portuguese Institute for Internal Audit (*Instituto Português de Auditoria Interna*), the Bank hosted the 16th *Audit and Management Conference* on the impact of the financial system's digital transformation on the development of internal audit, risk and compliance functions.

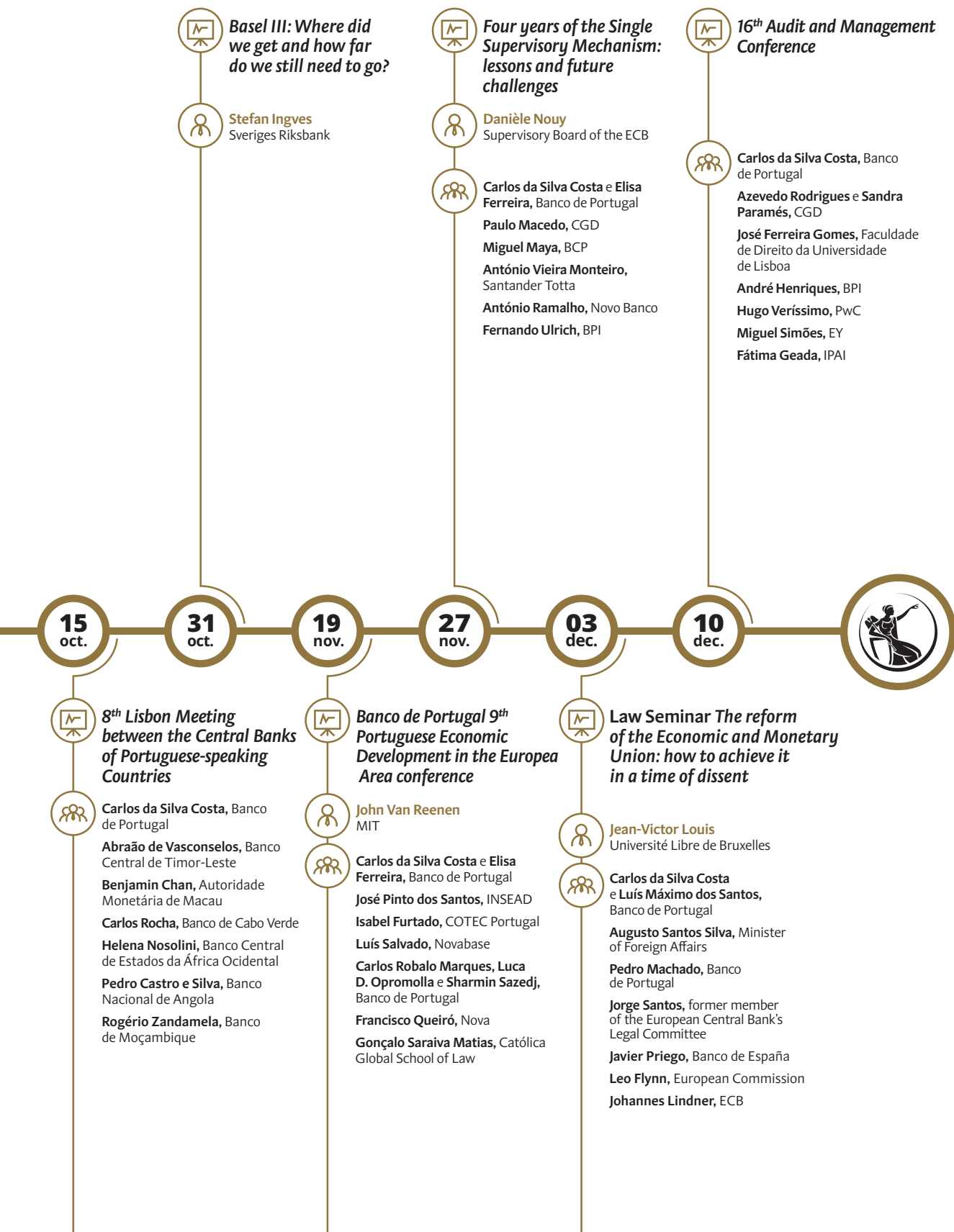
In addition to these activities, throughout the year Banco de Portugal organised 34 seminars and workshops on economic topics primarily aimed at experts and academics.

It also sponsored the *Annual international conference of the Research Center on Regulation and Supervision of the Financial Sector*, the 14th annual conference held by the Portuguese Economists' Association (*Conferência anual da Ordem dos Economistas*), the 10th *Portuguese Finance Network Conference* and the colloquium *New challenges facing the multilateral trading system* hosted by Faculdade de Direito da Universidade de Coimbra to mark the 70-year anniversary of the entry into force of the General Agreement on Tariffs and Trade. In addition, it supported the conference cycle *Economia Viva*, organised by students of Nova School of Business and Economics, the conference *O euro e a soberania económica* (Euro and economic sovereignty) hosted by Faculdade de Ciências Sociais e Humanas of Nova University, the *XXV Journeys of Classification and Data Analysis* and the conference *The Lisbon Meetings in Game Theory and Applications*, which took place at Lisbon School of Economics and Management.

36. The address by Jean-Victor Louis is available for consultation on Banco de Portugal's website.

Figure I.3.1 • Major conferences and seminars hosted by Banco de Portugal





3.3 Communication and stakeholder management

Banco de Portugal is accountable to the citizens and their elected representatives for the manner in which it exercises its powers. Banco de Portugal's Annual Report, which is subject to the approval of the Minister of Finance and submitted by the Governor at the annual hearing before the competent parliamentary committee (currently the Committee on Budget, Finance and Administrative Modernisation), is the primary means used to comply with this accountability requirement. The Bank also submits the annual budget to the Minister of Finance, and redesigned it in 2018 to make it clearer.

On its institutional website, the Bank regularly publishes press releases, addresses by members of the Board of Directors, statistical information, publications, and decoders related to its mission and tasks. Through the Bank Customer Website, the Bank provides information on the rights and duties of bank customers in relation to creating deposit accounts and credit agreements, managing debt and using payment instruments, and releases information on developments in retail banking markets. All this communication is amplified by Banco de Portugal's presence in social media and the conferences and seminars it promotes.

In 2018, the Bank published 241 press releases (including 123 on the main statistical results), 62 addresses and 43 decoders. The Bank created an institutional account on Instagram and stepped up communication actions in social media (Table I.3.1). In order to make institutional communication clearer, the Bank has adopted a style guide.

The Bank ran communication campaigns to explain the developments affecting bank customers, highlighting the new requirements applicable to consumer credit agreements (Box 3) and the launch of the Fees Comparator (Chapter 2.3), which was the most visited webpage on the Bank Customer Website in 2018.

Table I.3.1 • Communication: main indicators | 2016–2018

Indicators		2016	2017	2018
Website^(a)	Press releases	221	232	241
	Addresses	33	80	62
	Decoders	2	25	43
	Users	–	2,032,481	2,293,487
	Viewed webpages	–	15,117,198	17,718,152
Bank Customer Website^(b)	News	60	80	95
	Users	–	–	442,805
	Viewed webpages	–	–	1,561,893
BPstat	Statistical series	328,220	287,465	287,462
	Consultations	2,255,627	2,291,690	2,457,267
Instagram^(c)	Posts	–	–	25
	Impressions	–	–	49 466
LinkedIn	Posts	–	235	444
	Impressions	–	2,006,007	2,738,153
Twitter^(d)	Tweets	–	907	1,092
	Impressions	–	773,400	774,300
Youtube^(e)	New videos	–	31	21
	Views	–	35,760	69,400

Source: Banco de Portugal. | Notes: (a) The website was redesigned in November 2016. (b) The Bank Customer Website was redesigned in November 2017. (c) The Bank has had an Instagram account since 3 September 2018. (d) The Twitter account was launched in February 2017. (e) The Youtube account was launched in March 2017.

It published detailed information to clarify regulatory changes regarding mortgage credit, the activity of credit intermediaries, minimum banking services and payments,³⁷ and released best practice on the use of cash, direct debits, contactless cards and cheques. The content on the Bank Customer Website is now available in English also.

In 2018, Banco de Portugal launched a digital plan for financial education designed to inform bank customers of the benefits and risks associated with banking products offered through digital channels (internet and mobile applications), and thus promote a safer use of these channels. In this first year of implementation of the plan, priority was given to awareness-raising activities targeting young people, who are the most frequent users of new technologies. In September, in line with the start of the school year, the Bank launched the financial education campaign #ficaadica on the Bank Customer Website and on Instagram, with the purpose of alerting young people to the care needed when using digital channels in order to prevent over-indebtedness and fraud. A brochure of the materials produced for this campaign was also published for distribution at secondary schools.

Taking advantage of the range covered by its network of branches and delegations, the Bank organised 843 training initiatives throughout the country: 449 on personal finance management and 394 on euro banknotes and coins. In total, these initiatives brought together 23,815 participants.

Within the National Council of Financial Supervisors (*Conselho Nacional de Supervisores Financeiros* – CNSF), the Bank contributed to the implementation of the National Plan for Financial Education together with the Portuguese Securities Market Commission (*Comissão do Mercado de Valores Mobiliários* – CMVM) and the Insurance and Pension Funds Supervisory Authority (*Autoridade de Supervisão de Seguros e Fundos de Pensões*). Under the aegis of the CNSF, it concluded a cooperation agreement with the other supervisors and Institute for Employment and Vocational Training (*Instituto do Emprego e Formação Profissional*, I.P. – IEFP) to promote financial training in vocational courses offered by job centres. It also signed a protocol with the Portuguese Psychologists Association (*Ordem dos Psicólogos Portugueses*) and extended the partnership to the second Intermunicipal Community of the Portuguese northern region, within the framework of the joint project with the Northern Regional Coordination and Development Committee (*Comissão de Coordenação e Desenvolvimento Regional do Norte* – CCDR-N) for training and information activities. It participated in the celebrations of the *Financial Training Week*, an initiative aiming at alerting the population to the importance of financial literacy. With a growing number of partners, the *Financial Training Week* involved activities in various parts of the country, targeting young people of school age, teachers and other trainers, entrepreneurs, managers of micro and small enterprises, football players, psychologists and the general public.

In order for its mission to be better understood, the Bank organised workshops for journalists, was represented in media interviews, and published decoders on changes in consumer rights, monetary policy, the issue of banknotes, anti-money laundering and combating terrorist financing, and prudential supervision. It also launched a new regular publication – *Report on Monetary Policy Implementation* (Table I.3.2) – and conducted stakeholder surveys on the *Economic Bulletin*, the *Financial Stability Report* and the *Central Balance Sheet Studies*, implementing a set of identified improvements. Together with the European Central Bank and the national central banks of the Eurosystem, it organised the seventh *Generation Euro Students' Award*, which aims to raise secondary school students' awareness of the importance of monetary policy. In 2018, 746 students from 80 Portuguese schools took part in this contest.

37. Introduced by Decree-Law No 74-A/2017 (mortgage credit), by Decree-Law No 81-C/2017 (credit intermediaries), by Decree-Law No 107/2017, by Law No 21/2018 (minimum banking services), and by Decree-Law No 91/2018 (payments).

Table I.3.2 • Regular publications | 2018

Publication	Objective	Frequency	Language*
<i>Annual Report</i>	Description of the Bank's activities and financial statements	Annual	PT and EN
<i>Official Bulletin</i>	Collection of all legal acts produced by the Bank in its regulatory capacity	Monthly	PT
<i>Report on Monetary Policy Implementation (NEW)</i>	Summary on the implementation of the monetary policy of the Eurosystem in Portugal	Annual	PT
<i>Economic Bulletin</i>	Detailed analysis of the Portuguese economy and release of macroeconomic projections	Quarterly	PT and EN
<i>Banco de Portugal Economic Studies</i>	Publication of 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>	Publication of coincident indicators for economic activity and private consumption in Portugal	Monthly	PT and EN
<i>Spillovers</i>	Publication of research, economic analysis and economic events promoted by the Bank	Semi-annual	EN
<i>Bank Lending Survey</i>	Release of detailed results for Portugal taken from the Eurosystem's survey	Quarterly	PT and EN
<i>Financial Stability Review</i>	Evaluation of emerging risks in the Portuguese markets and financial system, by identifying possible adverse shocks and assessing their consequences for the stability of the financial system	Semi-annual	PT and EN
<i>Portuguese Banking System</i>	Description of the 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>	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 and since 2018 EN
<i>Summary Report on Banking Conduct Supervision</i>	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>	Developments in markets for simple term deposits, structured deposits, mortgage credit and consumer credit	Annual	PT
<i>Statistical Bulletin</i>	Banco de Portugal's statistics	Monthly	PT and EN
<i>Statistical Activity Plan</i>	Description of Banco de Portugal's statistical objectives and priorities	Annual	PT
<i>Statistical Activity Report</i>	Description of Banco de Portugal's activities as national statistical authority	Annual	PT
<i>Report on Payment Systems</i>	The most relevant facts on the operation of payment systems	Annual	PT
<i>Report on Cash Issuance</i>	Description of Banco de Portugal's cash issuance activities and main indicators	Annual	PT
<i>Bulletin on Banknotes and Coins</i>	Cash-related topics	Semi-annual	PT
<i>Annual Report on Cooperation</i>	Description of 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>	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>#Lusoфонia</i>	Individual and aggregate indicators on the economies of the eight Portuguese-speaking countries	Annual	PT and EN

Source: Banco de Portugal. | * PT – Portuguese; EN – English.

In October, in addition to the activities carried out by the European Central Bank, Banco de Portugal presented the new €100 and €200 banknotes at a press conference held at the Carregado Complex. On this occasion, the Bank also introduced Valora, Serviços de Apoio à Emissão Monetária S. A. to the journalists, a printing company 100 per cent owned by the Bank, which produces the share of euro banknotes allocated to Portugal by the Eurosystem.

Since 2017, the Bank has been working on building a public service model to provide a clear, timely and consistent response to information requests. In 2018, it completed another step in this process and started managing, in an integrated way, information requests from the press, clarifications requested by individuals and companies via e-mail, websites, and the call centre (currently based on a single contact number, due to the termination of the number beginning with '707'). Throughout the year, the Bank received 388 information requests from the press and 10,699 requests from the public by e-mail and through the webforms available on Banco de Portugal's website and Bank Customer Website. Since the integration of the call centre into the customer relationship management system in June, the Bank received 16,144 information requests through this channel. Contacts made by journalists mainly concerned issues related to supervisory functions. The majority of requests for clarification from the public focused on the services provided by the Bank and, in particular, on consultations of the credit liabilities report; the second most discussed topic in these contacts was the rules applicable to the offering of retail banking products and services.

The Bank provides the public with various services related to the powers attributable to it (Table I.3.3). In 2018, it conducted a satisfaction survey on the services provided at its information desks in Lisbon, the Porto Branch, the agencies and the regional delegations. Results showed a degree of overall satisfaction of 3.75, on a scale of 1 to 4, which is higher than the results achieved in the previous year (3.70).

In 2018, the Bank decided to transfer its call centre to Castelo Branco, which was completed only in 2019. In the context of consultations of account database reports, credit liabilities reports and information on the prohibition of the use of cheques, the service provided by this call centre has been reinforced and the office hours have been extended.

As part of the redesign of the Central Credit Register (Chapter 3.1), Banco de Portugal now provides individuals and legal persons with more detailed reports on the credits for which they are responsible. On the Bank's website, users can now access two documents: the 'credit liabilities report' itself, which contains detailed information on all credit agreements in which the holder is the debtor or guarantor, organised according to the reporting institution; and an 'aggregated credit liabilities report', which sums up credit liabilities of the holder as debtor and as guarantor. To support the interpretation of these new reports, the Bank published a decoder, a video tutorial and a set of answers to frequently asked questions. Consultations of credit liabilities reports continued to be the service most sought by the public (in 2018, more than 1.8 million reports were issued) and the most visited area on the website, besides being, as already mentioned, the most popular theme of information requests that citizens addressed to Banco de Portugal.

The Bank also renewed the information it provides online about Portuguese non-financial corporations through the "Sector Tables" (available to the public) and the "Enterprise and Sector Tables" (available to enterprises upon authentication), making it more interactive and easier to consult. The 'Sector Tables' include 150 economic and financial indicators on Portuguese enterprises, presented by sector of economic activity and by size class, and ratios of other European countries in each sector of activity. The 'Enterprise and Sector Tables' enable managers to compare the performance of their enterprises to the performance of enterprises of the same sector and size class.

Table I.3.3 • Services to the public: main indicators | 2016–2018

Services	Description	Indicators	2016	2017	2018
Analysis of bank customers' complaints	Banco de Portugal reviews the complaints against financial institutions in retail banking products and services and against credit intermediaries	Complaints received	14,141	15,282	15,254
Consultations of account reports	The Bank provides individuals and companies with detailed reports on their deposit, payment, credit and financial instrument accounts	Reports issued	164,802	225,764	249,767
Consultations of credit liabilities reports	The Bank provides individuals and companies with detailed reports on the credits for which they are responsible, as debtors and as guarantors	Reports issued	1,573,327	2,008,309	1,807,718
Consultation of information on the prohibition of the use of cheques	The Bank provides individuals and companies with information on any registration in their name in the List of Cheque Defaulters	Consultations of the List of Cheque Defaulters	7,033	7,023	7,026
Dissemination of information on lost documents	With a view to preventing fraud, the Bank disseminates information on lost documents containing personal information across the banking system, at the request of the holders concerned	Requests disseminated	304	289	244
Cash office	The Bank exchanges banknotes, including damaged euro and escudo banknotes, exchanges banknotes and coins for different denominations, and sells commemorative and collector coins.	Visits to customer services	190,501	141,931	156,111
Historical Archive	The Bank supports research, especially in the fields of law, economics and finance	Consultations	1,291	3,517	1,281
Library		Consultations	5,523	5,543	5,502
Money Museum	The Museum presents the history of money based on Banco de Portugal's collection. It opened the Financial Education Centre in 2018	Activities	913	1,227	1,165
		Visitors	58,467	62,859	62,396

Source: Banco de Portugal.

In the Money Museum, Banco de Portugal unveiled the Financial Education Centre, which complemented its educational offering on the management of personal finances. The Museum hosted three temporary exhibitions: between 1 November 2017 and 31 March 2018, the archaeology exhibition under the title *Tempus Fugit: Life, death and memory in the former Church of S. Julião*; between 16 June and 8 September, the contemporary art exhibition called *Listening to the waters – Works in the Schneider Collection and by Portuguese artists*, developed in partnership with François Schneider Foundation and the EGEAC – Municipal Galleries and shared with Torreão Nascente da Cordoaria Nacional; and, between 28 November 2018 and 23 February 2019, *The value of trust in money* exhibition on the history of the fight against counterfeiting. As part of the latter exhibition, the Bank supported the Arquivo Nacional Torre do Tombo in the restoration and digitisation of the 21,631 folios constituting the judicial process of Banco de Angola and Metrópole. Over the year, the Museum offered 1,165 activities as part of its programming. It received 62,396 visitors, of which 38% participated in planned activities.

In the Library, the Bank presented an exhibition on the ten years since the start of the financial crisis. In order to further develop the relationship with other national libraries and promote best practice in processing information, Banco de Portugal organised the workshop *Bibliotecas*, which brought together in Lisbon about 60 professionals from different entities, including the European Central Bank.

As social responsibility is one of its core values, Banco de Portugal has projects to support the community, primarily aimed at promoting the inclusion of children and adolescents.

Together with Entrepreneurs for Social Inclusion (Empresários pela Inclusão Social – EPIS), it has run the *Vocações* programme since 2012, through which volunteers teach Maths, Portuguese and English to students in lower secondary education. In the 2017/18 school year, the programme included 32 students from Escola Secundária Fernando Namora, in Amadora; in the 2018/19 school year, the initiative continues with 30 students from Escola Secundária Fernando Namora and Escola EB 2/3 Sophia de Mello Breyner Andresen, also in Amadora. EPIS identified the educational institutions supported by this initiative.

Banco de Portugal has participated in the project *Voluntários da Leitura* (Reading Volunteers) since 2016, promoted by the Interactive Technologies Research Centre (*Centro de Investigação para Tecnologias Interativas*) of Nova University and the *Associação para o Voluntariado de Leitura* (Association of Reading Volunteers). In the 2017/18 school year, 14 volunteers from the Bank participated in this initiative, and they were allocated to Luísa Ducla Soares, Maria Barroso, Padre Abel Varzim and Sampaio Garrido primary schools, in Lisbon. On the occasion of World Book Day, the Bank promoted a campaign to collect used children's books to offer educational institutions supported by its reading volunteers; also, on its own account, it donated books worth €1,000 to Maria Barroso and Sampaio Garrido schools.

At the D. Estefânia Hospital, in Lisbon, the Bank manages two projects to promote reading: *Ler+Histórias* (Reading+Stories) (since 2013) and, on special occasions, *A Hora do Conto* (Story Time). In 2018, the Bank staged 37 reading sessions with children hospitalised at that health facility.

The activities at D. Estefânia Hospital were originally launched with the support of Ajudaris, with which Banco de Portugal continues to collaborate in publishing books for charity. In 2018, the third book *Histórias da Ajudaris com o Banco de Portugal* (Ajudaris Stories with Banco de Portugal) was released to support Ajudaris's charity projects against hunger, poverty and social exclusion.

In 2018, the Bank and its cafeteria concessions contributed a total of 10,697 meals to the *Zero Desperdício* (Zero Waste) project, promoted by the DariAcordar association. At Christmas, the Bank and its staff members donated 5,900 euros that were converted into food baskets, and which Entrajuda has distributed to 295 households; the Bank, through the Social Fund Management Committee for Banco de Portugal's Employees, also offered 330 kilograms of food to the Arroios parish and to the social centre of Carregado. 500 litres of milk were also donated to the social centre of Carregado and 4,230 small afternoon meals were offered to the children at the summer holiday camp of the Arroios parish.

The Bank also provides secondary school students with a first contact with the labour market. In 2018, this job shadowing initiative took place between 18 and 22 June and involved five students from Escola Secundária Dona Luísa de Gusmão and Colégio Valsassina.

In addition to other one-off initiatives, Banco de Portugal donated €7,197 to the Portuguese Oncology Institute in Lisbon, raised from distribution of its first charitable Diary, launched in 2017. The second solidarity agenda charitable Diary, presented in December 2018, was designed with the contribution of children and volunteers of the *Ler+Histórias* project to support D. Estefânia Hospital. Sponsorship of €5,000 was also awarded to the Salvador Association to publish a charitable book for its 15th anniversary.

3.4 International cooperation

Banco de Portugal cooperates with the central banks of Portuguese-speaking countries and with counterparts from other emerging and developing countries, promoting the sharing of expertise and best practice, and helping address the modernisation challenges facing its partners. Among other responsibilities in this area, the Bank participates in the bodies responsible for monitoring the sound operation of the Exchange Rate Cooperation Agreement between Portugal and Cabo Verde and the Economic Cooperation Agreement between Portugal and São Tomé and Príncipe. Also, it regularly publishes analysis of economic environment and indicators on Portuguese-speaking countries (Chapter 3.3).

In 2018, the Bank entered into two technical cooperation agreements with the Central Bank of Morocco and the Monetary Authority of Macao, thus increasing to 12 the number of technical cooperation agreements in force. It carried out 130 cooperation initiatives (Figure I.3.2) covering most of the central bank functions: 93 initiatives with Portuguese-speaking countries and 37 with other emerging and developing countries (16 with EU neighbouring countries and 12 with Latin American countries).³⁸

With the other central banks of Portuguese-speaking countries, Banco de Portugal participated in a preparatory debate for the Spring Meetings of the International Monetary Fund and the World Bank Group held between 20 and 22 April, in Washington, D.C. In October, together with Banco Central de Timor-Leste, it organised the 28th *Lisbon Meeting of the Central Banks of Portuguese-speaking Countries*, the most important event of Portuguese-speaking central bank cooperation which took place outside Portugal (in Dili) for the first time in 2018 (Chapter 3.2).

In Lisbon, Banco de Portugal hosted the first seminar on bank resolution with central banks of Portuguese-speaking countries, in collaboration with high officials of the International Monetary Fund and the European Central Bank. It also took part in nine regular sectoral meetings with these counterparts in the areas of information systems and technology, accounting, statistics, legal affairs, banking supervision, issue and treasury, auditing, risk and compliance management, and payment systems.

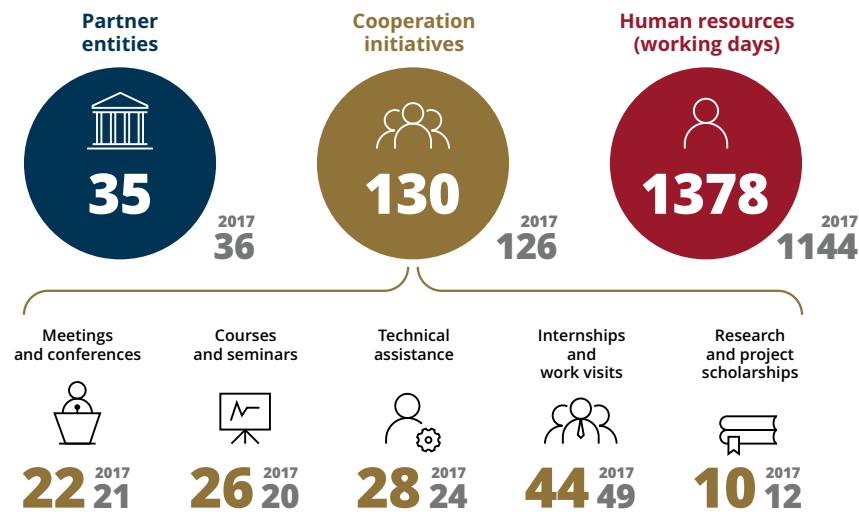
Together with Banco Central do Brasil and the Alliance for Financial Inclusion (AFI), Banco de Portugal organised a course to train trainers in the management of personal finances in Lisbon, addressed to staff members from the central banks of Portuguese-speaking countries. This course was the first initiative developed under the protocol concluded in 2017 between the Portuguese-speaking central banks and AFI with a view to promote financial inclusion and training in Portuguese-speaking countries, and leading Banco de Portugal and Banco Central do Brasil to be presented with an AFI Special Award in 2018.

The Bank also joined the celebrations of the 20th anniversary of the Exchange Rate Cooperation Agreement between Portugal and Cabo Verde, in whose monitoring structures it has been involved since 1998 and which has contributed to macroeconomic stability and the opening up of the Cape Verdean economy.

38. For further details on these initiatives, see the *Annual Report on Cooperation*, available on Banco de Portugal's website.

Outside the context of Portuguese-speaking countries, cooperation initiatives were carried out together with central banks in Latin America in the framework of the Centre for Latin American Monetary Studies (*Centro de Estudos Monetários Latino-Americanos* – CEMLA). In 2018, the Bank participated in a number of CEMLA initiatives, including the two meetings of governors of this institution, whose main mission is to promote education and research on monetary policy in Latin America and the Caribbean, and the exchange of information between monetary authorities.

Figure I.3.2 • Cooperation initiatives | 2018



Source: Banco de Portugal.

4 Internal management

This chapter presents the main developments in the organisational and internal governance model and the operation of Banco de Portugal in 2018, with the purpose of aligning them with the best practice adopted by Eurosystem central banks, substantiated in its fourth Broad Strategic Guideline set for 2017-20.

4.1 Internal governance

The bodies comprised in Banco de Portugal are the Governor, the Board of Directors, the Board of Auditors and the Advisory Board. The Governor's responsibilities include acting as a member of the Governing Council and the General Council of the European Central Bank, representing Banco de Portugal and acting on its behalf in foreign and international bodies. The Board of Directors is responsible for all the acts required to carry out the tasks entrusted to Banco de Portugal which do not fall within the exclusive competence of other bodies. On a proposal from the Governor, it assigns its members responsibilities over one or more departments. In 2018 the Board of Directors met 50 times.

The Board of Auditors monitors the functioning of Banco de Portugal, checks compliance with applicable legislation and regulations, issues its opinion on the budget, balance sheet and annual accounts, and brings to the attention of the Governor or the Board of Directors matters warranting due consideration. The Advisory Board issues non-binding opinions on the Annual Report of Banco de Portugal, the performance of Banco de Portugal arising from its tasks and any matters submitted to it by the Governor or the Board of Directors.

Supporting Banco de Portugal's Board of Directors in its decision-making are specialised in-house advisory committees, more specifically the Specialised Committee for Financial Supervision and Stability, the Committee for Risk and Internal Control, the Budget Monitoring Committee and the Specialised Committee for Information Systems and Technologies Management. The committees are coordinated by members of the Board of Directors and include Heads of Department and other representatives from the relevant departments in accordance with the matters under discussion.

The implementation of the Strategic Plan for 2017-20 is monitored, on the basis of overall enforcement indicators, by a steering committee, which includes the Board of Directors, the Strategy and Organisation Development Division and the Heads of Departments. At the end of 2018, the first two years of the Plan were revised, and priority follow-up initiatives were set for 2019.

Banco de Portugal's resource management policy is guided by efficiency criteria, with a view to putting operating expenses on a rational, sustained path, supplemented by a culture of accountability for results. For that purpose, since 2016 departments have been subject to an annual performance assessment process, based on an objectives and commitments framework approved by the Board of Directors. This assessment model considers: (a) budgetary performance metrics, to distinguish the departments with active and efficient budgetary management, (b) departmental key performance indicators (KPIs), set out at the beginning of each year and regularly monitored, and (c) headcount goals, due to resource constraints set in the Strategic Plan. Departments are also directly assessed by the Board of Directors and, in the case of support departments, go through an annual in-house customer survey. The integrated use of these (quantitative and qualitative) performance measurement

criteria allows for an overall performance assessment at departmental level, which is the basis for recognising merit and for managing the corresponding annual reward scheme at Banco de Portugal.

Banco de Portugal uses a costing system to support decision-making, which is based on a methodology developed by the Eurosystem and whose main objectives are to disclose total expenditure on key Eurosystem functions, thereby enabling comparability and transparency among central banks, and to release management information to help gauge the efficiency of functions and decision-making.

Through continuous improvement, Banco de Portugal continued to refine its internal governance and organisational development in 2018. The changes introduced were designed to enhance the efficiency and quality of Banco de Portugal's performance, for an agile and flexible organisation with an effective decision-making structure.

With this purpose, a number of departments were reorganised. The Legal Services Department was restructured to accommodate the need to coordinate primary banking regulation, the requirements of Banco de Portugal's enhanced role (particularly, as a resolution authority) and the exponential increase in litigation following several decisions under the resolution measures applied to BES and BANIF (Chapter 2). The structure of the Communication and Museum Department was adjusted to mirror its key tasks: managing stakeholders and the sustainability policy, producing content and digital communication, relations with the media and managing the Money Museum. To meet the new requirements resulting from digital transformation, new teams were set up in the Banking Prudential Supervision Department, the Payment Systems Department and the Information Systems and Technology Department (Box 1). The latter department set up a unit for the system recovery data centre in the event of a disaster in the Lisbon area. The Administration Services Department was also adjusted to meet the new requirements under facility management.

The General Data Protection Regulation entered into force in May 2018. Consequently, in the first half of 2018 the Data Protection Office, headed by the Data Protection Officer, performed a thorough diagnostic on the compliance of data handling by Banco de Portugal. This diagnostic formed the basis for a data protection action plan in the second half of the year in response to shortcomings identified. Furthermore, given that compliance with the new legal framework governing data protection also entails behavioural change, a specific professional training plan was developed, with 428 members of staff being trained on this matter in 2018.

Turning to ethics and business conduct, the enforcement of internal rules was strengthened, by putting in place more systematic procedures to prevent conflicts of interest and by monitoring the limits to private financial transactions, entrusted to the Compliance Office and the Ethics Committee. In this context, a cooling-off agreement was signed by all employees who hold management or equivalent positions, to mitigate the risk of conflict of interest after the termination of functions at Banco de Portugal. To check compliance with rules on specific limits to private financial transactions, for the first time in 2018, a monitoring procedure compiled data on ownership of bank accounts and securities, the submission of personal written commitments and the procurement from financial institutions of declarations stating that they have not carried out financial transactions subject to conditions. Between 2017 and 2018, the Compliance Office conducted 37 mandatory training workshops, in which 857 members of staff participated. At European level, substantial progress has been made following the ECB's approval of the Single Code of Conduct, which standardises stringency levels and monitoring mechanisms applicable to members of decision-making bodies in central banks and supervisory authorities.

4.2 Risk management

In 2018 Banco de Portugal proceeded with its integrated management policy on financial risks – mostly relating to asset management and monetary policy operations – and operational risks, stemming from the activities carried out according to Banco de Portugal's various areas of work. With this in mind, the Board of Directors approved an internal statement of Risk Acceptance Principles, in line with international best practice. This statement describes the tolerance level for the financial and non-financial risks to which Banco de Portugal is exposed when carrying out its work. In addition, Banco de Portugal carried out an annual exercise to identify key risk events to which it is exposed, as well as the relevant mitigation measures.

As regards non-financial risk, Banco de Portugal initiated a revision of its operational risk profile, on the basis of the standards approved in 2017, which set out the principles, objectives, stakeholders, responsibilities and working model of the operational risk management policy.

The incident handling process was also revised, most notably the procedure to monitor mitigation measures. Banco de Portugal's security policy standards were reviewed, and an action plan has been designed for its implementation. As part of business continuity management, crisis management plans were developed to ensure that Banco de Portugal responds to pre-set scenarios and that the annual test plan has been carried out.

With regard to financial risk, the risks underlying own investment asset management operations were controlled taking into account the limits and restrictions laid down in the internal guidelines approved by the Board of Directors. An information system similar to that used in most Eurosystem central banks carried out, on a daily basis, the valuation, calculation of yield and risk control on asset management operations.

Monetary policy operation risks were controlled in accordance with the rules set out within the Eurosystem (Chapter 1). Banco de Portugal also checked and analysed the performance of internal rating systems approved for use by national credit institutions to guarantee Eurosystem credit operations. It also monitored the performance of its In-house Credit Assessment System, and checked its compliance with the Eurosystem's rules and criteria. Overall developments in financial risks were examined through the regular calculation of a number of indicators, such as value at risk and expected shortfall, on the basis of standard methodologies in line with those used by the Eurosystem. These risks were analysed by comparison with the financial buffers in the balance sheet (provisions, reserves and income) to ensure that they are compatible with Banco de Portugal's risk tolerance.

4.3 Internal audit

In 2018 the internal audit function continued to provide assessment and consultancy services, thereby helping to increase the effectiveness of the governance, risk management and internal control processes. 36 audits were carried out, 32 of which were exclusively domestic and four related to systems and processes that are common or shared with the ESCB, the Eurosystem and the SSM (Table I.4.1).

The audit function of Banco de Portugal underwent a quality assessment by an accredited specialised body. In this exercise, which is carried out every five years in line with international best practice, the audit function was considered 'compliant' across the board, most notably taking into account the ethical standards and requirements that it entails, the rules and procedures applicable within the Eurosystem, the ESCB and the SSM, and the effectiveness and efficiency of audit procedures performed.

Increasingly complex systems and procedures and rising economic activity have driven changes in the audit function, most notably Banco de Portugal's investment in solutions that automate analytical exploitation of information in support of audits, thereby favouring an increasingly preventive approach.

Table I.4.1 • Audits in 2018

Breakdown by activity domain	Domestic	ESCB, Eurosystem and SSM
Governance, internal functioning and management quality	3	
Monetary policy and other operational duties		1
Supervision and legal enforcement	4	
Payment systems and means		1
Statistics and research	1	1
Reserve and financial asset management	3	
Resolution and deposit guarantee	4	
Human resources	2	
Information technology systems	2	
Security	1	
Budget and accounting	1	
Legal matters	2	
Cash issuance	8	1
Purchases and logistics	1	
Total	32	4

Source: Banco de Portugal.

4.4 Human resources

On 31 December 2018 the number of staff members employed by Banco de Portugal was 1,755, of which 1,690 were active (65 were on public interest assignment or unpaid leave) (Table I.4.2). This is in line with the goal of 1,700 staff members by 2020, set out in the Strategic Plan for 2017-20. Over the course of the year, 118 members of staff were recruited, 43% of which for supervision roles, and 123 left Banco de Portugal (87 retirements and 36 terminations of labour contracts). Of the 118 members of staff that were recruited, 37 were interns.

Banco de Portugal has achieved gender balance in staffing, with a 49.4% female share of staff, and gradual staff rejuvenation, with members of staff being, on average, 42.8 years old (Table I.4.3).

The breakdown of members of staff by function has remained stable over the past few years: approximately 19% are managerial staff and 70% are professional staff (Table I.4.4).

Table I.4.2 • Staff developments | 2016-2018

	2016	2017	2018	Δ 2018-2017
Total staff	1,797	1,761	1,755	-6
Active ^(a)	1,718	1,701	1,690	-11
Supervisory tasks ^(b)	431	440	445	5
Unpaid leave/secondment	79	60	65	5

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 | 2018

		2016	2017	2018
Gender	Male	913	900	888
	Female	884	861	867
Movements	Recruitments	112	78	118
	Retirements	62	85	87
	Termination of contracts	30	29	36
Age group	<=25	72	74	72
	[26;35]	570	556	561
	[36;45]	353	381	427
	[46;55]	288	265	259
	[56;65]	505	474	418
	>=66	9	11	18

Source: Banco de Portugal.

Table I.4.4 • Staff: breakdown by function | 2018

	Male	Female	Total	%
Senior management	42	18	60	3%
Middle management	139	143	282	16%
Professional staff	571	659	1230	70%
Technical-administrative staff	107	11	118	7%
Unpaid leave/secondment	29	36	65	4%
Total	888	867	1,755	100%

Source: Banco de Portugal.

Banco de Portugal invested further in the qualification of its staff by continually improving its policies on recruitment, career and selection for leading positions, as well as incentives to internal mobility and a strong emphasis on training and development of skills (formal, technical and behavioural). Over the past year, 70 members of staff moved to other departments. 51 external and 41 internal recruitment processes were launched.

Banco de Portugal continued to invest in a comprehensive, consistent and integrated training policy (Table I.4.5), embodied in the Banco de Portugal Academy (*Academia do Banco de Portugal*), a knowledge-sharing platform at the disposal of its members of staff, featuring short training videos, on managerial and soft skills, produced by renowned global organisations and experts, in addition to videos introducing specific content. It launched a mentoring programme, with the purpose of facilitating the integration and development of new members of staff and enhancing the institution's culture and values. Banco de Portugal once again carried out managerial leadership programmes, in which 116 senior and middle managers from Banco de Portugal participated.

In 2018, the 2nd Schuman Programme, a mobility programme between central banks, took place, offering staff from the ESCB and the SSM the opportunity to undertake a short-term project (six to nine months) from another central bank or supervisory authority. In this edition, Banco de Portugal welcomed a member of staff from the Central Bank of Ireland and seconded three members of staff to Banque de France, Banca d'Italia and Lietuvos Bankas.

Table I.4.5 • Training: participants and hours | 2018

	2016	2017	2018	Δ 2018-2017
Participants	1,733	1,707	1,712	0.3%
Hours	59,793	60,673	60,319	-0.6%
Attendance rate*	96.4%	96.9%	97.5%	0,6 pp

Source: Banco de Portugal. | *The attendance rate corresponds to the share of Banco de Portugal's members of staff that participated in at least one training course.

In 2018 Banco de Portugal launched pilot projects designed for the revision of the performance assessment model, with the establishment of individual and team goals in line with strategic objectives, and pursued initiatives to map and develop the potential of its workforce. The Third Banco de Portugal Open Day was held to promote Banco de Portugal in universities and the hiring of interns across various areas of expertise, whereby one event was held in both Lisbon and Porto. More than 250 final-year students from the main Economics, Management, Law and IT Schools participated in this initiative.

In 2018 Banco de Portugal came in 9th place in the Randstad Employer Brand Award 2018, which is presented to the most attractive employers in Portugal.

New company-level agreements were finalised between Banco de Portugal and the Portuguese Financial Sector Federation (which includes the trade unions for bank employees in the North, Centre, South and the Azores and Madeira), the National Union of Qualified Bank Employees and the Independent Union in Banking.³⁹ These agreements, which entered into force on 1 January 2019, were concluded following negotiations over a two-year period with the trade unions, and made it possible for Banco de Portugal to meet the two goals behind this review: to be in line with the new collective bargaining agreement in the banking sector, and to adjust Banco de Portugal's labour framework to the new working environments and practices, as well as the new human resource management paradigms and policies. Some of the latter have already been put in place, to ensure that resource management is guided by more stringent efficiency and merit criteria.

As at 31 December 2018 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 €1,916 million invested in euro area bonds and liquidity (84.6%), shares (4.5%) and real estate (10.9%). The fund was also exposed to euro area bond futures and equity futures, which corresponded to -7.6% and +5.1% respectively of the asset portfolio market value. On the same date, its overall funding level was 102.5%, i.e. above the minimum level established in Notice of Banco de Portugal No 12/2001 (98.2%). In 2018 returns on the asset portfolio of this fund stood at 1.3%.

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 815 participants, as the majority of new staff members have opted for this fund. In 2018 the asset portfolio of this fund, to the amount of €25.7 million, posted negative returns, of 2.8%.

39. These agreements were published in the *Boletim do Trabalho e Emprego* (Labour and Employment Bulletin).

4.5 Premises

In its Strategic Plan for 2017-20, Banco de Portugal set itself the objective of developing a construction project for a new office building in Lisbon, to gather in a single site all its services, which are currently located in four buildings in Lisbon. By bringing together all its services, Banco de Portugal will be able to save significantly on the costs of operating, maintaining and securing its premises, in addition to bringing very substantial efficiency and productivity gains. Furthermore, the construction of a new office building is an opportunity to design more sustainable, environmentally-friendly facilities management solutions, and to reap the benefits from new technologies applied to new workplace concepts. Against this background, Banco de Portugal seized a market opportunity and, with technical support from Sociedade Gestora do Fundo de Pensões (Banco de Portugal Pension Funds Management Company) with its experience and knowledge in real estate appraisal and investment), purchased a plot of land in the Alto dos Moinhos area in March 2018. This purchase was the culmination of work that started in 2015, which involved drawing up a list of potential locations in Lisbon, suitable to accommodate the new office building, and an extensive technical assessment of the possible alternatives identified, on the basis of optimisation criteria in terms of location, accessibility and market price requirements.

However, the final decision on the location and future construction of the new office building has yet to be made, as Banco de Portugal is still in talks with the Lisbon City Council and other State bodies, with the purpose of considering all possible alternatives and finding the best permanent solution for Banco de Portugal and the city.

Also as regards facility management, Banco de Portugal carried out major restoration works in 2018 to Tabacaria Mónaco's architectural and art heritage, a newsstand and tobacco shop that occupies part of the ground floor of a building owned by Banco de Portugal in the Pombaline Downtown district that was classified as a public interest monument in 2017.

4.6 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, mobility, cooperation and internal communication, as exemplified by the new intranet platform, which was launched in 2018.

One of the strategic priorities set by Banco de Portugal for the 2017-20 period was the implementation of an integrated information management programme, to streamline and standardise all information requested from entities with which it interacts in the performance of its duties and to enhance the quality, completeness and timeliness of its working data. In light of this priority, Banco de Portugal implemented a new technological platform in 2018 to meet its needs in terms of integrated information exploitation. The new platform consists of three pillars: a catalogue solution that makes it easier to find and share this information among business analysts, a reference database that allows cross-checking by ensuring that the data is used across systems and domains, and a corporate database broken down by areas of information for analytical purposes, validated to assure data quality, catalogued and separated into different access profiles, such that the various departments are able to safely share and exploit data.

Technological solutions were also developed and implemented to support its business areas, including the new Central Credit Register and the new enterprise and sector tables as part of

the Central Balance Sheet Database (Chapter 3), the fees comparator and the solutions for credit intermediary authorisation requests (Chapter 2), and, with regard to monetary policy, the new eligible assets analysis system and the new version of a system for the treatment of credit claims.

Several system security and cyber security solutions were implemented to comply with SWIFT's Customer Security Program (Box 1). The security requirements of e-mails and documents produced in-house were also tightened.

As regards innovation, Banco de Portugal carried out experimental work in Blockchain/DLT (Hyperledger) platforms. It launched the 'SecLending' project, harmonising and unifying information sharing and ensuring that the list of assets available for lending by the Eurosystem to its counterparties is updated in real time. The purpose of this project is to set up a registration and archiving all transactions performed in the scope of securities lending. Banco de Portugal also participates in the Eurochain initiative, launched by the ECB to evaluate the possibility of implementing digital central bank money.

A new outsourcing model was also adopted, with the purpose of increasing efficiency and improving the provision of services. Using this model, it was possible to assign higher value added projects to an in-house team.





II Report and Financial Statements

1 Management Report

2 Financial Statements and Notes

3 External Auditors' Report

4 Report and Opinion
of the Board of Auditors

1 Management Report

Presentation

The balance sheet of Banco de Portugal totalled €158 billion in 2018, representing a €5 billion increase from 2017.

Notable in Banco de Portugal's 2018 Balance Sheet composition are the €4,647 million increase in the securities portfolio regarding its active participation in the asset purchase programme (APP), the €3,388 million decrease in Lending to credit institutions and the €1,407 million decrease in Foreign reserves and euro assets.

Net profit for the year stood at €806 million, increasing by €149 million from 2017. Interest margin contributed €1,065 million in 2018 (2017: €1,010 million), driven by the increase in the monetary policy securities portfolio, and by the recognition of the adjustment to the estimate of the accrued interest for 2016 and 2017 in Lending to credit institutions under targeted longer-term refinancing operations II (TLTRO-II), as defined by the Eurosystem. In addition, the sale of assets denominated in foreign currency, associated with the above-mentioned decrease in Foreign reserves and euro assets, led to realised gains, in line with an appreciation of the US dollar.

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 2018 (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 (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 (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 Balance sheet



157,953 million
Total balance sheet

Table 1 shows the developments in the year-end positions of Banco de Portugal's main balance sheet items for the 2014-2018 period, from the management's perspective. Charts 1 and 2 show the evolution of the main items disclosed in the balance sheet. Chart 3 illustrates the developments in the main balance sheet items compared to 2017.

Table II.1.1 • Main balance sheet items 2014-2018 (management's perspective) | EUR millions

	2014	2015	2016	2017	2018	Δ 2018/2017
TOTAL BALANCE SHEET	105,608	116,899	137,717	152,965	157,953	4,988
Claims and liabilities related to monetary policy operations						
Claims related to monetary policy operations	36,462	42,851	54,626	69,100	69,952	852
Lending to credit institutions	31,191	26,161	22,372	22,131	18,743	(3,388)
Securities held for monetary policy purposes	5,272	16,690	32,254	46,969	51,208	4,240
Liabilities to credit institutions related to monetary policy operations	(3,589)	(7,712)	(5,649)	(13,865)	(14,096)	(231)
Gold and foreign reserves and euro assets (net)						
Gold	12,147	11,968	13,503	13,305	13,786	481
Foreign reserves and euro assets (net)	21,410	23,308	24,606	21,101	19,693	(1,407)
Other claims	1,456	1,431	1,612	1,753	1,983	230
Banknotes in circulation	23,299	24,686	25,661	26,675	28,051	1,377
Intra-Eurosystem claims and liabilities						
Intra-Eurosystem claims	(33,172)	(36,315)	(38,945)	(42,528)	(46,695)	(4,167)
Intra-Eurosystem liabilities	54,638	61,705	71,588	81,246	82,814	1,567
Liabilities to other entities denominated in euro	7,989	6,630	13,011	9,370	9,745	375
Other liabilities	342	303	426	712	657	(55)
Own funds						
Revaluation accounts	9,637	9,296	11,027	10,329	10,882	553
General risk provision	3,567	4,047	4,247	3,727	3,677	(50)
Capital and reserves	1,534	1,594	1,641	1,729	1,860	131
Retained earnings	(252)	(333)	(397)	(523)	(479)	44
Profit for the year	304	233	441	656	806	149

Chart II.1.1 • Developments in the balance sheet – total and main assets | EUR millions

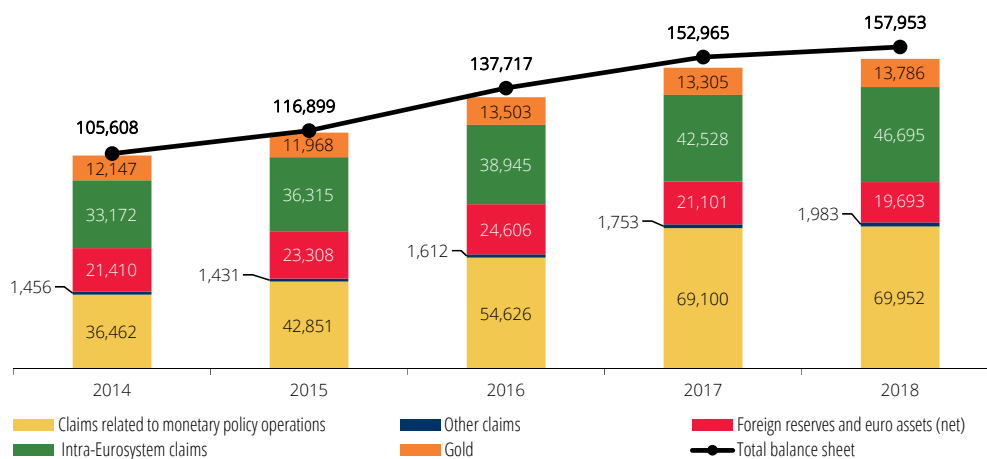


Chart II.1.2 • Developments in the balance sheet – main liabilities and own funds | EUR millions

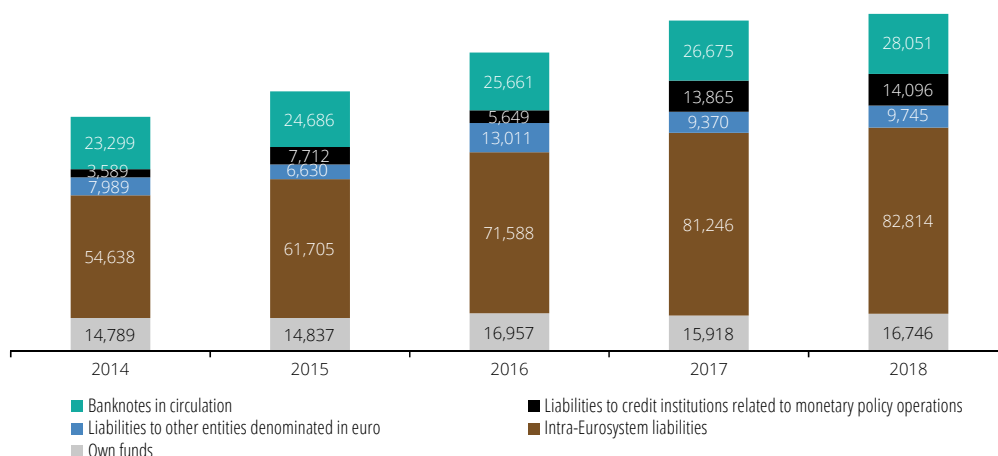
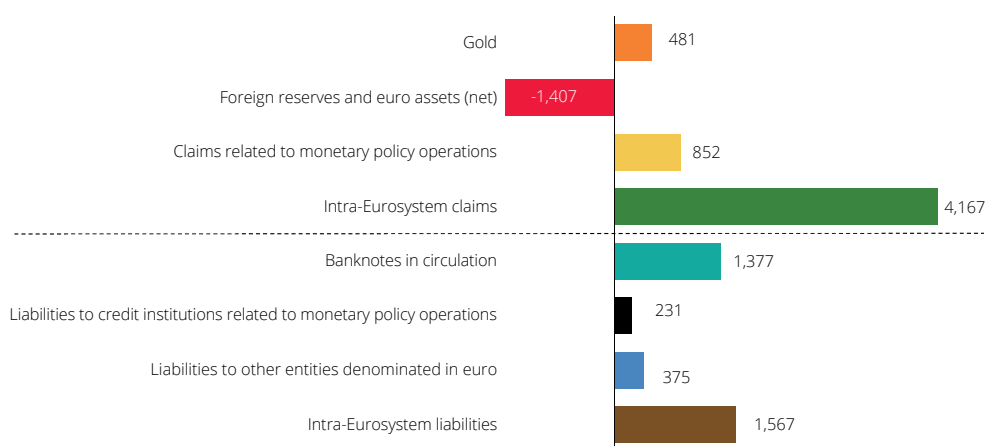


Chart II.1.3 • Main balance sheet item's variation towards 2017 | EUR millions



1.1.1 Claims and liabilities related to monetary policy operations

By the end of 2018, monetary policy claims had increased by €852 million, reflecting €4,240 million in net purchases under **non-standard monetary policy programmes**, €4,647 million of which in securities under the asset purchase programme (APP). This increase was partly offset by the early repayment of TLTRO-II (Charts 4 and 5).

Chart II.1.4 • Aggregates of monetary policy operations | EUR millions

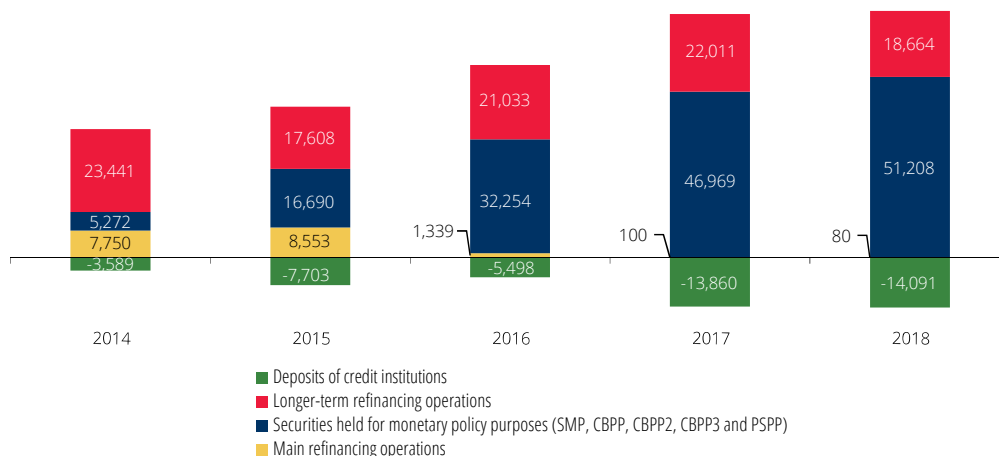
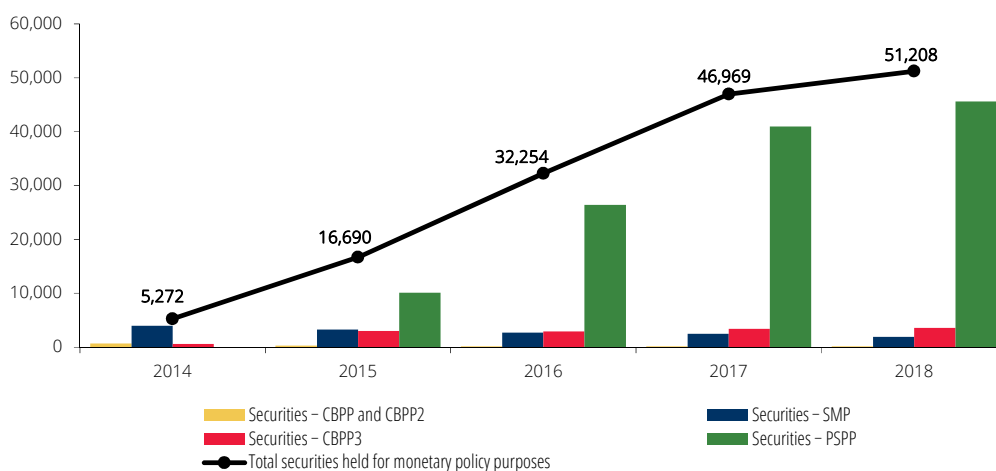


Chart II.1.5 • Securities held for monetary policy purposes | EUR millions



4,240 million

Net purchases under non-standard monetary policy programmes

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), closed to new purchases, and (ii) the third covered bond purchase programme (CBPP3) and the public sector purchase programme (PSPP), both still open to new purchases. Purchases of these securities are made by the national central banks (NCBs) and the ECB, under

the principle of decentralised implementation of the Eurosystem's monetary policy. Securities in the SMP portfolio reached maturity in 2018, leading to a decrease in that balance sheet item.


As at 31 December 2018, this portfolio totalled €51,208 million, 32% of Banco de Portugal's total assets.

In 2018 the balance sheet featured purchases under the PSPP, reflecting the Eurosystem's decisions to extend purchases under the APP, at an overall purchasing rate in the Eurosystem of €30 billion per month until September 2018 and €15 billion per month for the rest of that year, as decided by the Governing Council. In terms of Banco de Portugal's participation, these decisions led to growth of €4,647 million in the overall PSPP level in 2018, reaching a total of €45,571 million. This programme is divided into supranational securities and Portuguese government debt, with the latter included in the non-shared-risk component at Eurosystem level. The increase in 2018 was driven solely by Portuguese government debt (a €4,900 million increase), since the supranational securities component decreased by €253 million overall. At the end of 2018, supranational securities and Portuguese government debt reached a relative weight of 33% and 67% of total PSPP respectively, compared to 37% and 63% in 2017 respectively.

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 more than 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. These risks are covered by holding adequate financial buffers on Banco de Portugal's balance sheet and are monitored from a medium and long-term perspective (see 1.1.6).

Additionally in the case of the APP, Banco de Portugal also strengthened its CBPP3 securities portfolio with a €184 million increase from 2017 (reaching a total of €3,592 million).

All the programmes implemented within Securities currently held for monetary policy purposes are accounted for at amortised cost less potential impairment losses, not reflecting gains that may materialise. Losses are recognised only if securities are sold.

 **2,285 million**
Early repayment of TLTRO-II

Also within the scope of **liquidity-providing operations**, €2,285 million in TLTRO-II were repaid early. These operations have a four-year maturity, with a possibility of repayment after two years. The interest rate applicable to such operations was only known in June 2018. Until that time, the deposit facility rate was used for calculating interest (set at -0.4% since 16 March 2016). The rate calculation led to a €53 million adjustment to Banco de Portugal's interest margin in 2018, regarding 2016 and 2017 (see 1.2.1). Furthermore, in 2018, the remainder of targeted longer-term refinancing operations (TLTRO-I), amounting to €1,012 million, matured.

By the end of 2018, TLTRO-II totalled €18,635 million, while the main refinancing operations accounted for €80 million. Prior to TLTRO, credit institutions' main sources of funding were the main refinancing operations and longer-term operations with maturities up to three years (Chart 6).

Chart II.1.6 • Liquidity-providing operations | EUR millions

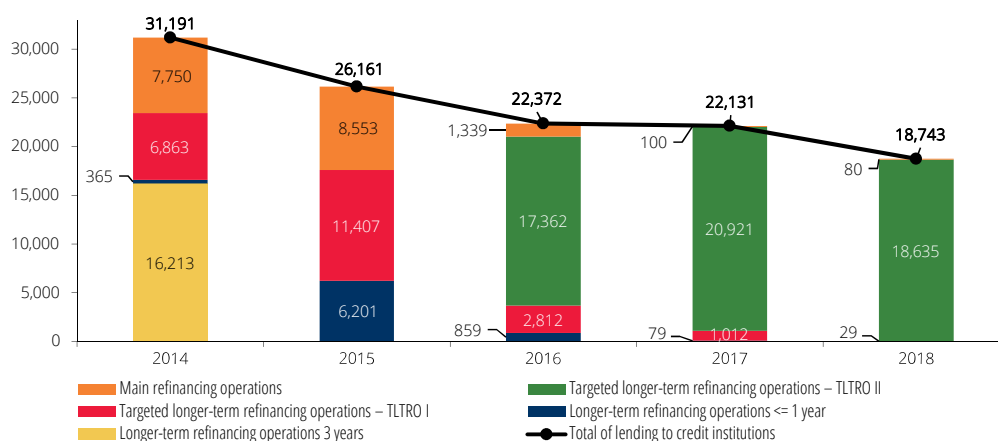
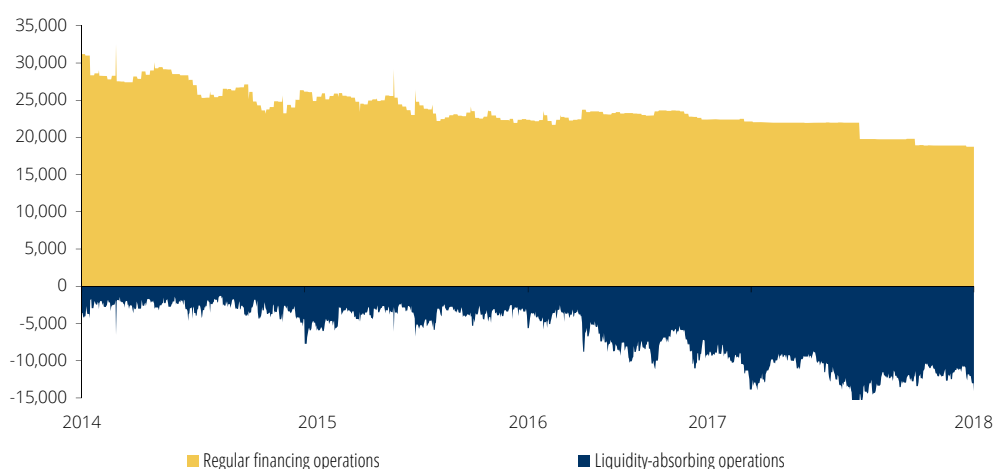


Chart II.1.7 • Daily balances in regular financing and liquidity-absorbing operations | EUR millions



Also within the scope of monetary policy, throughout 2018, as in previous years, Banco de Portugal recorded higher lending than liquidity absorption, even if the liquidity injection made through the monetary policy securities purchases is ignored. Chart 7 shows the daily balances in regular financing and liquidity-absorbing operations by Banco de Portugal in the Portuguese financial system.

1.1.2 Gold, foreign reserves and euro assets (net)

Gold



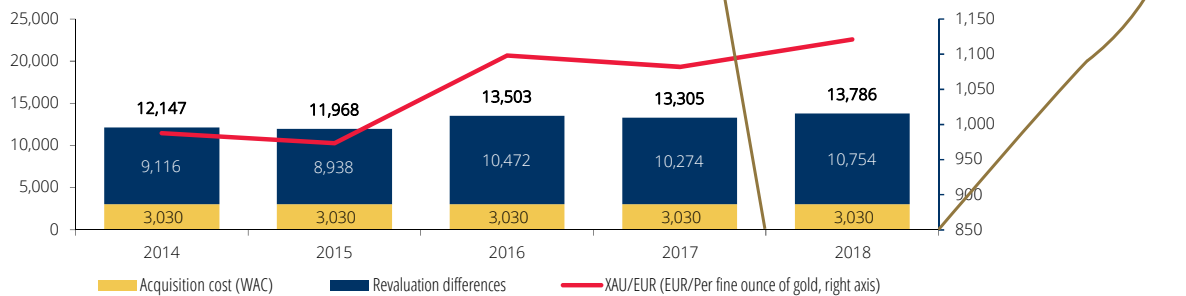
13,786 million
Gold reserve

Banco de Portugal's **gold reserve** totalled €13,786 million at the end of 2018, a €481 million increase from 2017, arising from the positive trend in the gold price in euro. This development was caused by the appreciation of the US dollar against the euro, as the gold price in US dollars depreciated by 1.1% from 2017. The volume of this reserve remained unchanged at 382.5 tons. The euro

value increase was offset by a change of an equivalent amount in the balance sheet item Revaluation accounts (Chart 8) (see 1.1.6). At the end of 2018, the revaluation differences for gold came to €10,754 million.

In 2018, Banco de Portugal entered into gold swaps for foreign currency, with the aim of profiting from gold assets.

Chart II.1.8 • Gold reserve and quote price | EUR millions

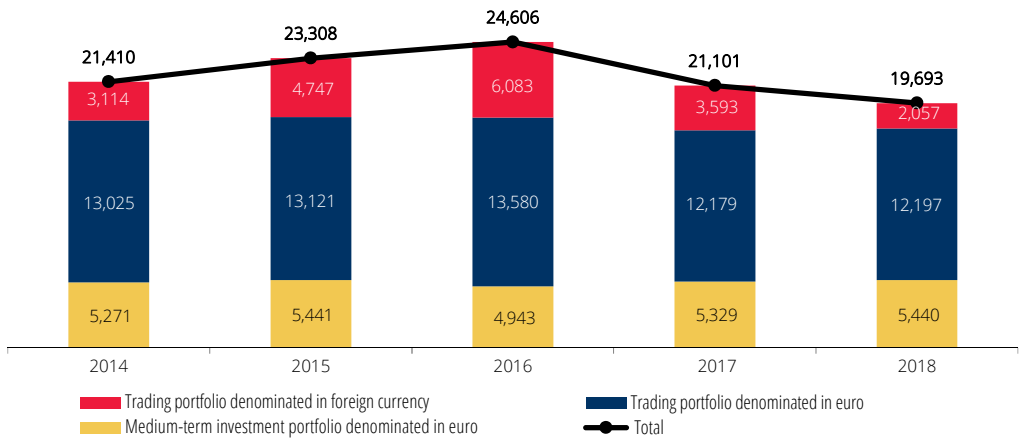


Foreign reserves and euro assets (net)



At the end of 2018, **net foreign reserves and euro assets** totalled €19,693 million, broken down between the trading portfolio denominated in euro (€12,197 million), the trading portfolio denominated in foreign currency (€2,057 million) and the medium-term investment portfolio denominated in euro (€5,440 million). Against 2017, there was a €1,407 million decrease due to a reduction in the volume of the portfolio denominated in foreign currency (Chart 9).

Chart II.1.9 • Foreign reserves and euro assets (net) | EUR millions



- Trading portfolios (denominated in euro and foreign currency)



-1,536 million

Decrease of the trading portfolio denominated in foreign currency

The **trading portfolio denominated in euro** totalled €12,197 million in December 2018, an €18 million increase from 2017, being mostly made up of securities issued by euro area residents (€10,050 million). By type of issuer, government debt bonds (€9,136 million) and paragonovernmental and supranational bonds (€1,786 million) accounted for most of this portfolio.

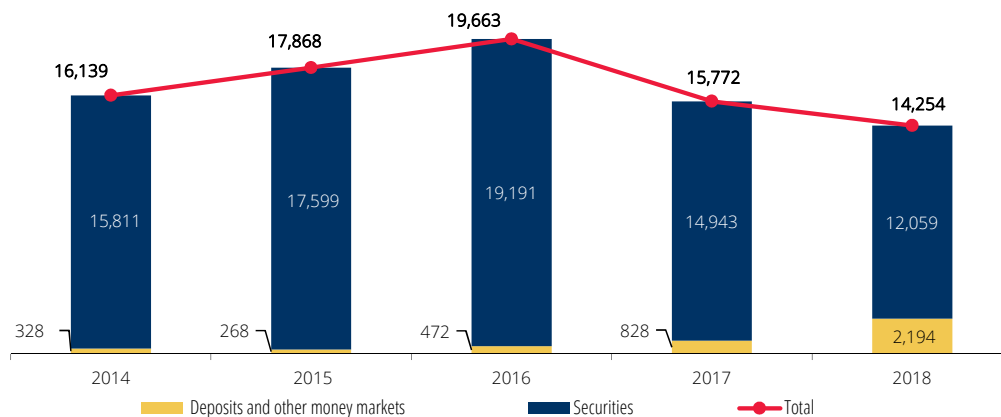
The **trading portfolio denominated in foreign currency** reached €2,057 million after falling sharply by €1,536 million versus 2017 (-43%). This decrease reflects Banco de Portugal's investment decisions within the limits set by the agreements established at Eurosystem level.¹ Sales of foreign currency led to realised gains mainly due to the appreciation of the US dollar throughout the year and were offset by a decrease in intra-Eurosystem liabilities (TARGET). The reduction to the foreign currency volume led to lower risk associated with foreign reserves and euro assets.

In terms of composition by currency, the US dollar remains the currency with the largest weight in this portfolio.

In terms of composition by instrument, securities remain the backbone of the trading portfolio denominated in foreign currency, though less than in the trading portfolio denominated in euro (53% of the total as at 31 December 2018). Regarding type of issuer, the securities portfolio is comprised by government debt bonds (€619 million), participation units in the Bank for International Settlements (BIS) (€269 million) and securities issued by paragonovernmental and supranational entities (€210 million).

Securities in the trading portfolios are valued at market price.

Chart II.1.10 • Trading portfolio (euro and foreign currency) | EUR millions



1. One of the agreements reached was the Agreement on Net Financial Assets (ANFA), between the national central banks of the euro area and the ECB (SEC/ GovC/16/420/07a.R), which sets rules and limits for non-monetary policy holdings that are related to national tasks of Eurosystem central banks.

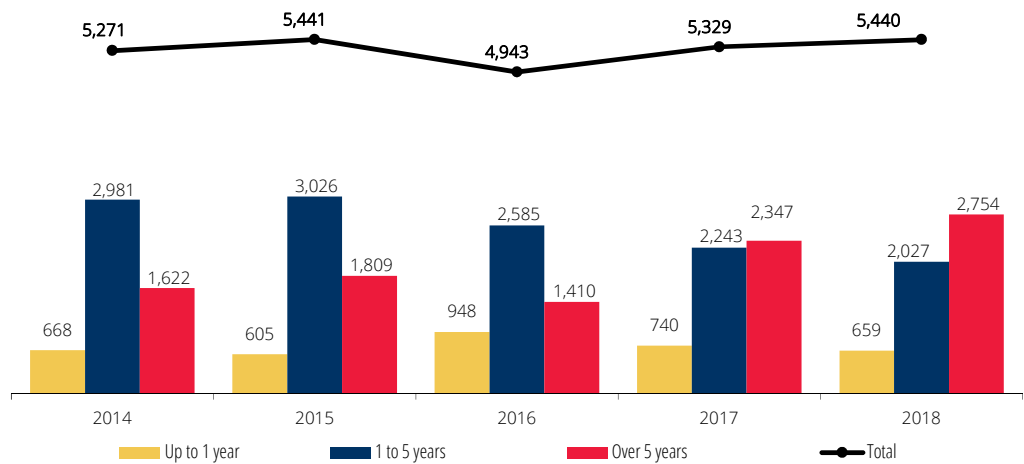
The value presented in Deposits and other money markets (Chart 10) includes the net effect of the assets and liabilities relating to these gold swap operations.

- Medium-term investment portfolio



The **medium-term investment portfolio** reached €5,440 million as at 31 December 2018, increasing by €111 million versus 2017 (Chart 11). The portfolio consisted of securities denominated in euro and the main component was government debt bonds by euro area issuers (€5,390 million). All securities in this portfolio are valued at amortised cost, subject to impairment.

Chart II.1.11 • Medium-term investment portfolio by maturity | EUR millions



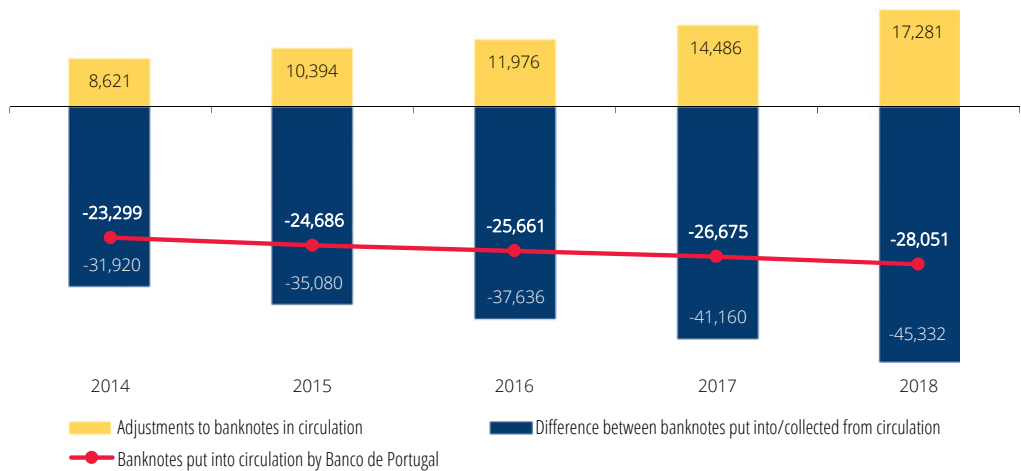
1.1.3 Banknotes in circulation



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 12). This aggregate has continued to grow since the euro entered into circulation, reflecting a rise in circulation at Eurosystem level (+5.2% from 2017).

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. On 31 December 2018 these adjustments totalled €45,332 million (+€4,172 million than in December 2017). As in previous years, the growth in these adjustments reflected the combination of increased circulation in the Eurosystem and the widening of the aforementioned difference.

Chart II.1.12 • Banknotes in circulation | EUR millions

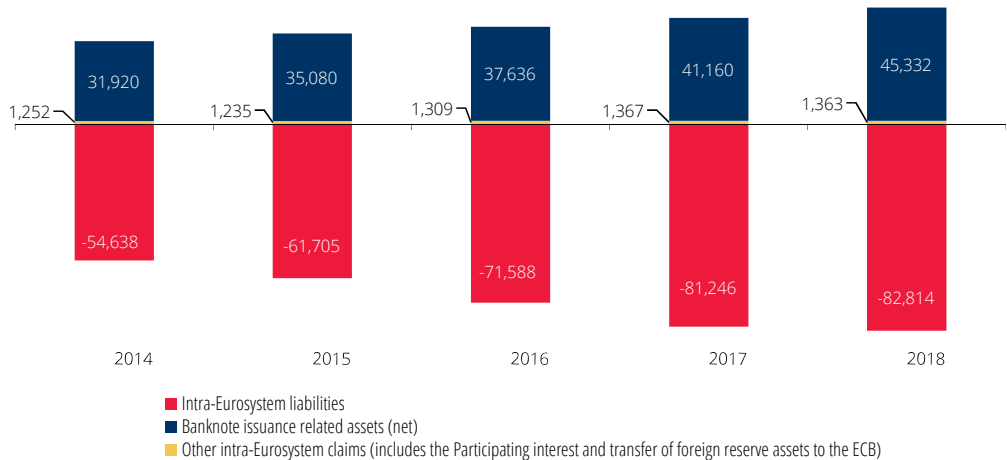


1.1.4 Intra-Eurosystem claims and liabilities



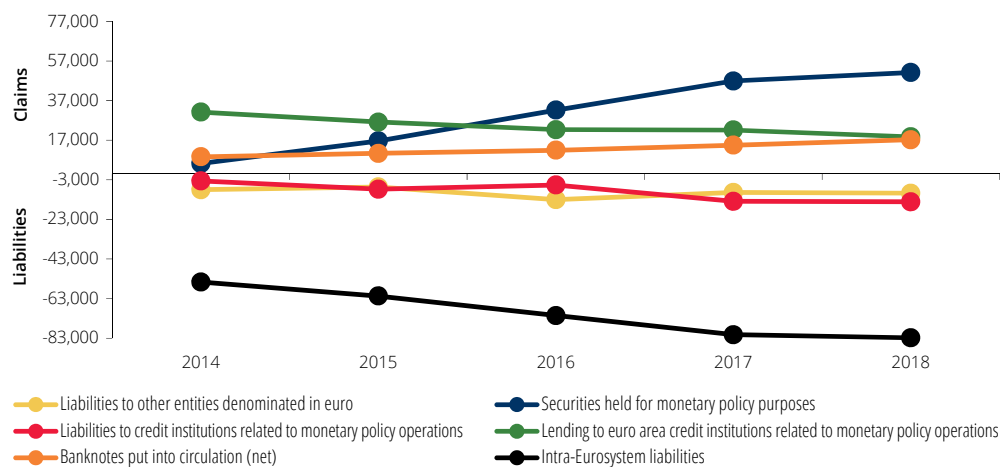
Regarding **Intra-Eurosystem claims** (Chart 13), it included the remunerated position relating to adjustments to banknotes in circulation (€45,332 million), mentioned in 1.1.3 on Banknotes in circulation.

Chart II.1.13 • Intra-Eurosystem claims and liabilities | EUR millions



As at 31 December 2018, **Intra-Eurosystem liabilities** grew €1,567 million from 2017 (to €82,814 million) (Chart 13) 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) and by the increase in the positive difference between the banknotes withdrawn from circulation and banknotes put into circulation by Banco de Portugal, partly offset by the reduction in lending to credit institutions and by the settlement of operations that reduced the trading portfolio as described above (Chart 14).

Chart II.1.14 • Intra-Eurosystem liabilities and main offsetting balance sheet items
| EUR millions



1.1.5 Liabilities to other euro area residents denominated in euro



9,226 million

Balance of general government current accounts held by Banco de Portugal

The item **Liabilities to other entities denominated in euro** was essentially composed of general government current accounts and autonomous funds' deposits held by Banco de Portugal (€9,226 million and €376 million respectively as at 31 December 2018). 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).

1.1.6 Own funds



-50 million

Decrease in general risk provision

Banco de Portugal's **Own funds** (which includes the items Revaluation accounts, General risk provision, Equity and Net profit for the year) increased by €828 million in 2018 (to €16,746 million), largely due to the increases in the Revaluation accounts item and to the positive Net profit for the year (Chart 15).

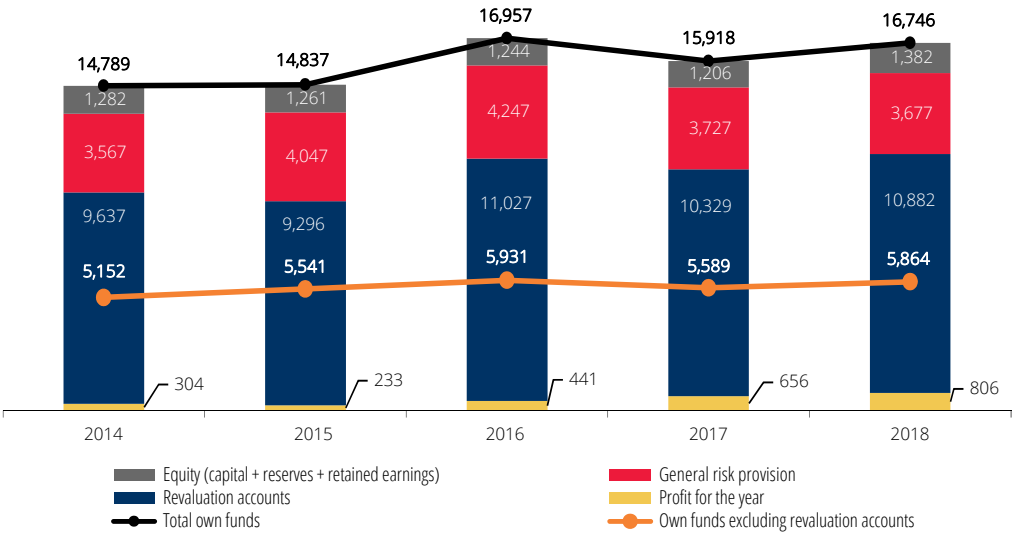
Contributing to the increase in revaluation accounts (of €553 million, totalling €10,882 million) was the rise in potential gains from Gold (€481 million), in potential exchange rate gains from assets denominated in foreign currency (€66 million), and in potential gains from trading portfolio securities (€7 million).

Besides the increases in the **Revaluation accounts**, Own funds were affected by (i) the €50 million decrease in December 2018 of the General risk provision; (ii) the recognition of €806

million in Net profit for 2018; (iii) the impact of the distribution of €525 million in Dividends to the State from the 2017 Net profit; and (iv) the recognition in Retained earnings of net actuarial and financial gains of 2018, relating to the Pension Fund – Defined-benefit plan (totalling €45 million).

The **General risk provision** for 2018 was reduced by €50 million in 2018, reaching a total of €3,677 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. In 2018, this provision was primarily allocated to the structural reduction of the exposure to foreign exchange risk, pursuant to the Board of Directors' decision to change long-term investment policies due to the lower amount of foreign currency assets in the asset management portfolios (see 1.1.2).

Chart II.1.15 • Own funds | EUR millions



1.2 Profit and loss account



1,115 million

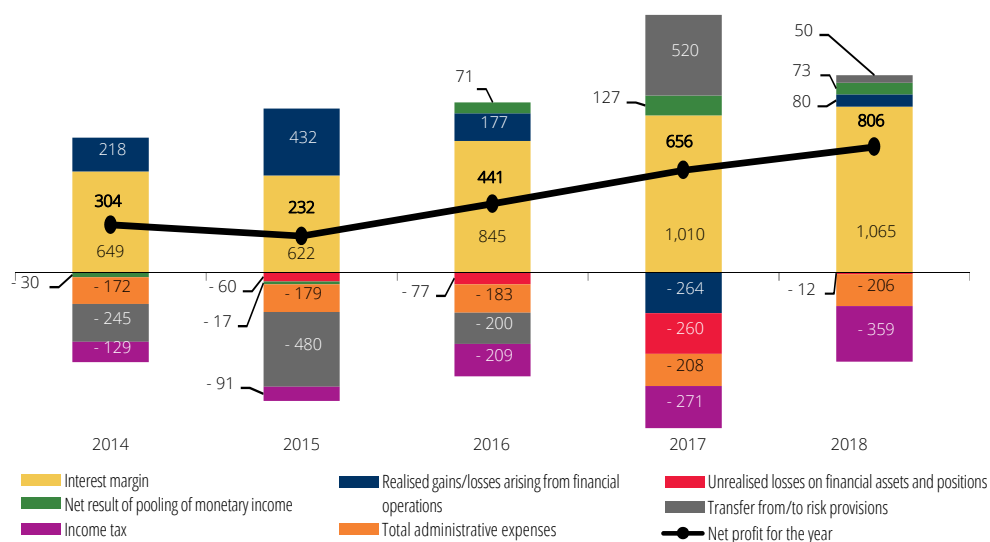
Income before provisions and taxes

The main components of the Profit and loss account from 2014 to 2018 are shown in Table 2. The **Net profit for the year 2018** was €806 million.

Table II.1.2 • Main Profit and loss account items 2014-2018 | EUR millions

	2014	2015	2016	2017	2018	Δ 2018/2017
Interest margin	649	622	845	1,010	1,065	55
Realised gains/losses arising from financial operations	218	432	177	(264)	80	344
Unrealised losses on financial assets and positions	(1)	(60)	(77)	(260)	(12)	248
Income from equity shares and participating interests	25	26	33	33	39	6
Net result of pooling of monetary income	(30)	(17)	71	127	73	(54)
Total administrative expenses	172	179	183	208	206	(2)
Staff costs	115	120	122	136	138	2
Supplies and services from third parties	42	47	48	56	52	(4)
Other administrative expenses	1	1	1	1	1	-
Depreciation and amortisation for the year	14	11	13	15	15	-
Banknote production costs	13	16	15	23	13	(9)
Other net profit/loss	4	(3)	(1)	(7)	89	96
Income before provisions and taxes	678	804	850	408	1,115	707
Transfer from/to risk provisions	(245)	(480)	(200)	520	50	(470)
Income before taxes	433	324	650	928	1,165	237
Income tax	(129)	(91)	(209)	(271)	(359)	(88)
Net profit for the year	304	232	441	656	806	149

Chart II.1.16 • Developments in the main profit/loss items | EUR millions



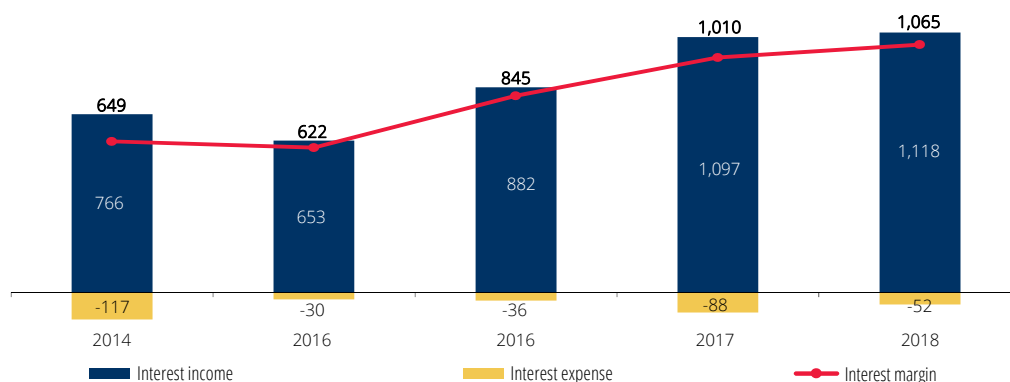
Income before provisions and taxes was €1,115 million, representing a €707 million increase from 2017. The main items are Net interest income (up €55 million from 2017), Realised gains/losses arising from financial operations (€80 million, in contrast to the -€264 million in 2017) and Net result of pooling of monetary income (€73 million, reflecting a €54 million decrease from 2017). In 2018 Unrealised losses totalled €12 million, compared to €260 million in 2017.

Net profit for the year did not show such an expressive increase, because €520 million of the above-mentioned general risk provision was used in 2017, compared to the €50 million decrease in 2018.

1.2.1 Interest margin

As in previous years, the main component of Banco de Portugal's Profit and loss account is the **Interest margin**, which reached €1,065 million in 2018, representing growth of €55 million from 2017 (+5%) (Chart 17).

Chart II.1.17 • Interest margin | EUR millions



886 million

Interest income from securities held for monetary policy purposes

The Interest margin item for 2018 was driven by interest income from the portfolio of securities held for monetary policy purposes, which totalled €886 million, an increase of €83 million. This was largely due to the increase in the government securities component of the PSPP. Interest margin also grew due to the adjustment to the estimate used for calculating accrued interest for 2016 and 2017 in Lending to credit institutions – TLTRO-II – (€53 million), since the final interest rate applicable to these operations (-0.2%), set only in June of 2018, was less negative than the deposit facility rate (-0.4%) used for the initial accrual, as defined by the Eurosystem. A further contribution to Interest margin was made by 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.



-98 million

Decrease in interest from trading portfolios

Partly offsetting these contributions was the reduction in interest from trading portfolios (-€98 million from 2017), mainly resulting from negative net yields from securities denominated in euro, as well as lower yield from the medium-term investment portfolio (-€30 million). The medium-term investment portfolio's average yield decreased because reinvestment targeted securities with better credit quality than those that reached maturity throughout the year.

1.2.2 Net result of financial operations and unrealised losses

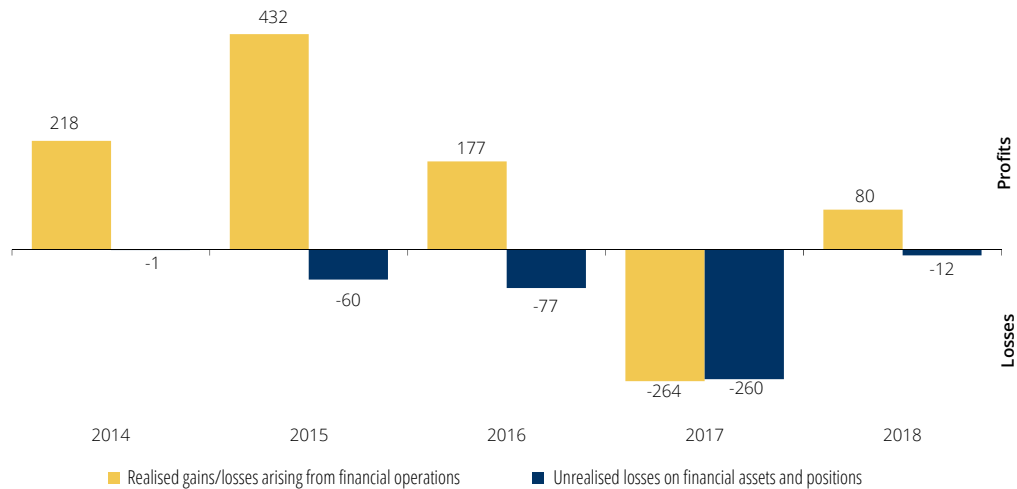


80 million

Realised gains/losses arising from financial operations

The item **Realised gains/losses arising from financial operations** in 2018 reached a cumulative total of €80 million, a €344 million increase when compared to 2017 (Chart 18).

Chart II.1.18 • Net result of financial operations and unrealised losses | EUR millions



This positive result arose chiefly from exchange rate gains realised when reducing the volume of the portfolio denominated in foreign currency, essentially comprising gains on sales of US dollars, because of this currency's appreciation against the euro, compared to December 2017 (Chart 19).



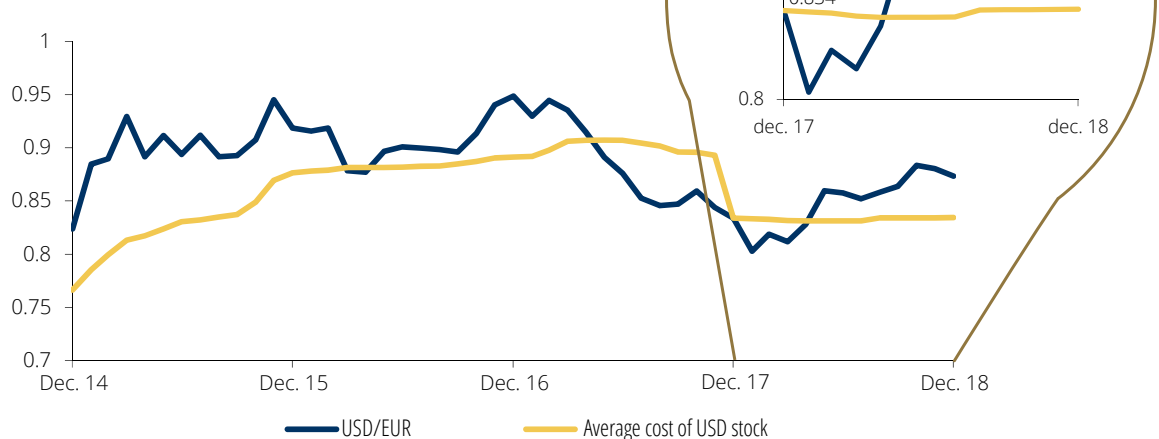
12 million

Unrealised losses on financial assets and positions

Regarding the item **Unrealised losses on financial assets and positions**, the overall amount of €12 million recognised in 2018 was mainly related to unrealised foreign currency losses associated with portfolio assets denominated in foreign currency (€8 million), as well as losses from price decreases in securities in the trading portfolio denominated in euro and foreign currency (€4 million and €1 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 are recognised in the balance sheet in the respective revaluation differences items.

Chart II.1.19 • Evolution of the USD/EUR exchange rate

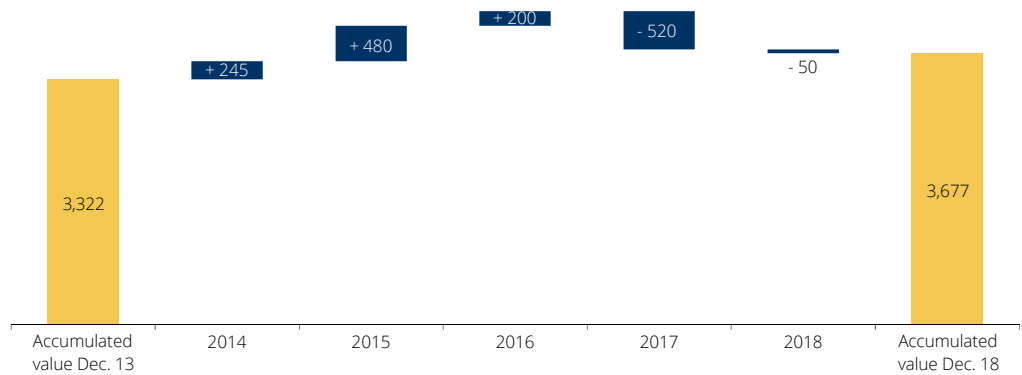


1.2.3 General risk provision

 **3,677 million**
General risk provision

The **General risk provision** was reduced by €50 million (Chart 20), taking into consideration the structural decrease in the financial risks on the balance sheet faced by Banco de Portugal over the long term, as mentioned above (see 1.1.6).

Chart II.1.20 • Movements in the General risk provision | EUR millions



1.2.4 Net result of pooling of monetary income

 **119 million**
Net result of pooling of monetary income by the Eurosystem

In 2018 the item **Net result of pooling of monetary income** was driven by (i) the result of the method of pooling monetary income (totalling €119 million), (ii) adjustments made this year, due to the changes to the TLTRO-II interest rates for 2016 and 2017 (totalling -€44 million) and (iii) the specific provision for the Eurosystem (a net effect of -€2 million).

The Net result of pooling of monetary income for the year decreased by €10 million from the previous year (€129 million in 2017), mainly because the actual rates for TLTRO-II operations were applied for the first time. Up to the end of 2017, the Eurosystem decided to use the deposit facility rate for calculating these operations, while the final interest rate set in June applied to 2018. Since rates recorded in the remainder of the Eurosystem were more negative than those recorded by Banco de Portugal, its share of net contributions to the pooling of monetary income in the Eurosystem decreased and led to a smaller allocation of monetary income to Banco de Portugal within the Eurosystem. Nevertheless, Banco de Portugal's share of these net contributions remained below its adjusted capital key, due to which an amount receivable was recorded under Net result of pooling of monetary income.

 **-44 million**
Adjustments to the TLTRO-II interest rates (2016 and 2017 interest rates)

This revision of the TLTRO-II interest rates also had a considerable impact on the revision of the monetary income for 2016 and 2017, with a -€44 million effect for Banco de Portugal.

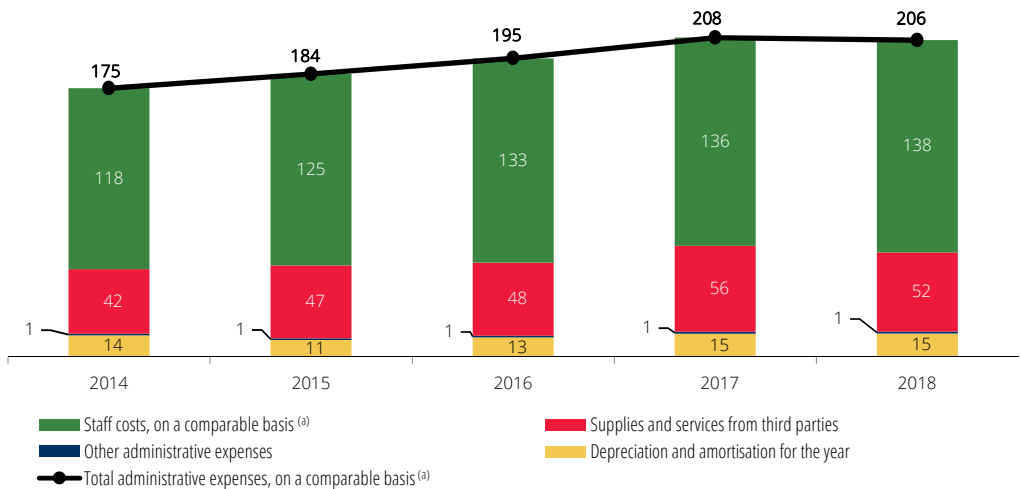
The Eurosystem’s specific provision set in 2017 was reversed and a new specific provision was taken, both for expected losses from securities included in the CSPP, which constitute a shared risk at Eurosystem level, even though they are not in Banco de Portugal’s portfolio.

1.2.5 Total administrative expenses



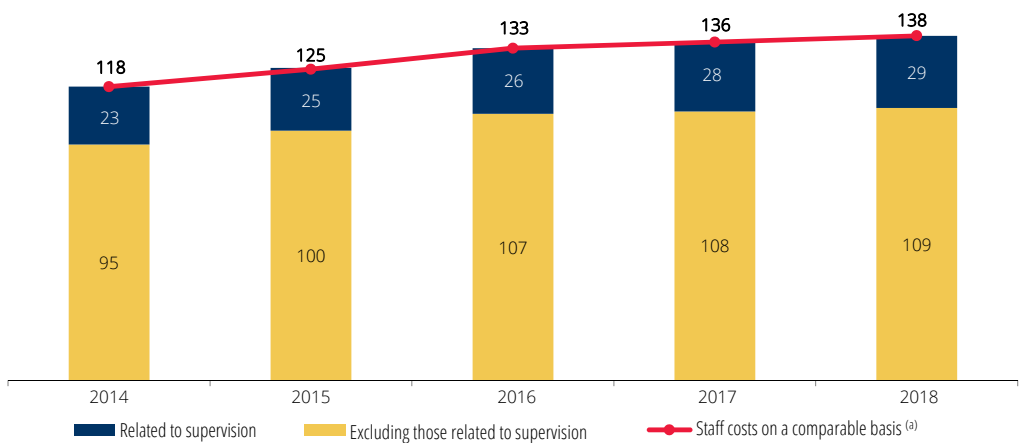
In 2018 Total administrative expenses came to €206 million (Chart 21).

Chart II.1.21 • Administrative expenses | EUR millions



(a) For the years from 2014 to 2016, the presented value includes, for comparability purposes, the costs related to Early retirements, which where until then recognised in the Own funds item.

Chart II.1.22 • Staff costs | EUR millions



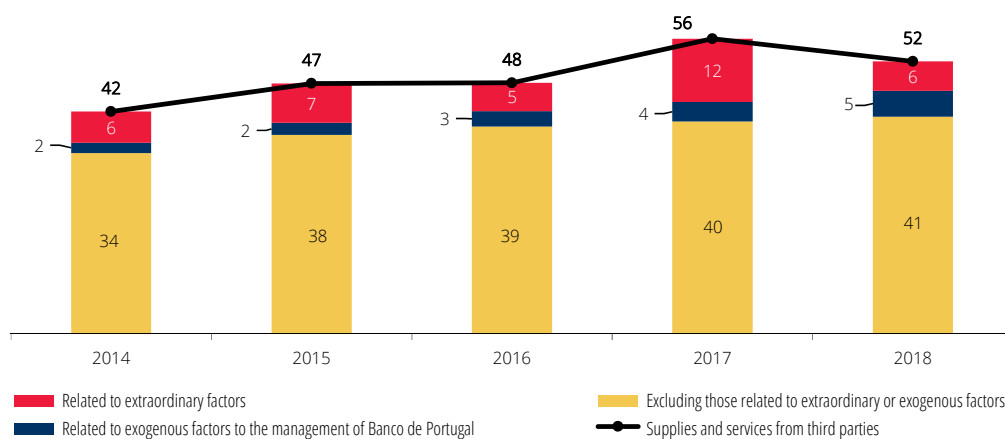
(a) For the years from 2014 to 2016, the presented value includes, for comparability purposes, the costs related to Early retirements, which where until then recognised in the Own funds item.



+2 million
Increase in Staff costs

The increase in **Staff costs** in 2018 (Chart 22) essentially reflected (i) the €1 million impact of the 0.75% salary update following the revision of the salary growth rate as defined by Associação Portuguesa de Bancos (Portuguese Banking Association) for 2018 and (ii) the €1 million increase in costs of early retirements. The average number of staff members employed by Banco de Portugal remained the same as in 2017, although renovation continued with the recruitment of around 100 new members of staff and the same number of retirements in 2018.

Chart II.1.23 • Supplies and services from third parties | EUR millions



-4 million
Decrease in Supplies and services from third parties, 25% of total administrative expenses

The item **Supplies and services from third parties** (accounting for around 25% of total administrative expenses) fell -€4 million from 2017 (Chart 23). Contributing to this decrease was the fall in expenses related to extraordinary factors, which comprised the legal and financial advice expenses from the resolution measure on Banco Espírito Santo, S. A. (-€6 million), partly resulting from the fact that Banco de Portugal had met in full these expenses relating to the sale of Novo Banco in 2017, by decision of the Ministry of Finance in October of that year.

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 2017, mainly because the TARGET2-Securities (T2S) system went live.

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 2018 (by around €1 million, +2%). Higher costs of outsourcing and other expenses related to information systems and technologies, databanks and security contributed to this growth in expenses.

Such increases were partly mitigated by savings in legal and litigation fees, representation expenses and utilities contracts. The Board of Directors of Banco de Portugal has 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, 14 March 2019

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

The 2018 Accounts of Banco de Portugal were approved under the terms laid down in Article 54(2) of the Organic Law of Banco de Portugal. The net profit for the year 2018, to the amount of €805.69 million, was distributed as follows:

10% to the legal reserve	€80,568,722.15
10% to other reserves	€80,568,722.15
The remainder to the State, as dividends	€644,549,777.22

pursuant to the provisions of Article 53(2) of the Organic Law of Banco de Portugal.

2 Financial Statements and Notes

Financial Statements

Table II.2.1 • Balance sheet of Banco de Portugal

Assets	Note number	31 Dec. 2018		31 Dec. 2017	
		Gross assets	Depreciation, amortisation and impairment	Net Assets	Net Assets
1 Gold and gold receivables	2	13,785,717	-	13,785,717	13,304,644
2 Claims on non-euro area residents denominated in foreign currency		7,987,452	-	7,987,452	8,451,598
2.1 Receivables from the IMF	3	1,219,538	-	1,219,538	1,189,726
2.2 Balances with banks and security investments, external loans and other external assets	4	6,767,914	-	6,767,914	7,261,872
3 Claims on euro area residents denominated in foreign currency	4	153,143	-	153,143	552,154
4 Claims on non-euro area residents denominated in euro	5	2,130,893	-	2,130,893	64,066
4.1 Balances with banks, security investments and loans		2,130,893	-	2,130,893	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	18,743,420	-	18,743,420	22,131,400
5.1 Main refinancing operations		79,500	-	79,500	100,000
5.2 Longer-term refinancing operations		18,663,920	-	18,663,920	22,011,400
5.3 Fine-tuning reverse operations		-	-	-	-
5.4 Structural reverse operations		-	-	-	-
5.5 Marginal lending facility		-	-	-	20,000
5.6 Credits related to margin calls		-	-	-	-
6 Other claims on euro area credit institutions denominated in euro	5	16,152	-	16,152	239,140
7 Securities of euro area residents denominated in euro		61,258,035	-	61,258,035	58,844,194
7.1 Securities held for monetary policy purposes	7	51,208,353	-	51,208,353	46,968,576
7.2 Other securities	5	10,049,681	-	10,049,681	11,875,619
9 Intra-Eurosystem claims	8	46,694,869	-	46,694,869	42,527,539
9.1 Participating interest in the ECB		203,700	-	203,700	203,700
9.2 Claims equivalent to the transfer of foreign reserves to the ECB		1,010,318	-	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		45,332,211	-	45,332,211	41,160,392
9.5 Other intra-Eurosystem claims		148,640	-	148,640	153,130
10 Items in the course of settlement		205	-	205	1
11 Other assets		7,458,956	276,112	7,182,844	6,850,094
11.1 Coins of the euro area		57,553	-	57,553	42,538
11.2 Tangible fixed assets and intangible assets	9	429,544	274,852	154,692	116,121
11.3 Other financial assets	10	5,495,805	-	5,495,805	5,383,265
11.4 Off-balance-sheet instruments revaluation differences		-	-	-	1,335
11.5 Accruals and prepaid expenses	11	905,235	-	905,235	918,389
11.6 Sundry	12/19	570,819	1,260	569,558	388,446
Total depreciation and amortisation	9	-	274,852	-	-
Total impairment	19	-	1,260	-	-
Total assets		158,228,843	276,112	157,952,731	152,964,831

Liabilities, revaluation accounts, general risk provision and equity	Note number	EUR thousands	
		31 Dec. 2018	31 Dec. 2017
1 Banknotes in circulation	13	28,051,388	26,674,764
2 Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	14	14,095,809	13,864,548
2.1 Current accounts of credit institutions for compliance with minimum reserve requirements		14,090,809	13,859,548
2.2 Deposit facility		5,000	5,000
2.3 Fixed-term deposits		-	-
2.4 Fine-tuning reverse operations		-	-
2.5 Deposits related to margin calls		-	-
3 Other liabilities to euro area credit institutions denominated in euro		-	-
5 Liabilities to other euro area residents denominated in euro	15	9,744,612	9,369,829
5.1 General government		9,226,187	8,952,911
5.2 Other liabilities		518,425	416,918
6 Liabilities to non-euro area residents denominated in euro	16	2,888	6,009
7 Liabilities to euro area residents denominated in foreign currency		-	-
8 Liabilities to non-euro area residents denominated in foreign currency	4	4,864,219	4,221,095
8.1 Deposits, balances and other liabilities		4,864,219	4,221,095
8.2 Liabilities arising from the credit facility under ERM II		-	-
9 Counterpart of special drawing rights allocated by the IMF	3	980,192	957,772
10 Intra-Eurosystem liabilities	8	82,813,568	81,246,236
10.1 Liabilities related to the issuance of ECB debt certificates		-	-
10.2 Net liabilities arising from balances of TARGET accounts		82,769,710	81,246,162
10.3 Net liabilities related to the allocation of euro banknotes within the Eurosystem		-	-
10.4 Other net liabilities within the Eurosystem		43,858	74
11 Other liabilities		650,119	704,558
11.1 Off-balance-sheet instruments revaluation differences		632	-
11.2 Accruals and income collected in advance	17	139,172	142,548
11.3 Sundry	18	510,315	562,010
12 Provisions	19	3,989	1,706
13 Revaluation accounts	20	10,882,105	10,328,833
14 General risk provision	19	3,676,622	3,726,622
15 Equity	21	1,381,532	1,206,375
15.1 Capital		1,000	1,000
15.2 Reserves and retained earnings		1,380,532	1,205,375
16 Profit for the year		805,687	656,484
Total liabilities, revaluation accounts, general risk provision and equity		157,952,731	152,964,831

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.2.2 • Profit and loss account | EUR thousands

	Items	Note number	31 Dec. 2018	31 Dec. 2017
1	Interest income		1,117,573	1,097,343
2	Interest expense		52,450	87,593
3	Net interest income	22	1,065,123	1,009,750
4	Realised gains/losses arising from financial operations	23	80,208	(264,191)
5	Unrealised losses on financial assets and positions	24	12,199	260,333
6	Transfer from/to risk provisions	19	50,000	520,000
7	Net result of financial operations, unrealised losses and risk provisions		118,010	(4,525)
8	Fees and commissions income		4,858	4,995
9	Fees and commissions expense		9,130	10,244
10	Net income from fees and commissions		(4,272)	(5,250)
11	Income from equity shares and participating interests	25	39,048	33,234
12	Net result of pooling of monetary income	19/26	72,991	126,886
13	Other income	27	96,049	9,181
14	Total net income		1,386,949	1,169,276
15	Staff costs	28	138,217	135,721
16	Supplies and services from third parties	29	51,574	55,871
17	Other administrative expenses		1,345	1,338
18	Depreciation and amortisation for the year	9	15,254	15,058
19	Total administrative expenses		206,390	207,989
20	Costs of banknote production		13,430	22,814
21	Other expenses	27	2,572	14,754
22	Losses for impairment of assets (losses/reversals)	19	(112)	(4,002)
23	Transfer to the reserve relating to capital gains on gold sales		-	-
24	Total costs and losses (net)		222,280	241,555
25	Income before taxes		1,164,669	927,721
26	Income tax		358,982	271,237
26.1	Income tax – current	30	358,297	271,964
26.2	Income tax – deferred	30	685	(727)
27	Profit for the year		805,687	656,484

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.2.3 • Statement of changes in equity | EUR thousands

Description	Note number	Paid up capital	Legal reserves	Other reserves	Retained earnings	Net profit for the year	Total equity
Position as at 31 December 2016 (1)		1,000	351,900	1,288,102	(397,439)	440,590	1,684,153
2016 profit distribution							
Dividends distribution to shareholders	21	-	-	-	-	(352,472)	(352,472)
Other operations	21	-	44,059	44,059	-	(88,118)	-
Sub-total of 2016 profit distribution (2)		-	44,059	44,059	-	(440,590)	(352,472)
Changes in 2017							
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 (3)		-	-	-	(125,307)	-	(125,307)
Net profit for the year (4)						656,484	656,484
Comprehensive income for the year (5) = (3) + (4)		-	-	-	(125,307)	656,484	531,177
Position as at 31 December 2017 (6) = (1) + (2) + (5)		1,000	395,959	1,332,161	(522,747)	656,484	1,862,858
Position as at 31 December 2017 (7)		1,000	395,959	1,332,161	(522,747)	656,484	1,862,858
2017 profit distribution							
Dividends distribution to shareholders	21	-	-	-	-	(525,187)	(525,187)
Other operations	21	-	65,648	65,648	-	(131,297)	-
Sub-total of 2017 profit distribution (8)		-	65,648	65,648	-	(656,484)	(525,187)
Changes in 2018							
Actuarial gains/losses of the Pension Fund	32	-	-	-	44,529	-	44,529
Actuarial gains/losses from group life insurance		-	-	-	(721)	-	(721)
Income tax – current	30	-	-	-	6,714	-	6,714
Adjustments on account of deferred taxes	30	-	-	-	(6,660)	-	(6,660)
Sub-total of changes in 2018 (9)		-	-	-	43,862	-	43,862
Net profit for the year (10)		-	-	-	-	805,687	805,687
Comprehensive income for the year (11) = (9) + (10)		-	-	-	43,862	805,687	849,549
Position as at 31 December 2018 (12) = (7) + (8) + (11)		1,000	461,608	1,397,810	(478,885)	805,687	2,187,219

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.

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”),² 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/ECB”), 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 IFRS³ 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 the Profit and loss account (points 1.2(d) and (p) of Note 1); and (ii) the General risk provision, which unlike the other provisions, is equivalent to a reserve, although its reinforcements and reversals are made directly against the Profit and loss account (point 1.2(q) of Note 1). 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 point 1.2(e) of Note 1. 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

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.europa.eu.

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

laid down by the ECB as a basis. As to the other business areas, the disclosures are on the information 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 (point 1.2(g) of this Note).

(d) Recognition of gains and losses

Banco de Portugal applies an asymmetric valuation approach to unrealised gains/losses 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 (point 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.⁴ 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
Tangible fixed assets	
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
Intangible assets	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 other balance sheet positions denominated in euro not previously mentioned in this item, are recognised at nominal value, less any impairment losses where applicable (point 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 purposes other than monetary policy

Securities for purposes other than monetary policy 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 point 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 point 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/ECB, 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 TARGET⁵ 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 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, giving each NCB's position vis-à-vis the ECB.

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

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 (point 1.2(i) of this Note).

(i) Banknotes in circulation

The ECB and the NCBs of the euro area, which together comprise the Eurosystem, put euro banknotes in circulation.⁶ The ECB and 12 of these NCBs have issued euro banknotes since 1 January 2002; Banka Slovenije adopted the euro on 1 January 2007; the Central Bank of Cyprus and Central Bank of Malta adopted the euro on 1 January 2008; Národná banka Slovenska adopted the euro on 1 January 2009; Eesti Pank adopted the euro on 1 January 2011; Latvijas Banka adopted the euro on 1 January 2014; and Lietuvos bankas adopted the euro on 1 January 2015.

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 total value of euro banknotes in circulation is allocated on the last working day of each month in accordance with the 'banknote allocation key'.⁷

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.⁸ 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 new Member State adopts the euro, the 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 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.

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) (ECB/2016/36), OJ L 347, 20 December 2016, p. 26.

(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, will 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.⁹ It will 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.

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

Banco de Portugal's liabilities related to the Pension Fund, explained 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 are directly recognised under Retained earnings.

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

As regards these Plans, contributions made to 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 started working at Banco de Portugal after 3 March 2009, pursuant to Decree-Law No 54/2009 of 2 March 2009, are covered by the general social security scheme. These employees may participate in a supplementary pension plan, to which Banco de Portugal contributes 1.5% of the actual monthly compensation. However, since this is a defined-contribution plan, Banco de Portugal has no legal or constructive obligation to pay any additional contribution.

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.

(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 in the Profit and loss account 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 the Profit and loss account, 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 with a deduction 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 if: (i) Banco de Portugal has a present obligation, legal or constructive, (ii) payment is likely to be required and (iii) the amount can be estimated reliably. 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 point 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 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 (point 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 on a set of qualitative and quantitative factors, involving technical assessment of developments in the financial statements, balance sheet risks (measured following methodologies common to the Eurosystem NBCs) and financial buffers that allow risks to be covered over a medium-term time horizon to a level defined by the Board of Directors.

(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 for the year.

Retained earnings represent profits of previous years pending distribution by the Board of Directors, or profits 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, Banco de Portugal's financial statements 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/ECB, 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. 2018		31 Dec. 2017	
	Fine ounces ^(a)	EUR thousands	Fine ounces ^(a)	EUR thousands
Gold stored at the Bank	5,549,238	6,220,479	5,549,238	6,003,615
Gold sight accounts	2,364,715	2,650,753	2,716,456	2,938,882
Gold allocated to swaps	4,384,171	4,914,485	4,032,003	4,362,147
Gold reserve	12,298,124	13,785,717	12,297,697	13,304,644

(a) Ounce of fine gold.

As at 31 December 2018, the gold item increased by €481,072 thousand compared to the 2017 end balance. This increase was chiefly due to the rising price of gold denominated in euro. This rise was caused by the appreciation of the US dollar against the euro, as the gold price in US dollars depreciated by 1.1% from 31 December 2017. The variation in the gold reserve level arose from small changes in the execution of gold transactions.

Banco de Portugal's gold reserve was valued on 31 December 2018 at the market price of €1,120.96 per fine ounce of gold, a 3.6% increase from 31 December 2017, when it was €1,081.88.

There were also gold swap transactions for foreign currency in 2018, although these do not affect the gold reserve level, as described in point 1.2(g) of Note 1 on accounting policy.

Unrealised gains resulting from this asset (€10,754,267 thousand on 31 December 2018 and €10,273,653 thousand on 31 December 2017) are recognised on the balance sheet (Note 20) as positive revaluation differences according to the accounting policy described in points 1.2(e) and (p) of Note 1.

The gold reserve invested in deposits was held in the following banks:

	31 Dec. 2018		31 Dec. 2017	
	Fine ounces	EUR thousands	Fine ounces	EUR thousands
Bank of England	1,605,730	1,799,961	1,957,472	2,117,751
Bank for International Settlements (BIS)	640,658	718,152	640,658	693,115
Federal Reserve Bank – United States	118,327	132,640	118,327	128,015
Total	2,364,715	2,650,753	2,716,456	2,938,882

All of the gold allocated to swaps is located in the Bank of England.

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

	31 Dec. 2018		31 Dec. 2017	
	SDR thousands	EUR thousands	SDR thousands	EUR thousands
IMF quota	2,060,100	2,503,846	2,060,100	2,446,575
IMF's holdings	(1,594,232)	(1,937,630)	(1,594,428)	(1,893,542)
Reserve tranche position in the IMF	465,868	566,215	465,672	553,032
SDR holdings	537,537	653,322	536,117	636,693
Claims on the IMF	1,003,404	1,219,538	1,001,790	1,189,726
Counterpart of special drawing rights allocated by the IMF	(806,477)	(980,192)	(806,477)	(957,772)
Liabilities to the IMF	(806,477)	(980,192)	(806,477)	(957,772)

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

The Reserve tranche position in the IMF reflects the equivalent in euro, on 31 December 2018, 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 2018 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 2017.

The liability position corresponding to the item Counterpart of special drawing rights allocated by the IMF showed a €980,192 thousand (SDR 806,477 thousand) liability to the IMF on 31 December 2018.

The changes in the different claim and liability items also include the effect of the SDR appreciation against the euro (2.3%), from 1.1876 on 31 December 2017 to 1.2154 on 31 December 2018.

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

	31 Dec. 2018	31 Dec. 2017
Claims on non-euro area residents denominated in foreign currency		
Securities	966,822	2,483,424
Balances with banks, deposits and other money markets	5,801,093	4,778,448
	6,767,914	7,261,872
Claims on euro area residents denominated in foreign currency		
Securities	131,301	527,139
Balances with banks, deposits and other money markets	21,842	25,015
	153,143	552,154
Liabilities to non-euro area residents denominated in foreign currency		
Deposits, balances and other liabilities	(4,864,219)	(4,221,095)
Total security investments denominated in foreign currency	1,098,123	3,010,563
Total balances with banks, deposits and other money markets in foreign currency (net)	958,716	582,367
	2,056,839	3,592,931

In 2018 there was a decrease in the trading portfolio of claims denominated in foreign currency arising from Banco de Portugal's strategic investment options, which translated into a volume decrease in the portfolio of securities of non-euro area residents.

As at 31 December 2018 and 2017, the securities portfolio denominated in foreign currency was broken down as follows:

	31 Dec. 2018	31 Dec. 2017
Securities of non-euro area residents denominated in foreign currency		
Government debt	619,334	1,693,037
Paragovernmental and supranational	347,487	790,387
	966,822	2,483,424
Securities of euro area residents denominated in foreign currency		
Paragovernmental and supranational	131,301	527,139
	131,301	527,139
	1,098,123	3,010,563

Gold swaps for foreign currency were also entered into in 2018 (Note 2) and are reflected in the balances with banks, deposits and other money markets item (under Claims on non-euro area residents denominated in foreign currency) against an increase of the same amount in Liabilities to non-euro area residents denominated in foreign currency, as described in point 1.2(g) of Note 1.

As at 31 December 2018 the portfolio denominated in foreign currency continued to be mainly composed of US dollars, as in previous years.

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

	31 Dec. 2018	31 Dec. 2017
Claims on non-euro area residents denominated in euro		
Securities	911,589	57,288
Balances with banks, deposits and other money markets	1,219,304	6,777
	2,130,893	64,066
Claims on euro area residents denominated in euro		
Securities	10,049,681	11,875,619
Balances with banks, deposits and other money markets	16,152	239,140
	10,065,834	12,114,759
Total security investments denominated in euro	10,961,271	11,932,907
Total balances with banks, deposits and other money markets denominated in euro	1,235,456	245,917
	12,196,727	12,178,824

The volume of the trading portfolio denominated in euro (securities and balances with banks, deposits and other money markets) recorded a slight increase from December 2017, retaining the same structure in terms of composition by financial instrument and origin of issuer. In accordance with Banco de Portugal's strategic decisions, securities of euro area residents continued to account for the largest share in this portfolio (82% of total claims in 2018 and 98% in 2017).

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

	31 Dec. 2018	31 Dec. 2017
Securities of non-euro area residents denominated in euro		
Paragovernmental and supranational	888,375	25,464
Companies/financial institutions	23,214	31,825
	911,589	57,288
Securities of euro area residents denominated in euro		
Government debt	9,136,410	11,541,728
Paragovernmental and supranational	898,032	313,196
Companies/financial institutions	15,240	20,695
	10,049,681	11,875,619
	10,961,271	11,932,907

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

On 31 December 2018 the euro value of the refinancing operations to euro area credit institutions relating to monetary policy operations denominated in euro at Eurosystem level reached €734,381,501 thousand (2017: €764,310,316 thousand), of which Banco de Portugal held €18,743,420 thousand, broken down as follows:

	31 Dec. 2018	31 Dec. 2017
Main refinancing operations	79,500	100,000
Longer-term refinancing operations	18,663,920	22,011,400
Marginal lending facility	-	20,000
	18,743,420	22,131,400

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, with allotment of the total amount bid. On 31 December 2018 the total amount allotted by Banco de Portugal amounted to €79,500 thousand (2017: €100,000 thousand). These operations are still a main instrument for pursuing interest rate objectives, for managing market liquidity and for signalling the ECB's single monetary policy stance.

The longer-term refinancing operations (LTROs) are liquidity-providing reverse transactions with a maturity of between 3 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 (TLTRO-II). These operations have a four-year maturity, with a possibility of repayment after two years. According to the decisions taken by the Governing Council, the final interest rate applicable to each TLTRO-II operation depended on the lending behaviour of the counterparties for the period between 1 February 2016 and 31 January 2018 and would be between the MRO rate and the deposit facility rate at the time of the allotment. Given that the actual rate could only be calculated in 2018 and a reliable estimate was not possible until this time, the deposit facility rate was used for calculating the TLTRO-II interest up to the end of 2017 in a harmonised way at Eurosystem level, as this was deemed a prudent approach, set at -0.40% since 16 March 2016. Interest income for that period resulting from the difference between the deposit facility rate and the calculated rate was recorded in the Profit and loss account under Interest income in 2018.

On 31 December 2018 the combined LTRO balance outstanding of the amount allotted by Banco de Portugal reached €18,663,920 thousand (2017: €22,011,400 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 2018 recourse to this operation by Banco de Portugal was nil (2017: €20,000 thousand).

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/ECB, losses from monetary policy operations, if they materialise, may be shared, if so decided by the Governing Council, 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 2018, the portfolio of Securities held for monetary policy purposes contained public sector securities and covered bonds, acquired by Banco de Portugal under the securities markets programme (SMP),¹⁰ the covered bond purchase programmes (CBPP, CBPP2 and CBPP3),¹¹ and the public sector purchase programme (PSPP),¹² in its governmental and supranational components (point 1.2(f) of Note 1).

	31 Dec. 2018		31 Dec. 2017	
	Amortised cost	Market value	Amortised cost	Market value
Securities held for monetary policy purposes				
Eurosystem's securities markets programme (SMP)	1,887,958	2,034,391	2,479,596	2,740,591
Covered bond purchase programme (CBPP)	99,953	104,616	99,909	109,119
Covered bond purchase programme 2 (CBPP2)	58,141	65,733	58,089	68,098
Covered bond purchase programme 3 (CBPP3)	3,591,664	3,627,336	3,407,710	3,446,652
Public sector purchase programme (PSPP) – Governmental securities	30,747,930	33,141,430	25,847,533	27,938,738
Public sector purchase programme (PSPP) – Supranational securities	14,822,707	14,696,836	15,075,738	14,968,216
	51,208,353	53,670,342	46,968,576	49,271,414

The following table presents the movements in these programmes during the year 2018:

	31 Dec. 2017	Purchases	Sales	Maturing securities	Accrual of premiums and discounts	Realised gains/losses arising from financial operations	31 Dec. 2018
Securities held for monetary policy purposes							
Eurosystem's securities markets programme (SMP)	2,479,596	-	-	(609,800)	18,161	-	1,887,958
Covered bond purchase programme (CBPP)	99,909	-	-	-	44	-	99,953
Covered bond purchase programme 2 (CBPP2)	58,089	-	-	-	52	-	58,141
Covered bond purchase programme 3 (CBPP3)	3,407,710	453,128	-	(245,800)	(23,374)	-	3,591,664
Public sector purchase programme (PSPP) – Governmental securities	25,847,533	5,606,320	(394,944)	-	(317,757)	6,778	30,747,930
Public sector purchase programme (PSPP) – Supranational securities	15,075,738	-	-	(143,400)	(109,631)	-	14,822,707
	46,968,576	6,059,448	(394,944)	(999,000)	(432,505)	6,778	51,208,353

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.

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 close this programme to new purchases. Therefore, no purchases have been made for this portfolio since 2016. The reduction in this item, in 2018, was solely due to securities that matured.

Under 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).

Under the asset-backed securities purchase programme (ABSPP),¹³ 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 2018, the Eurosystem continued to purchase securities under the expanded asset purchase programme (APP), which includes the 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. As of 2018 Banco de Portugal had not made any purchases under this programme.

In 2018, the pace of net purchases of securities under the APP by NCBs and the ECB was €30 billion per month on average up to September and €15 billion per month from October to the end of the year, when net purchases ended. The Governing Council intends to maintain its policy of reinvesting in full the principal payments from maturing securities purchased under the APP for an extended period of time after the ECB key interest rates start going up, and for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

In 2018, Banco de Portugal carried out a one-off sale of securities in the PSPP, from the governmental securities component, so as to keep within the limits and volume set for that programme.

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

Within the monetary policy programmes, the total Eurosystem NCBs' holding of securities amounts to €67,654,011 thousand in the SMP portfolio (2017: €82,490,038 thousand), €3,961,499 thousand in the CBPP portfolio (2017: €5,446,721 thousand), €3,683,458 thousand in the CBPP2 portfolio (2017: €4,367,919 thousand), €240,655,912 thousand in the CBPP3 portfolio (2017: €220,954,586 thousand), €1,681,113,356 thousand in the PSPP – Governmental securities portfolio (2017: €1,508,841,676 thousand), €224,506,518 thousand in the PSPP – Supranational securities portfolio (2017: €203,931,996 thousand), and €178,050,268 thousand in the CSPP portfolio (2017: €131,593,122 thousand).

In accordance with Article 32.4 of the Statute of the ESCB/ECB, losses from monetary policy operations (i.e. SMP, CBPP3, PSPP – Supranational securities and CSPP), if they were to materialise, may be shared, by decision of the Governing Council, in full by the Eurosystem NCBs, in proportion to the prevailing ECB capital key shares.

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

The Governing Council assesses on a regular basis the financial risks associated with the securities held under these programmes. As referred to in point 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 2018 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.

As to the impairment test conducted at the end of 2018 on the securities purchased under the CBPP3, the Governing Council identified one impairment indicator, relating to securities issued by a credit institution that faced financial difficulties in the course of 2018. The Governing Council considered that, based on the information available on 31 December 2018, 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 held under CBPP, CBPP2 and CBPP3.

Based on the decision made by the Governing Council pursuant to Article 32.4 of the Statute of the ESCB/ECB, losses from securities held under the CSPP, if they materialise, 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).

NOTE 8 • INTRA-EUROSISTEM CLAIMS AND LIABILITIES

- Participating interest in the ECB

Pursuant to Article 28 of the Statute of the ESCB/ECB, the NCBs of the ESCB are the sole subscribers to and holders of the capital of the ECB. The subscription of capital shall be made according to the key established in Article 29, which in paragraph 3 sets forth that the weightings assigned to the NCBs shall be adjusted every five years after the establishment of the ESCB.¹⁴ The latest adjustment entered into force on 1 January 2019.

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 this share, including supplementary payments due to the adjustment of accumulated reserves, came to €203,700 thousand.

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.

NCB	Country	Key for subscription of the ECB's capital
		From 01 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%
Euro area NCBs		70.3915%
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%
Non-euro area NCBs		29.6085%
		100.0000%

- Foreign reserves transferred 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 2018, the position of Banco de Portugal in claims equivalent to the transfer of foreign reserves to the ECB remained at €1,010,318 thousand.

- 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 (points 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 2017 (from €41,160,392 thousand to €45,332,211 thousand) was due to the combination of a rise in overall circulation in the Eurosystem (5% up from 2017) and a rise in Banco de Portugal's asset position relating to the difference between banknotes put into circulation and banknotes withdrawn from circulation by this central bank (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 2018 the balance of the item Other intra-Eurosystem claims, to the amount of €148,640 thousand, referred to: (i) the calculation method of the monetary income of 2018, totalling €119,133 thousand, settled on 31 January 2019 (Note 26); and (ii) an amount receivable of €29,507 thousand in respect of the early distribution of 2018 ECB income relating to the securities purchased by the ECB under the SMP, CBPP3, ABSPP and PSPP portfolios, also settled on 31 January 2019, following a decision of the Governing Council.

On 31 December 2018, the balance of the item Other intra-Eurosystem liabilities, to the amount of €43,858 thousand, referred to Eurosystem adjustments to the calculation method of the monetary income relating to previous years, settled on 31 January 2019 (Note 26).

- Net liabilities arising from balances of TARGET accounts

On 31 December 2018, Net liabilities arising from balances of TARGET accounts to the ECB (net) (point 1.2(h) of Note 1) showed a credit position of €82,769,710 thousand (on 31 December 2017: €81,246,162 thousand). Interest on this position is calculated at the marginal interest rate used by the Eurosystem for MROs.

NOTE 9 • TANGIBLE FIXED ASSETS AND INTANGIBLE ASSETS

	31 Dec. 2018	31 Dec. 2017
Tangible fixed assets		
Land	50,762	8,840
Buildings and other constructions	107,847	108,047
Facilities	84,294	83,402
Equipment	101,905	98,817
Museum and art collections	9,495	9,396
	354,303	308,502
Intangible assets		
Computer software	67,787	63,857
Other intangible assets	388	132
	68,175	63,989
Tangible fixed assets and intangible assets under construction	7,066	3,921
Total gross tangible fixed assets and intangible assets	429,544	376,412
Accumulated depreciation and amortisation		
Depreciation of tangible fixed assets	(216,856)	(207,999)
Amortisation of intangible assets	(57,996)	(52,292)
	(274,852)	(260,290)
Total net tangible fixed assets and intangible assets	154,692	116,121

In 2017 and 2018 movements in this item were as follows:

	31 Dec. 2016			Depreciation and amortisation for the year	31 Dec. 2017
	Net balance	Additions	Disposals		Net balance
Tangible fixed assets					
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
Intangible assets					
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
Tangible fixed assets and intangible assets under construction					
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

	31 Dec. 2017 Net balance	Additions	Disposals	Depreciation and amortisation for the year	31 Dec. 2018 Net balance
Tangible fixed assets					
Land	8,840	42,018	96	-	50,762
Buildings and other constructions	53,212	86	224	1,628	51,446
Facilities	15,775	891	-	2,977	13,690
Equipment	13,281	3,842	124	4,945	12,053
Museum and art collections	9,396	99	-	-	9,495
	100,504	46,937	443	9,550	137,447
Intangible assets					
Computer software	11,570	3,930	-	5,681	9,819
Other intangible assets	127	256	-	24	359
	11,697	4,186	-	5,704	10,179
Tangible fixed assets and intangible assets under construction					
Fixed assets under construction – Projects	3,921	7,395	4,250	-	7,066
Advances	-	-	-	-	-
	3,921	7,395	4,250	-	7,066
	116,121	58,518	4,694	15,254	154,692

Land increased by €42,018 thousand in 2018 due to the purchase of land to build a new office building for Banco de Portugal.

The increase in spending on Equipment was mainly driven by acquisitions of computer hardware and IT systems infrastructure, as well as cash handling equipment.

The acquisitions in 2018 relating to Intangible assets were essentially associated with server software licensing and the go-live of IT systems, namely the Central Credit Register (CCR), 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 2018 is chiefly due to projects related to the IT systems, equipment and facilities in various buildings of Banco de Portugal and cash handling equipment.

NOTE 10 • OTHER FINANCIAL ASSETS

	31 Dec. 2018	31 Dec. 2017
Participating interest in non-euro area resident entities	21,650	21,650
Participating interest in euro area resident entities	34,124	32,488
Impairments of participating interests	-	-
Medium-term investment portfolio	5,439,739	5,328,925
Other assets	293	202
	5,495,805	5,383,265

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

Banco de Portugal's participating interests as at 31 December 2018 are broken down as follows:

	31 Dec. 2018		31 Dec. 2017	
	% Share	Value	% Share	Value
Participating interest in non-euro area resident entities				
In the Bank for International Settlements (BIS)	1.57%	21,650	1.57%	21,650
Participating interest in euro area resident entities				
SGFPBP, S. A.	97.87%	3,356	97.85%	3,290
Valora, S. A.	100.00%	30,418	100.00%	28,848
EUROPAFI	0.25%	349	0.25%	349
Swift	0.01%	1	0.01%	1
		34,124		32,488

Changes in the value of the participating interests in SGFPBP and Valora resulted chiefly from the use of the Net Asset Value valuation method, in which the valuation differences are directly recognised in the Profit and loss account (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 2018, 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 point 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.

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. 2018	31 Dec. 2017
Medium-term investment portfolio		
Government debt	5,389,771	5,268,484
Paragovernmental and supranational	49,968	60,441
	5,439,739	5,328,925

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

NOTE 11 • ACCRUALS AND PREPAID EXPENSES

	31 Dec. 2018	31 Dec. 2017
Accruals		
Interest and other income receivable from central bank operations	840,630	803,883
Other accruals	1,153	1,108
	841,783	804,991
Prepaid expenses		
Prepaid expenses from central bank operations	20,432	63,162
Other prepaid expenses	11,911	11,772
Deferred tax assets	31,109	38,465
	63,452	113,398
	905,235	918,389

As at 31 December 2018, accruals relating to Interest and other income receivable from central bank operations include essentially outstanding accrued interest receivable from securities held for monetary policy purposes, amounting to €742,753 thousand (2017: €693,082 thousand). Furthermore, there was interest to the amount of (i) €87,343 thousand on securities and other assets of trading portfolios denominated in euro and in foreign currency and of the medium-term investment portfolio denominated in euro (2017: €97,964 thousand), (ii) €6,803 thousand on gold swaps for foreign currency (2017: €10,063 thousand), (iii) €852 thousand on current accounts of credit institutions in regard to the excess reserves portion (2017: €719 thousand) and (iv) €232 thousand on deposits in Banco de Portugal from general government and the autonomous funds, remunerated at negative interest rates (2017: €609 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 as at 31 December 2018 is interest on (i) securities held for monetary policy purposes (€8,558 thousand in 2018 and €49,751 thousand in 2017) and (ii) trading and medium-term investment portfolios (€11,874 thousand in 2018 and €13,411 thousand in 2017).

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 Collective Labour Agreements (*Convenções Coletivas de Trabalho*) and market interest rates, totalling €7,624 thousand (2017: €8,754 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 2018.

NOTE 12 • OTHER ASSETS – SUNDRY

	31 Dec. 2018	31 Dec. 2017
Lending to employees	163,503	158,949
Special credit situations – BP/Finangeste Arrangement	841	948
Other special credit situations	409	409
Claims related to reorganisation of credit institutions	-	2,211
Pension Fund – Defined-benefit plan	101,084	40,977
Pension Fund – Defined-contribution plan – Reserve account	22,520	23,806
Sundry debtors	7,668	1,419
Corporate Income Tax – Payments on account and additional payment on account	233,817	155,794
Corporate Income Tax recoverable	18,436	-
Billing to third parties	723	778
Other central bank claims	17,190	-
Other reduced value accounts	4,628	6,736
	570,819	392,027
Impairment of recoverable amounts	(1,260)	(3,581)
	569,558	388,446

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 worth €841 thousand on 31 December 2018 (2017: €948 thousand). An impairment for the total value of this asset is recognised (Notes 19 and 30). The reduction recorded in 2018 related to the nominal amount of claims recovered by this entity, transferred to the Bank through the calculation of the annual instalment for 2018.

The item Claims related to reorganisation of credit institutions included, until 2017, credit from the winding up of Caixa Económica Açoreana, which was subtracted from the overall value of the BP/Finangeste Arrangement (under the aforementioned 2016 annex to the initial contract). Recovery of this credit became the responsibility of the judicial liquidator designated by Banco de Portugal itself. Said winding up proceeding was closed in 2018 and pursuant to the pro rata distribution of credit, Banco de Portugal received €7 thousand. The remainder of the asset was written off against impairment provisions made for the total amount as a precaution by Banco de Portugal (Notes 19 and 30).

The amounts paid as payments on account, in 2017 and in 2018, under Corporate Income Tax comply with the provisions of Articles 104 and 104-A of the Corporate Income Tax Code.

In 2018, Banco de Portugal recorded under assets €18,436 thousand on account of Corporate Income Tax recoverable, due to €62.5 million in write-downs recognised in 2016 following the Annex to the BP/Finangeste Arrangement. Such losses, recorded in 2016, were not computed as taxable profit on account of the specific circumstances and uncertainty about how they should be taxed. Banco de Portugal asked the Portuguese Tax and Customs Authority for a binding ruling to clarify this matter. In December 2018, the Portuguese Tax and Customs Authority agreed with

Banco de Portugal as to the tax deduction on said write-down, under the terms of Article 23(1) and (2)(1) of the Portuguese Corporate Income Tax Code. Thus, in 2018 Banco de Portugal recorded €18,436 thousand in income from the return of said tax (Note 27).

The item Pension Fund – Defined-benefit plan relates to this Fund's surplus on 31 December 2018, 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 reflected the value of the participation units of this Fund earmarked for Banco de Portugal on 31 December 2018, valued at market price, on that date (Note 32).

The value recognised in 2018 in Other central bank claims regards amounts received from counterparties as collateral for foreign exchange forward transactions.

NOTE 13 • BANKNOTES IN CIRCULATION

Euro banknotes in circulation on 31 December 2018 consist of Banco de Portugal's share in total euro banknotes in circulation in the Eurosystem (point 1.2(i) of Note 1).

	31 Dec. 2018	31 Dec. 2017
Banknotes in circulation		
Banknotes put into circulation (net)	(17,280,823)	(14,485,627)
Adjustments to circulation in the Eurosystem	45,332,211	41,160,392
	28,051,388	26,674,764

In 2018 the total value of euro banknotes in circulation in the Eurosystem increased by 5%. In accordance with the banknote allocation key, on 31 December 2018 Banco de Portugal recorded an aggregate value of banknotes in circulation of €28,051,388 thousand, compared with €26,674,764 thousand on 31 December 2017. The difference between banknotes put into circulation and banknotes withdrawn from circulation recorded again on 31 December 2018 a debtor balance, rising from 2017. These two effects combined account for the increase in Adjustments 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 2018, the balance on Liabilities to euro area credit institutions related to monetary policy operations denominated in euro (€14,095,809 thousand) reflected chiefly the current accounts of credit institutions with Banco de Portugal (€14,090,809 thousand). These accounts 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 2018, as in 2017, this item also included the balance on deposit facility operations outstanding on this date (€5,000 thousand in both years), 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.

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

	31 Dec. 2018	31 Dec. 2017
Liabilities to other euro area residents denominated in euro		
General government		
Current accounts of the Portuguese Treasury and Debt Management Agency (IGCP)		
European Financial Stabilisation Mechanism (EFSM)	8,187,274	8,139,512
European Financial Stability Facility (EFSF)	812,931	813,399
Current accounts of General government for SICOI guarantees	225,982	-
	9,226,187	8,952,911
Other liabilities		
Current accounts of the autonomous funds	376,384	361,621
Current accounts of other entities	142,041	55,297
	518,425	416,918
	9,744,612	9,369,829

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 2018 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 2018 and 31 December 2017 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. 2018	31 Dec. 2017
Income collected in advance		
Other income collected in advance	3	3
Deferred tax liabilities	327	338
	330	341
Accruals		
Accruals from central bank operations	113,952	117,516
Other accruals	24,889	24,691
	138,842	142,207
	139,172	142,548

Of the amount recorded in Accruals from central bank operations, accrued interest payable on lending to credit institutions (€111,942 thousand) was noteworthy and related to operations under the new series of targeted longer-term refinancing operations (TLTRO-II).

Other accruals reflected essentially the above-mentioned accrued staff costs (€19,341 thousand) and accrued supplies and services from third parties payable (€5,549 thousand).

NOTE 18 • OTHER LIABILITIES – SUNDRY

	31 Dec. 2018	31 Dec. 2017
Banknotes withdrawn from circulation	96,269	152,654
Third parties	19,429	21,344
Liabilities relating to the payment to employees of seniority bonuses	13,392	13,583
Estimate for income taxes	351,583	242,271
Other central bank liabilities	28,960	130,377
Other accounts of reduced individual value	681	1,782
	510,315	562,010

The item Banknotes withdrawn from circulation represented Banco de Portugal's liability to the holders of banknotes denominated in Portuguese escudos (legacy currency), for as long as these can be exchanged. This decrease from 31 December 2017 was largely due to the expiry of the time limit for exchanging the following banknotes: (i) 10,000 escudo banknote, portraying Egas Moniz, (ii) 1,000 escudo banknote, portraying Teófilo Braga, (iii) 2,000 escudo banknote, portraying Bartolomeu Dias, (iv) 5,000 escudo banknote, portraying Antero de Quental, and (v) 500 escudos, portraying Mouzinho da Silveira.

The item Liabilities relating to the payment to employees of seniority bonuses as at 31 December 2018 reflected 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 the Profit and loss account, as described in point 1.2(m) of Note 1. In 2018 actuarial gains/losses were positive (Note 32) and were recognised under Other income.

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

The value recognised in Other central bank liabilities regards amounts transferred to counterparties as collateral for foreign exchange forward transactions.

NOTE 19 • IMPAIRMENT, PROVISIONS AND GENERAL RISK PROVISION

Accounting movements in the items Impairment and Provisions in the years 2017 and 2018 may be summarised as follows:

	Balance as at 31 Dec. 2016	2017				Balance as at 31 Dec. 2017
		Increase	Transfer	Decrease	Net value	
Impairment of assets						
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
	7,583	6	-	(4,008)	(4,002)	3,581
Provisions						
Provision for Eurosystem monetary policy operations	-	1,706	-	-	1,706	1,706

	Balance as at 31 Dec. 2017	2018				Balance as at 31 Dec. 2018
		Increase	Transfer	Decrease	Net value	
Impairment of assets						
Adjustments for Special credit situations – BP/Finangeste Arrangement	948	-	-	(107)	(107)	841
Adjustments for claims related to reorganisation of credit institutions	2,211	-	-	(2,211)	(2,211)	-
Adjustments for other special credit situations	409	-	-	-	-	409
Adjustments for other recoverable amounts	14	-	-	(3)	(3)	11
	3,581	-	-	(2,321)	(2,321)	1,260
Provisions						
Provision for Eurosystem monetary policy operations	1,706	3,989	-	(1,706)	2,284	3,989

In regard to impairment of assets, there was significant movement in the item Adjustments for claims related to reorganisation of credit institutions (€2,211 thousand total reversal in impairment), following the closure of the winding up of Caixa Económica Açoreana, without impact on Banco de Portugal's Profit and loss account (Note 12).

The decrease 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 instalment of 2018, 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 provisions of €161 million for losses on monetary policy operations in 2018, related to a security held by a Eurosystem NCB. In accordance with Article 32.4 of the Statute of the ESCB/ECB, these provisions are shared by all the Eurosystem NCBs, in proportion to the prevailing ECB capital key shares in 2018. Thus, €3,989 thousand were allocated to provisions, corresponding to 2.467% of the total amount.

In 2017, provisions of €1,706 thousand had been made for Banco de Portugal's share of losses on monetary policy operations totalling €69 million, also connected to a security held by a Eurosystem NCB within the scope of CSPP (corresponding to 2.48% of total provisions). Provisions in the 2017 financial statements were computed taking into account data from the sale of that security in January 2018. The loss realised in 2018 was fully covered by such provisions, which were therefore fully reversed in Banco de Portugal's balance sheet.

Movements in the General risk provision in 2017 and 2018 were as follows:

	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

	Balance as at 31 Dec. 2017	2018		Balance as at 31 Dec. 2018
		Increase	Decrease	
General risk provision	3,726,622	-	(50,000)	3,676,622

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, gaining visibility since the latest financial crisis was triggered. This provision policy is formally recommended by the Governing Council, in Article 8 of the ECB Accounting Guideline (as amended).

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. Such movements are made as described in point 1.2(q) of Note 1. Taking into consideration, among other factors, the medium-term income projection and risk assessment, the Board of Directors defines, every year at the time of closing of the annual accounts, a medium-term strategic risk coverage goal, 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.

In 2018, 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 2017, despite its increase in volume. However, the volume of this portfolio is expected to continue to grow, which will partly offset the aforementioned risk reduction effect over the medium term. In addition, the trading portfolio of claims denominated in foreign currency decreased, a structural consequence of the medium to long-term investment decisions made by Banco de Portugal, causing the Board of Directors to decide to reduce the General risk provision by €50,000 thousand.

NOTE 20 • REVALUATION ACCOUNTS

	31 Dec. 2018	31 Dec. 2017
Gold revaluation differences	10,754,267	10,273,653
Foreign currency revaluation differences	82,319	16,233
Securities revaluation differences	45,520	38,946
Revaluation accounts	10,882,105	10,328,833

Gold increased by €481 thousand, as a result of the increase in potential gains resulting from the rise in the gold price in euro (Note 2).

As at 31 December 2018 Foreign currency revaluation differences had increased, driven by investments denominated in US dollar and Special Drawing Rights at €60,694 thousand and €21,622 thousand respectively (only SDR revaluation differences stood out in 2017 at €16,162 thousand).

Potential gains resulting from fluctuations in the price of securities as at 31 December 2018 regarded securities denominated in foreign currency and in euro, amounting to €32,767 thousand and €12,753 thousand respectively (2017: €17,113 thousand and €21,834 thousand).

NOTE 21 • EQUITY

Movements in Equity for 2017 and 2018 are set out in the Statement of Changes in Equity.

The capital of Banco de Portugal amounts to €1,000 thousand and may be raised, 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, 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. Net profit for the year 2017 gave rise to the transfer of €65,648 thousand to the legal reserve and an equal amount to other reserves, and to the distribution of dividends to the State totalling €525,187 thousand.

Movements in 2018 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, the group life insurance, as well as to deferred taxes, recognised on 31 December 2018 (Notes 30 and 32).

NOTE 22 • NET INTEREST INCOME

	31 Dec. 2018	31 Dec. 2017
Interest income		
Securities in the trading portfolio	39,544	95,979
Denominated in foreign currency	39,544	77,125
Denominated in euro	-	18,853
Balances with banks, deposits and other money markets	29,093	37,414
Denominated in foreign currency	25,027	26,648
Denominated in euro	4,066	10,766
International Monetary Fund	10,877	6,240
Lending to euro area credit institutions	2,661	4
Securities held for monetary policy purposes	886,398	803,414
Medium-term investment portfolio	90,154	119,806
Off-balance-sheet instruments	8,248	1,231
Other claims	654	714
Current accounts of credit institutions for compliance with minimum reserve requirements	40,122	21,530
Liquidity-absorbing operations	9	8
General government	7,836	7,013
Other liabilities to euro area residents denominated in euro	1,977	3,990
	1,117,573	1,097,343
Interest expense		
Trading portfolio denominated in euro	42,976	-
International Monetary Fund	9,010	5,177
Off-balance-sheet instruments	464	1,398
Longer-term refinancing operations	-	81,018
	52,450	87,593
Net interest income	1,065,123	1,009,750

The increase in the Net interest income item in 2018 was essentially driven by the sharp rise in volume in Securities held for monetary policy purposes, as a result of the PSPP investment, which, due to the nature of these assets, presents much higher yields than most of the interest-bearing assets on the portfolio. Furthermore, interest from longer-term refinancing operations (LTRO), which recorded costs in 2017, posted net profits in 2018 recorded under Lending to credit institutions, because TLTRO-II interest rates were only set in 2018 (-0.24%), leading to positive adjustments to interest for 2016 and 2017 (as these operations had accrued interest at -0.4% – Note 6). Another contribution was made by the 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 2018, in a context of negative rates.

These increases were partly offset by the decline in yields on some of the main interest assets, especially the trading and medium-term investment portfolios.

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 in general at Banco de Portugal.

NOTE 23 • REALISED GAINS/LOSSES ARISING FROM FINANCIAL OPERATIONS

	31 Dec. 2018	31 Dec. 2017
Foreign exchange transactions	55,861	(256,544)
Other financial operations in foreign currency	(11,550)	19,057
Financial operations in euro	10,517	91,015
Medium and long-term investments	4,253	-
Interest rate futures	14,349	(117,719)
Transactions in the portfolio for monetary policy purposes	6,778	-
	80,208	(264,191)

Realised gains/losses arising from financial operations were positive in 2018, in contrast to the negative value of 2017. Gains from spot and forward foreign exchange operations greatly contributed to this sharp increase. Figures for both years were mainly associated with sales of US dollars, in a context of US dollar depreciation in 2017 and appreciation in 2018.

Furthermore, realised gains from sale operations of securities in the trading portfolio in euro and in foreign currency decreased, with the latter realising losses. This reduction was offset by the increase in realised gains from interest rate futures. These results are analysed together with those of related assets for management purposes, as these operations are undertaken for the purpose of hedging interest rate risk associated with the trading portfolios. Losses from sales of securities denominated in foreign currency largely occurred due to the implementation of a structural reduction in the volume of securities denominated in foreign currency in 2018, which in turn generated realised exchange rate gains.

Realised gains/losses arising from monetary policy operations resulted from the sale of PSPP securities, set out in Note 7.

NOTE 24 • UNREALISED LOSSES ON FINANCIAL ASSETS AND POSITIONS

	31 Dec. 2018	31 Dec. 2017
Unrealised exchange rate losses	7,525	230,186
Unrealised losses on investments in foreign currency	1,077	11,479
Unrealised losses on euro operations	3,596	18,669
	12,199	260,333

Within unrealised losses, the component related to unrealised losses on investments in foreign currency associated with US dollar-denominated assets in the portfolio decreased significantly from 2017, pursuant to this currency's aforementioned appreciation.

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. In 2018, this item included the amount of €29,507 thousand relating to the aforementioned portion of income from securities from that year (2017: €24,463 thousand).

In 2018 this item also included dividends received for Banco de Portugal's participating interests in 2017, chiefly: (i) in the ECB, to the amount of €7,109 thousand (2017: €5,619 thousand); and (ii) in the Bank for International Settlements (BIS), to the amount of €2,433 thousand (2017: €3,151 thousand).

NOTE 26 • NET RESULT OF POOLING OF MONETARY INCOME

This item recorded the net result of the pooling of monetary income method for the year, amounting to €119,133 thousand (2017: €128,666 thousand). The decrease from 2017 was due to the increase in the share of Banco de Portugal's net contributions in the Eurosystem's total contributions to income compared to the year before. Nevertheless, Banco de Portugal's share of these contributions remained below its adjusted capital key, due to which a receivable from other Eurosystem national central banks continued to be observed.

This item also recorded negative adjustments made in 2018 to update the TLTRO-II rates corresponding to 2016 and 2017, totalling €43,858 thousand.

The amount of each Eurosystem NCB's monetary income is determined by measuring the effective 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 rates presented are 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	Real remuneration rate
Lending to euro area credit institutions related to monetary policy operations denominated in euro	Real 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	Real remuneration rate		
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, is 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 2017 and 2018, 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.

In 2018, this item also included Banco de Portugal's share of the provision for losses in monetary policy operations, related to a security held by a Eurosystem NCB as part of the CSPP (Note 19), which is a shared risk at Eurosystem level, despite not belonging to Banco de Portugal's portfolio on account of Banco de Portugal not being an active participant in that programme. Therefore, the level of the provision reflected Banco de Portugal's share of the total impairment and was offset by a loss recognised in the Profit and loss account, in the item Net result of pooling of monetary income. Also included in this item was Banco de Portugal's share of the loss realised in the 2018 sale of a security held by a Eurosystem NCB as part of the CSPP, as well as the use of the provision established in 2017 for losses in monetary policy operations (Note 19).

The difference between Banco de Portugal's net contribution, amounting to €183,189 thousand, and the income allocation under the aforementioned capital key, amounting to €302,322 thousand, less (i) the adjustments made this year regarding 2016 and 2017 to the amount of -€43,858 thousand, and (ii) the impact of the provision for losses in monetary policy operations of the Eurosystem, with a net effect of -€2,284 thousand (Note 19), gave the Net result of pooling of monetary income (€72,991 thousand).

		31 Dec. 2018	31 Dec. 2017
A	Total contribution from all Eurosystem NCBs	12,206,559	10,788,991
B	Paid-up capital key	2.4767%	2.4767%
C = A x B	Total reallocation to Banco de Portugal	302,322	267,213
D	Total effective contribution from Banco de Portugal	183,189	138,547
E = C - D	Result of the method	119,133	128,666
F	Eurosystem adjustments to the result of the method relating to previous years	(43,858)	(74)
G	Eurosystem provisions	(2,284)	(1,706)
H = E + F + G	Net result of pooling of monetary income	72,991	126,886

NOTE 27 • OTHER INCOME AND EXPENSES

	31 Dec. 2018	31 Dec. 2017
Other income		
Capital gains on tangible and intangible fixed assets	35	52
Previous fiscal years income	271	135
Sales and supply of services to third parties	3,635	3,277
Sundry income	92,108	5,717
	96,049	9,181
Other expenses		
Capital losses on tangible and intangible fixed assets	73	82
Previous fiscal years expenses	502	14,189
Sundry expenses	1,996	483
	2,572	14,754
	93,477	(5,573)

The item Sales and supply of services to third parties related mostly to services provided by Banco de Portugal through the BpNet portal totalling €2,805 thousand (2017: €2,944 thousand).

Sundry income included: (i) €55,588 thousand due to the expiry of the time limit for exchanging escudo banknotes of various denominations in the year under review (Note 18); (ii) €18,436 thousand in recoverable tax, regarding the capital loss accounted for in 2016, resulting from the annex to the BP/Finangeste Arrangement (Note 12); (iii) €15,473 thousand for the reduction in past-service liabilities, as explained in Note 32; and (iv) profit resulting from the adjustment of the value of Banco de Portugal's participating interests in Valora, S. A. and SGFPBP, due to the implementation of the Net Asset Value method, as explained in point 1.2(e) of Note 1 and Note 10 (€1,571 thousand and €65 thousand, respectively).

The Sundry expenses item in 2018 includes (i) €1,103 thousand for the underestimation of Corporate Income Tax, due to the difference between the estimated tax for the 2017 financial year and the tax actually paid in 2018 and (ii) €634 thousand for losses in the valuation of the Reserve Account of the Sponsor, relating to the Pension Fund – Defined-contribution plan (Note 32).

NOTE 28 • STAFF COSTS

	31 Dec. 2018	31 Dec. 2017
Remuneration of the members of the Board of Directors and Board of Auditors	1,366	1,243
Employees' salaries	83,982	82,967
Compulsory social charges	34,216	34,297
Voluntary social charges	17,127	15,417
Other staff costs	1,526	1,798
	138,217	135,721

In 2018, Staff costs came to €138,217 thousand, a €2,496 thousand increase from 2017 (+1.8%).

This was chiefly due to rising amounts relating to the increase in liabilities for early retirements approved in 2018 versus 2017, under the Pension Fund – Defined-benefit plan (+€1,313 thousand) (Note 32).

Furthermore, there was a 0.75% salary update following the revision of the salary growth rate, in line with that defined by the Portuguese Banking Association for 2018 (with an impact of around +€1,000 thousand).

NOTE 29 • SUPPLIES AND SERVICES FROM THIRD PARTIES

	31 Dec. 2018	31 Dec. 2017
Electricity, fuel and water	3,166	3,378
Travel, accommodation and other transport	3,044	2,912
Litigation and notary services	6,171	13,066
Maintenance and repairs	5,027	5,232
Rentals	3,059	2,660
Specialised work		
Surveillance and security	4,124	3,993
IT	2,781	2,173
Use of databanks	2,683	2,497
Remuneration of SGFPBP	2,919	2,861
Other specialised work	3,691	3,788
Software licensing and maintenance	9,168	7,272
Other supplies and services from third parties	5,742	6,039
	51,574	55,871

In 2018, Supplies and services from third parties came to €51,574 thousand, a €4,298 thousand decrease from 2017. Driving this decrease was the reduction in the Litigation and notary services item, which relates primarily to legal services regarding the resolution measures on Banco Espírito Santo. This sharp reduction (of €6,895 thousand) resulted from the fact that Banco de Portugal bore the expenses relating to the sale of Novo Banco in full in 2017, by decision of the Ministry of Finance in October 2017, with the Profit and loss account for that year reflecting the impact of the cumulative value of services provided since 2014.

The increase in Software licensing and maintenance (€1,896 thousand) is largely due to information technology and systems within the scope of the Eurosystem (increasing by €1,620 thousand) essentially explained by the go-live of the TARGET2-Securities (T2S) system. Furthermore, strategic innovation in Banco de Portugal's information technology and systems led to a €980 thousand increase. This strategy also had an impact on the items Specialised work – IT (increasing by €608 thousand) and other rentals (increasing by €196 thousand).

These increases were offset by the reduction in expenditure on Electricity, fuel and water (€213 thousand). These reductions were 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 revise 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 significant additional payments regarding previous financial periods.

As at 31 December 2018 and 2017, income tax assets and liabilities were broken down as follows:

	2018	2017
Estimated income tax on profit for the year	358,297	271,964
Estimated income tax on retained earnings	(6,714)	(29,694)
Withholdings at source	(7)	(7)
Payments on account and additional payments on account	(233,817)	(155,794)
Income tax recoverable	(18,436)	-
	99,323	86,469

In 2018, income tax on retained earnings was the result of the 2011 change to the accounting treatment of actuarial gains and losses from the Pension Fund – Defined-benefit plan.¹⁵

Presented below are the expense/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:

	2018	2017
Current tax		
For the year	242,131	202,662
Municipal corporate tax and state surtax	116,022	69,041
Autonomous taxation	143	262
	358,297	271,964
Deferred tax	685	(727)
Total income tax	358,982	271,237
Income before taxes	1,164,669	927,721
Tax burden	30.82%	29.24%

15. 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:

	2018		2017	
	Rate	Tax	Rate	Tax
Profit/loss before taxes		1,164,669		927,721
Tax calculated at nominal rate	31.36%	365,276	29.40%	272,783
Definitive differences to be deducted				
Net Asset Value	(0.04%)	(515)	(0.12%)	(1,141)
Payment or placement at disposal of beneficiaries of severance benefits, retirement benefits and other post-employment or long-term benefits	(0.29%)	(3,349)	(0.25%)	(2,363)
Impairment losses	(0.00%)	(4)	(0.01%)	(75)
Restoration of non-deductible tax and tax estimate surplus	(0.50%)	(5,807)	(0.01%)	(120)
Tax gains/losses	(0.00%)	(31)	0.00%	(44)
Definitive differences to be added				
Adjustments from previous periods	0.01%	117	0.01%	58
Expenses from severance benefits, retirement benefits and other post-employment or long-term benefits	0.28%	3,312	0.15%	1,355
Depreciation and amortisation not deductible as costs	0.00%	0	0.01%	64
Pension Fund	0.03%	366	0.14%	1,255
Accounting capital gains/losses	0.00%	12	0.00%	9
Charges not fully documented	0.00%	22	0.00%	28
Other	0.03%	381	0.01%	48
Tax benefits				
Net job creation	(0.07%)	(834)	(0.09%)	(799)
Other	(0.00%)	(2)	0.00%	(7)
Autonomous taxation	0.01%	143	0.03%	262
Deferred tax assets and liabilities - Effect of rate change	(0.01%)	(93)	(0.01%)	(75)
	30.82%	358,982	29.24%	271,237

In 2017 and 2018, the movements related to deferred tax assets and liabilities can be broken down as follows:

	31 Dec. 2016	2017		31 Dec. 2017
		Change in Equity	Change in Profit/loss	
Assets				
Temporarily non-deductible provisions and impairments	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
	42,311	(4,584)	738	38,465
Liabilities				
Depreciation surplus (reinvestment of capital gains)	(328)	-	(11)	(338)
	(328)	-	(11)	(338)
	41,983	(4,584)	727	38,127

	2018			
	31 Dec. 2017	Change in		31 Dec. 2018
		Equity	Profit/loss	
Assets				
Temporarily non-deductible provisions and impairments	1,115	-	(726)	389
Staff benefits				
Pension fund - transitional regime	26,715	(6,660)	-	20,055
Seniority bonus	4,255	-	(56)	4,199
Early retirements	6,380	-	85	6,465
	38,465	(6,660)	(696)	31,109
Liabilities				
Depreciation surplus (reinvestment of capital gains)	(338)	-	11	(327)
	(338)	-	11	(327)
	38,127	(6,660)	(685)	30,782

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.

The rate used to calculate deferred tax in 2018 was 31.36% (2017: 31.33%).

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. 2018	31 Dec. 2017
Contracted financial operations	(1,328,200)	(1,707,890)
Collateral given	(1,471,623)	(1,464,598)
Collateral received	59,103,322	59,378,744
Items held in custody	25,807,868	32,374,746
Irrevocable credit lines	(3,152,366)	(3,188,085)

Contracted financial operations

This item recorded open positions in financial operations that are under contract but still outstanding at the year-end. As at 31 December 2018 and 31 December 2017, these positions related only to derivative financial instruments designed essentially to manage risks associated with their assets and liabilities, as follows:

	31 Dec. 2018					31 Dec. 2017	
	Contract value ^(a)		Market value ^(b)	Profit/loss ^(c)	Accrued interest ^(d)	Contract value ^(a)	
	Purchases	Sales	Net	Net	Net	Purchases	Sales
Currency forwards	13,416	(13,416)	(652)	(640)	(12)	15,848	(15,848)
Currency swaps	21,934	(21,934)	75	94	(19)	25,336	(25,336)
Interest rate futures	-	(1,328,200)	-	-	-	290,169	(1,998,059)

(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 included 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 included collateral related to the monetary policy operations of the Eurosystem (€59,098,226 thousand on 31 December 2018), 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 comprised securities owned by the Portuguese State (€17,576,775 thousand) and securities held in custody by Banco de Portugal as collateral in monetary policy operations with other NCBs, under the CCBM (€7,448,242 thousand).

As at 31 December 2018, the item Irrevocable credit lines recorded the amount of €2,200,100 thousand for the limit on the intraday credit lines of the Portuguese financial system and the amount of SDR 783,500 thousand (€952,266 thousand) for a credit line granted to the IMF under the New Arrangements to Borrow (NAB).

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)¹⁶ the family allowance fund for 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.

16. Dissolved by this Decree-Law.

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. 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 Banco de Portugal'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 were 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 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, namely inherent charges to SAMS (social health assistance service for banking sector employees) related to pensions in payment.

The table below shows the most significant 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 take-up of subsidised clinical services being higher than assumed in actuarial valuations, resulting in an increase of the 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.

The risks from population movements and regulatory changes are mitigated by defining prudent actuarial assumptions. The risks from adverse movements in inflation and interest rates are mitigated by using asset/liability management.

- Pension Fund Plans
 - Pension Plans
 - (a) Scheme members

The number of members covered by the pension plan is as follows:

Number of scheme members	31 Dec. 2018	31 Dec. 2017
Active members	960	1,054
Retired members	2,012	1,978
Pensioners	590	589
	3,562	3,621

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

Average life expectancy (years)	31 Dec. 2018	31 Dec. 2017
Active members	34	34
Retired members	15	15
Pensioners	13	13

(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 as follows:

	Actuarial and financial assumptions used			
	31 Dec. 2018	01 Jan. 2018	31 Dec. 2017	01 Jan. 2017
Discount rate	1.652%	1.803%	1.803%	1.619%
Expected return rate on the Fund's assets	n.a.	1.803%	n.a.	1.619%
Wage growth rate				
1st year	2.506%	1.750%	1.750%	1.750%
Subsequent years	2.543%	2.786%	2.786%	2.682%
Pensions growth rate				
1st year	1.506%	0.750%	0.750%	0.750%
Subsequent years	1.543%	1.786%	1.786%	1.682%
Tables used				
- Mortality – Male population	TV 88/90 adjusted by 1 year		TV 88/90 adjusted by 1 year	
Female population	TV 88/90 adjusted by 4 years		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 5 months		66 years and 5 months	
Percentage of married members	80%		80%	
Age difference between spouses	3 years		3 years	

The discount rate shown in the above table was calculated using interest rates on high-quality private bond issues, whose denomination and maturity are adequate for the term structure of the Pension Fund's liabilities.

For the purpose of establishing the funding needs of the Pension Fund – Defined-benefit plan, SGFPBP uses, as a matter of prudence, a lower discount rate, based on interest rates on bond issues of higher average quality.

Thus, the value of the Fund's liabilities considered in Banco de Portugal's accounts is below that calculated by considering the aforementioned funding needs.

– Healthcare plan

(a) Scheme members

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

Number of scheme members	31 Dec. 2018	31 Dec. 2017
Active members	1,751	1,755
Retired members and pensioners	2,550	2,512
	4,301	4,267

The assumed average life expectancy for scheme members and beneficiaries is as follows:

Average life expectancy (years)	31 Dec. 2018	31 Dec. 2017
Active members	41	41
Retired members	15	15
Pensioners	13	13

(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:

	Actuarial and financial assumptions used			
	31 Dec. 2018	01 Jan. 2018	31 Dec. 2017	01 Jan. 2017
Discount rate	1.652%	1.803%	1.803%	1.619%
Expected return rate on the Fund's assets	n/a	1.803%	n/a	1.619%
Growth rate of the average/annual expenses				
Disability pensions	5.278%	5.635%	5.635%	5.512%
Other	4.248%	4.198%	4.198%	4.075%
Tables used				
- Mortality – Male population	TV 88/90 adjusted by 1 year		TV 88/90 adjusted by 1 year	TV 88/90
Female population	TV 88/90 adjusted by 4 years		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 5 months		66 years and 4 months	
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. 2018			31 Dec. 2017		
	Retired members and pensioners	Active members	Total	Retired members and pensioners	Active members	Total
Total past-service liabilities of the Pension Fund						
Retirement and survivors benefits	1,044,619	601,348	1,645,967	1,042,544	671,772	1,714,316
Pensions' inherent charges to SAMS	60,004	28,097	88,101	60,162	37,025	97,187
Death grants	2,590	1,281	3,871	2,139	730	2,870
Healthcare	52,088	24,859	76,947	55,948	27,827	83,774
	1,159,301	655,586	1,814,887	1,160,793	737,353	1,898,147

The table below presents the evolution of past-service liabilities of the Pension Fund in 2018 and 2017:

Past-service liabilities	2018	2017
Value at the beginning of the year	1,898,147	1,761,650
Current service cost	15,732	15,920
Benefits payable (expected value)	(70,157)	(67,498)
Interest cost	34,224	28,521
Actuarial gains/losses	(59,362)	149,091
Increase in liabilities arising from early retirements	11,777	10,463
Past-service cost	(15,473)	-
Value at the end of the year	1,814,887	1,898,147

In 2018, the decline in liabilities, of €15,473 thousand, under the item Past-service cost, corresponds to the net value of the impact of (i) the revision of Banco de Portugal's company-level agreements, including principally the revision made to the financing of SAMS, and (ii) the changes to Decree-Law No 187/2007 made by Decree-Law No 26-B/2017 of 6 October 2017, regarding the totalling of the contribution periods to the general social security scheme. This change was recorded under the offsetting item Profit for the year (Note 27).

The Fund's financial management is oriented towards hedging the risks implicit in assumed liabilities, which may be mitigated by financial instruments, with the aim of maintaining the funding level.

Among the various 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 the sensitivity of the Fund's assets and liabilities to changes in the assumptions adopted:

Sensitivity as at 31 December 2018	One-year increase in life expectancy	10 b.p. reduction in discount rate	10 b.p. increase in wages and pensions growth rates
Impact on the Pension Fund's assets	0.0%	1.0% ^(a)	1.2%
Impact on the Pension Fund's liabilities	4.3%	1.6%	1.5%
Impact on the Pension Fund's funding ratio	-4.3%	-0.5% ^(a)	-0.3%

(a) Assuming a stable spread between interest rates on private and sovereign debt. Should this spread between the rates vary, the impact on the Fund's assets and the financing of a 10 b.p. reduction in discount rate will be different from that presented.

Note that in terms of the wages and pensions growth rate, its change only affects the value of the Pension Plan's liabilities (and not that of the Healthcare Plan). The impact on the Fund's assets is based on the assumption that the wages and pensions growth rate results from an increase in inflation, with a resulting increase in the price of inflation-linked bonds comprised in the Fund's assets.

On 31 December 2018 the modified duration of liabilities stood at 15.5 (2017: 16.0) 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 -4.6 (2017: -5.6).

Fund's assets	2018	2017
Value at the beginning of the year	1,939,124	1,818,648
Current contributions paid to the Fund	15,098	15,792
On account of the Bank	13,192	13,826
On account of the employees	1,906	1,966
Contributions paid on account of early retirements	11,777	10,463
Extraordinary contributions paid to the Fund	-	133,600
Benefits and inherent charges paid by the Fund	(74,022)	(71,623)
Net income of the Fund	23,995	32,244
Value at the end of the year	1,915,971	1,939,124

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

Fund's investments	31 Dec. 2018	31 Dec. 2017
Land and buildings	197,322	163,926
Variable income securities	97,166	174,537
Fixed income securities	1,596,233	1,575,133
Cash and bank deposits	8,749	13,310
Other	16,501	12,217
	1,915,971	1,939,124

Land and buildings includes the Castilho Building, used by Banco de Portugal, which was recorded in 2018 at a value of €33,821 thousand.

Securities portfolio of the Fund	31 Dec. 2018	31 Dec. 2017
Variable income securities		
Participation units – Investment funds	97,166	174,537
Fixed income securities		
Government debt	1,596,233	1,575,133
	1,693,399	1,749,670

At the end of 2018, the funding level of Banco de Portugal's Pension Fund – Defined-benefit plan stood at 105.6%, above that of the scenario used to calculate the funding needs (most prudent scenario) of 102.5%.

The value of actuarial gains and losses calculated in 2018 and 2017 can be broken down as follows:

	31 Dec. 2018	31 Dec. 2017
Actuarial gains/losses		
Population movements	(6,478)	(12,660)
Technical gains and losses	8,083	9,254
Wage growth	18,239	192
Increase in pensions	23,889	834
Change in average healthcare expenses	(450)	609
Adjustments to the model	5,316	2,837
Other gains and losses	(67)	(192,026)
Indexation of assumptions:		
Future wage growth	30,239	(11,058)
Future increase in pensions	21,597	(2,602)
Discount rate	(41,006)	55,530
	59,362	(149,091)
Financial gains and losses		
Gains and losses in paid pensions	(3,866)	(4,125)
Gains and losses in expected income of the Fund	(10,968)	2,799
	(14,833)	(1,326)
	44,529	(150,417)

Among the actuarial gains and losses of 2018 are gains from wages and pensions growth, which result from various factors, including the impact arising from the fact that the agreement on the 2018 salary update was only reached at the start of 2019. The valuation of the Fund's liabilities did not consider any wages and pensions growth in 2018, thus creating these gains. As a result, the assumption for the wages and pensions growth rate for 2019 was adjusted to take into account the two wages and pensions updates (2018 and 2019), producing a loss of the same size (under the item Indexation of assumptions).

Furthermore, the loss associated with the discount rate, arising from the difference between the initial value for this rate and that calculated at the end of the year (see the table of assumptions), resulted in a €41,006 thousand increase in the Fund's liabilities.

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

	2018	2017
Staff costs		
Current service cost ^(a)	13,366	13,483
Interest cost	34,224	28,521
Expected return on the Fund's assets	(34,962)	(29,444)
Increase in liabilities arising from early retirements	11,777	10,463
	24,404	23,023

(a) Excludes costs borne by staff and other entities.

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.

The risks from the undervaluation of salary increases are mitigated by defining prudent actuarial assumptions.

Changes in past-service liabilities were as follows:

Past-service liabilities	2018	2017
Value at the beginning of the year	13,583	13,200
Seniority bonuses paid	(1,096)	(1,115)
Current service cost	1,163	1,120
Interest cost	184	168
Actuarial gains/losses	(441)	209
Value at the end of the year	13,392	13,583

On 31 December 2018 the modified duration of liabilities stood at 10.1 (2017: 10.3).

The main actuarial and financial assumptions used in the calculation of these liabilities are the following:

	Actuarial and financial assumptions used			
	31 Dec. 2018	01 Jan. 2018	31 Dec. 2017	01 Jan. 2017
Discount rate	1.361%	1.354%	1.354%	1.276%
Wage growth rate				
1st year	2.506%	1.750%	1.750%	1.750%
Subsequent years	2.209%	2.575%	2.575%	2.524%
Tables used				
- Mortality – Male population	TV 88/90 adjusted by 1 year		TV 88/90 adjusted by 1 year	
- Female population	TV 88/90 adjusted by 4 years		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 5 months		66 years and 4 months	

The population considered for the calculation of these liabilities in December 2018 is 1,751 participants (2017: 1,755).

Group Life Insurance – Defined-benefit plan

For a group of workers, pension contributions associated with their complementary salary are collected, on a voluntary basis, under a group life insurance scheme, and not by the Pension Fund of Banco de Portugal – Defined-benefit plan.

On 31 December 2018, this insurance scheme covered a population of 16 members, with an average age of 57.9 years.

Past-service liabilities for this insurance, estimated at €1,103 thousand, are fully financed through an extraordinary contribution made by Banco de Portugal in 2018, of €722 thousand.

The value recognised in 2018 for this insurance, under Staff costs, was of €29 thousand.

Pension Fund of Banco de Portugal – Defined-contribution plan

Banco de Portugal's company-level agreements provide for 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 (Point 1.2(l) 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 when the participant chooses 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 able to choose an investment profile for their contributions. The funding vehicle can be changed annually on the employees' initiative.

At the end of 2018, the supplementary pension plan funded through this Pension Fund covered 815 members (2017: 723).

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 this 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 2018 the assets of the Fund amounted to €25,692 thousand, broken down as follows:

Participation units (in value)	31 Dec. 2018	31 Dec. 2017
Reserve account (Note 12)	22,520	23,806
Members' individual accounts	3,172	2,666
	25,692	26,472

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 and loss account of Banco de Portugal:

Reserve account of the sponsor	2018	2017
Value at the beginning of the year	23,806	23,503
Transfer of rights to members – contributions of the year	(652)	(573)
Revaluation of the period (Note 27)	(634)	876
Value at the end of the year	22,520	23,806

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, as well as 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. State-of-the-art commercial software and the integrated financial risk model developed by the Eurosystem are also used to calculate VaR and expected shortfall for credit risk and market risk.

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 taken into account to determine how the General risk provision is to be used (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 2018 and 2017 is as follows:

	31 Dec. 2018		31 Dec. 2017	
	Amortised cost	Market value	Amortised cost	Market value
Securities held for monetary policy purposes (Note 7)	51,208,353	53,670,342	46,968,576	49,271,414
Medium-term investment portfolio (Note 10)	5,439,739	5,634,906	5,328,925	5,560,151
	56,648,092	59,305,248	52,297,501	54,831,565

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 (point 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 • PENDING LEGAL PROCEEDINGS

As at 31 December 2018, various legal proceedings were pending 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, duly coordinated by this Department.

The litigation currently pending falls under the following categories: common lawsuits, administrative lawsuits, interim injunctions, administrative offence proceedings (judicial phase), monitoring of judicial winding-up of credit institutions and financial companies and monitoring of proceedings related to labour disputes.

Although the Board of Directors of Banco de Portugal regularly monitors administrative offence proceedings and the judicial winding-up proceedings of credit institutions and financial companies, these do not have a direct impact on the financial statements of Banco de Portugal, as they result from the exercise of the Board's legal powers.

The Board of Directors' assessment of Banco de Portugal's current position in the most relevant judicial proceedings, considering both the significant amount of lawsuits pending and the nature of the 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"), taking the form of the transfer of most of BES's activity and assets, liabilities and off-balance-sheet items 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 by virtue of its decisions as national resolution authority as adopted pursuant to its Organic Law and the Legal Framework of Credit Institutions and Financial Companies (Regime Geral das Instituições de Crédito e Sociedades Financeiras – RGICSF), approved by Decree-Law No 298/92 of 31 December 1992.

Within Banco de Portugal's competences as resolution authority of the Portuguese financial sector, by decision of the Board of Directors of Banco de Portugal of 3 August 2014, pursuant to Article 145-G(5) of RGICSF, 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 decision of the Board of Directors of Banco de Portugal of 3 August 2014 (8pm), as amended by the decision 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 decision.

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

Several court order proceedings for the provision of information and issuance of certificates have been brought before the Administrative Court of the Lisbon District.

Most of these proceedings relate to the sale process of Novo Banco to Lone Star, with Banco de Portugal being summoned to make available documentation related to that very 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 on the basis of supervisory secrecy as provided for in Article 80 of RGICSF and on the grounds that disclosure of certain documentation 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 most of these proceedings, the courts have already delivered judgements with the force of *res judicata*. Even in those judgements sentencing Banco de Portugal to make the documents available, Banco de Portugal's right to redact the documents was recognised in regard to information deemed confidential.

Furthermore, litigation in these types of proceedings declined in 2018, not only because just one court order proceeding for the provision of information was lodged (which is at the end of the initial exchange of information phase), but also because judgements with the force of *res judicata* were handed down leading to the closure of several proceedings in 2019.

Lastly, it should be noted that in these types of proceedings, if Banco de Portugal is convicted by a judgement that has the force of *res judicata*, Banco de Portugal will only have to provide information and issue certificates, which will not involve at any time the payment of pecuniary sums (aside from legal costs), hence there is no financial risk for Banco de Portugal connected to these proceedings.

(ii) Actions for annulment of the decisions applying and implementing the resolution measure

Proceedings challenging the legality of the decisions of the Board of Directors of Banco de Portugal regarding the BES resolution measure, chiefly the decisions of 3 and 11 August 2014 and 29 December 2015, are pending at the administrative courts. These lawsuits were mostly brought within the three-month limit following publication of the decisions 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 annulment of administrative acts).

The aforementioned lawsuits do not carry any financial risk for Banco de Portugal, as it would not be ordered to pay any amount as compensation for damages, aside possibly from legal costs, should the claims be judged to be well-founded. In these annulment claims, 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 BES's resolution awards responsibility for any compensation claims to the Resolution Fund.

Indeed, in order to assess the financial risk at stake, due consideration must be given to the purpose of the Resolution Fund, which is to provide financial assistance to the application of the resolution measures adopted by the resolution authority as per Article 153-C of RGICSF. The rationale behind the resolution regime, both in the version prior to publication of Law No 23-A/2015 (which transposed the BRRD into Portuguese legislation) 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. For the sake of consistency, if a resolution measure were to be annulled by a judgement that has the force of *res judicata* and the resolution authority deemed that, for public interest and financial stability reasons, the effects of the resolution measure should stay untouched, then it shall be the Resolution Fund that settles any compensation payable should the resolution measure remain in effect. However, this compensation is distinct from that that may arise from any tort claims filed against Banco de Portugal, in relation to which, given the legal and procedural information available at present, there is a higher probability of a decision in favour of Banco de Portugal.

Regarding the annulment actions challenging the initial BES resolution measure (decisions of the Board of Directors of Banco de Portugal of 3 and 11 August 2014), an order was handed down in October 2018 by the President of the Administrative Court of the Lisbon District requiring the application of the procedural mechanism provided for in Article 48 of the CPTA (Administrative Courts Procedural Code), which provided for the selection of two actions (pilot proceedings) with suspension of the remaining related proceedings. The order in question specified the selection of the proceedings numbered 2586/14.3BELSB and 2808/14.0BELSB as pilot proceedings, and suspended another 24 proceedings, which will await procedural developments in regard to the former.

In regard to the selection of the pilot proceedings, the order states: "On 10/10/2018, a meeting took place among all 27 Judges of this Court, in which an exhaustive analysis and reanalysis was undertaken of the proceedings and issues identified, therein establishing that the proceedings in which the issue is argued in greater detail, in terms of the facts and the application of the law, are Proceedings Numbers 2586/14.3BELSB and 2808/14.0BELSB, following which it was unanimously agreed that these should be the selected proceedings, despite their considerable complexity". And: "The selection of these two proceedings arises [...] also as it affords the possibility of addressing a greater number of issues to be decided. These include, in general terms, those issues that relate to the constitutional conformity of the legal acts that served as the basis for applying the resolution measure, the violation of principles provided for in the Constitution, the violation of European Union Law, and infringements of form and procedure, among others, which constitute the causes for the respective lawsuits".

In one of the pilot proceedings (No 2586/14.3BELSB), an order has already been handed down to present successive allegations by the beginning of 2019. Thus, Banco de Portugal awaits the

latter developments of this proceeding, as well as those of the other pilot proceeding, and their consequences for the remainder of the suspended litigation.

In relation to the annulment actions challenging the Retransfer Decision (decision of the Board of Directors of Banco de Portugal of 29 December 2015), the pre-trial hearing phase is yet to be scheduled and conducted. The Courts have already raised the possibility of suspending some of those actions, which would thereafter await the procedural developments of the pilot proceedings.

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 to predict the tendency of the decisions to be delivered by the Courts. The application of the procedural mechanism mentioned above is also unprecedented.

Annulment of the decisions in question does not raise any type of financial risk for Banco de Portugal, as payment by Banco de Portugal of a pecuniary amount is not sought in these lawsuits. In the other cases, given the legal and procedural information available at present, there is no evidence to refute the belief that there is a higher probability of a decision in favour of Banco de Portugal.

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

Pending both at the civil courts and administrative courts are proceedings pleading for Banco de Portugal and/or the Resolution Fund to pay financial compensation for damages arising from alleged deposits in BES and for moral damages.

Following defence based on inadmissibility grounds presented by Banco de Portugal and/or the Resolution Fund, a considerable number of decisions have been handed down in favour of Banco de Portugal and the Resolution Fund. In addition, financial claims on damages in various pending lawsuits were withdrawn following the agreement between former BES customers and PATRIS – SGFTC, S. A., in its capacity as management company of FRC – INQ – Papel Comercial and Rio Forte.

As a result of such procedural developments, 229 lawsuits were closed at the end of 2018 (brought against Banco de Portugal and/or the Resolution Fund).

In the other pending proceedings, where the civil courts deemed themselves without jurisdiction by reason of the subject matter, lawsuits were remitted to the administrative courts or new suits were lodged, which are at the end of the initial procedural phase or awaiting the pre-trial hearing phase.

There have been cases where the administrative courts received remitted proceedings and deemed themselves without jurisdiction also, by reason of the subject matter, which led to those proceedings – brought against the Resolution Fund – being transferred to the Conflicts Court.

The Conflicts Court has deemed the civil courts as having jurisdiction to resolve civil law disputes, when brought against the Resolution Fund. Importantly, in just one lawsuit brought against Banco de Portugal were the civil courts deemed as having jurisdiction.

In all other cases pending before civil courts, the latter declared themselves as lacking jurisdiction – decisions which were appealed in higher courts. Thus, legal discussions continue as to which is the jurisdiction (civil or administrative) competent to settle this sort of litigation.

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 put into question our assessment that there is a higher probability of a decision in favour of Banco de Portugal. Furthermore, given the abovementioned inherent uncertainty, it is impossible to estimate accurately the likely value of any financial obligation, for reporting purposes, as at the closing date of the accounts.

(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 seek the annulment of the decisions of the Board of Directors of Banco de Portugal of 22 December 2014, 15 September and 29 December 2015.

The next stage of these lawsuits is the scheduling of pre-trial hearings.

In two of the pending lawsuits (No 910/15.0BELSB and No 919/15.4BELSB), the Court is considering the possibility of suspending proceedings, which would thereafter await the procedural developments of the aforementioned pilot proceedings, arising from the application of the mechanism laid down in Article 48 of the CPTA, by reason of an existing preliminary matter.

Furthermore, in the proceedings heard in England – “Goldman Sachs International (Appellant) v Novo Banco SA (Respondent)” – in which Banco de Portugal intervened, a favourable decision was handed down in defence of its interests, with the English courts deeming that they did not have jurisdiction to settle litigation related to the resolution measure of BES.

The fact that these proceedings have no legal precedent and involve considerable legal complexity precludes any prediction, even directional, of the decisions to be handed down by the Courts. Therefore an adequate assessment is not possible until further procedural developments occur. This said, annulment of the decisions in question does not trigger any type of financial risk for Banco de Portugal, as payment by Banco de Portugal of a specified pecuniary amount is not sought.

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

During 2017, six interim injunctions were filed relating to the sale process of Novo Banco to Lone Star, by means of which the suspension of the choice of that entity was sought, with the consequent prohibition from concluding the definitive contract.

In four of those six interim injunctions, rulings favourable to Banco de Portugal and the Resolution Fund have been handed down. In the other two still pending, one is awaiting decision, and in the other a decision favourable to Banco de Portugal was handed down, against which an appeal was lodged.

As these matters have no doctrinal or case-law precedent, Banco de Portugal is unable to predict the outcome of the decisions to be delivered by the Courts. However, the following factors indicate that there is no financial risk for Banco de Portugal in this regard: (i) four decisions on merit in the interim injunctions identified have already been ruled in favour of Banco de Portugal; (ii) the provisional decisions on interim injunctions were rejected; (iii) the sale process of Novo Banco has now been concluded and (iv) the interim injunctions are ancillary to the main lawsuits.

Finally, there are also the lawsuits of the members of the Board of Directors of BES contesting the precautionary retention of the claims held by them in BES.

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

Within the exercise of its powers as national resolution authority, and pursuant to Article 17-A of the Organic Law of Banco de Portugal and Articles 145-E and 146 of RGICSF, Banco de Portugal applied a resolution measure to Banif – Banco Internacional do Funchal, S. A. (hereinafter “Banif, S. A.”) on 19 and 20 December 2015, 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 decision of 20 December 2015.

Currently there are 18 administrative lawsuits contesting these decisions, of which five were proposed during 2018. All 18 are at the end of the initial procedural phase and await scheduling of the pre-trial hearing phase.

Following the decision to join proceedings Nos 99/16.8BEFUN, 100/16.5BEFUN, 101/16.3BEFUN, 102/16.1BEFUN and 197/16.8BEFUN to proceeding No 98/16.0BEFUN (main proceeding), the hearing was held from October to December 2018, in which the legality of the resolution measure applied to Banif was discussed and statements were issued. At the end of the hearing, final written statements will be submitted.

There are also 21 civil lawsuits pending at the Lisbon District Court, requesting Banco de Portugal and/or the Resolution Fund to pay financial compensation for losses and moral damages arising from investments made in Banif, S. A. Decisions have already been handed down in these suits by the Civil Courts, which deemed themselves deprived of jurisdiction to settle them. The plaintiffs in some of those decisions have lodged appeals. In others, the plaintiffs have presented requests to withdraw the suit or request. Given these favourable procedural developments, the majority of these civil proceedings are expected to come to an end in 2019.

Finally, the decision favourable to Banco de Portugal that was handed down in the interim injunction pending at the Administrative and Fiscal Court of Sintra, pleading for the suspension of the award to PROTEUS ASSET MANAGEMENT, UNIP., Lda. of exclusive control over the business of managing credit and real estate assets of Oitante, became *res judicata* in 2018.

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 compensation amounts resulting therefrom. However, considering the legal and procedural information available at present, there is no evidence to refute the belief that there is a higher probability of a decision in favour of Banco de Portugal.

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 implementation of 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. For the sake of consistency, if a resolution measure were to be annulled by a judgement that has the force of *res judicata*

and the resolution authority deems that, for public interest and financial stability reasons, the effects of the resolution measure should remain in force, then it shall be the Resolution Fund that settles any compensation payable for the continuation of the resolution measure. However, this compensation is distinct from other sorts of compensation that may arise from any tort claims filed against Banco de Portugal, in relation to which, given the legal and procedural information available at present, there is a higher probability of a decision in favour of Banco de Portugal.

- Judicial winding-up proceedings of Banco Privado Português, S. A. ("BPP, S. A.")

There are 23 lawsuits pending in court, mostly pleading for 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 initial phase has come to an end.

There is the possibility of financial risk to Banco de Portugal in these proceedings. The fact that these proceedings have no legal precedent and involve considerable legal complexity precludes any prediction, even directional, of the Courts' decisions. These factors, combined with the general procedural dynamic and the vicissitudes of legal proceedings, impede the recognition of actual risks for Banco de Portugal in this phase and the estimation of possible compensation amounts 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 the belief that there is a higher probability of a decision in favour of Banco de Portugal.

- Overall assessment of the Board of Directors of Banco de Portugal

The complexity and procedural developments of the litigation, compared to the number of legal proceedings in 2017, has continued to warrant the additional allocation in 2018 of specialised internal resources in the Legal Services Department and the engagement of external legal services, to respond to Banco de Portugal's considerable needs in terms of legal workload and representation in court. The majority of lawsuits described above are in progress at different procedural phases, and are thus expected to be pending 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 have not yet come to a meaningful number of judgements – although, those few judgements that have been delivered indicate a generally favourable tendency for Banco de Portugal and the Resolution Fund – it has been deemed impossible to use the criterion of case-law precedent to make a 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 pending lawsuits as at 31 December 2018.

In compliance with its Organic Law, Banco de Portugal has established, in turn, a General risk provision (point 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 2018, the participating interest of Banco de Portugal in the equity of its related parties was 97.87% in SGFPBP and 100% in Valora, S. A. (Note 10). On 31 December 2018, one member of the Board of Directors of Banco de Portugal was on the Board of Directors of SGFPBP and of Valora.

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.

3 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 2018 (showing a total of 157,952,731 t.euros and equity of 2,187,219 t.euros, including a net profit of 805,687 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 2018 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.

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 2018 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 2018 is consistent with the financial statements.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

On the activity report of 2018

It is our opinion that the information included in the activity report of 2018 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, 21 March 2019

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.)

4 Report and Opinion of the Board of Auditors



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Board of Auditors

Report and Opinion of the Board of Auditors

2018

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 Annual Report presented by the Board of Directors.

During the course of 2018, 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 meetings of Board of Directors and 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, (ii) regular meetings with those in charge of the monitored services and (iii) 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.

The Board of Auditors analysed in particular the financial information contained in the Management Report and Accounts for the fiscal year ended on 31 December 2018 – approved in the meeting of the Board of Directors held on 19 March 2019 – 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, which showed an increase of €4,988 million from 2017, the Board of Auditors paid particular attention to the developments in the main items and financial risks linked to Assets, notably (i) the decrease in Lending to credit



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institutions, (ii) the increase in Securities held for monetary policy purposes, (iii) the decrease in foreign reserves and euro assets, and (iv) an increase in Intra-Eurosystem claims arising from the adjustment to euro banknotes in circulation assigned to Banco de Portugal. With regard to Liabilities, special attention was paid to developments in Own Funds coverage of the Balance sheet and other contingent liabilities (including the items Revaluation accounts, General risk provision, Equity and Net profit for the year).

The developments in Profit for the year, which increased by €149 million from 2017, reflect the impact of various relevant factors, including (i) the increase in interest margin on Securities held for monetary policy purposes, (ii) the significant increase in Realised gains/losses and Unrealised losses arising from financial operations, (iii) the decrease in the net result of pooling of monetary income, and (iv) the decision to reduce the general risk provision by €50 million arising in particular from a decline in the foreign currency exposure, compared with the €520 million decrease in 2017, 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 2018, to the amount of €805,687,221.52. 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 €80,568,722.15
- 10% to other reserves €80,568,722.15
- Dividends to the State €644,549,777.22

In light of the above, the Board of Auditors raises no objection to the approval of the 2018 Financial Statements of Banco de Portugal, nor to the proposal for the distribution of profit mentioned above.

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, 21 March 2019

The Board of Auditors

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Nuno Gracias Fernandes

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António Gonçalves Monteiro

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Margarida Abreu

