



BANQUE PRIVÉE
EDMOND DE ROTHSCHILD
EUROPE





Pillar III of Basle II 2010

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1. Introduction

The first Swiss bank to open in the Grand Duchy of Luxembourg in 1969, the original aim of Banque Privée Edmond de Rothschild Europe was to receive fiduciary investments from the Geneva head office. From the mid-80s, BPERE developed private banking activities followed by custodian services and investment fund administration.

Specialising in wealth management, fund administration and custodian services as well as global asset management, (family office), BPERE now has more than 700 employees and is therefore the largest Swiss bank in the Luxembourg financial market.

Within the framework of Pillar III of the new accord on the international standardisation of capital measurements and standards known as “Basle II” (hereinafter referred to as “Basle II”), the Basle Committee defined a set of requirements aimed at improving the financial transparency of banks vis-à-vis the market so as to enable third parties to assess their capital adequacy in the light of their risk profiles.

The recommendations of the new accord have been transposed into European directives; directives which were then transposed into Luxembourg law in the form of a circular issued by the Financial Sector Supervisory Commission (CSSF).

This document is designed to meet the requirements of Part XIX “Disclosure by credit institutions” of CSSF Circular 06/273 relating to capital adequacy; and is intended to supplement the information published in BPERE’s 2010 audited annual accounts.

2. Scope of Pillar III

The scope of this report covers Banque Privée Edmond de Rothschild Europe (hereinafter referred to as the “Bank”) as well as its four branches in Belgium, Spain, Italy and Portugal respectively.

On the basis of criteria established under Luxembourg law, the Bank is exempt from the obligation to produce consolidated accounts.

No current or foreseen material or legal impediment should prevent the prompt transfer of own funds or repayment of liabilities between Banque Privée Edmond de Rothschild SA (hereinafter referred to as the “Parent Company”) and the Bank as well as between the Bank and its subsidiaries.



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3. Risk management and capital adequacy

3.1 General principles

The Bank's risk management and capital adequacy policy falls strictly within the framework of the capital and risk policies defined at Banque Privée Edmond de Rothschild SA Group level (hereinafter referred to as the "Group") by its Parent Company. In accordance with this policy, the Bank provides capital adequacy and risk management via a comprehensive framework of principles, an organisational structure, limits and processes closely linked to the Bank's activities and the nature of the risks to which it is or could be exposed.

In line with CSSF Circular 06/273 (transposition of the European Directive on capital adequacy), the capital adequacy and risk management policy is the subject of an annual report "Report on the Internal Capital Adequacy Assessment Process (ICAAP)" validated by the Board of Directors of the Bank and intended for the Luxembourg control authority. This report is part of the dialogue between the latter and the Bank regarding risks and capital adequacy.

The report must, among other things, cover an assessment of all the risks to which the Bank is or might be exposed, their sensitivity to crisis scenarios and their expected changes in the light of the Bank's development strategy. Once the risks have been identified and quantified, the Bank determines the amount of capital needed to be raised to cover its risks or implements appropriate management and control procedures for those risks, such as the liquidity risk, which may not be covered by capital.

This internal assessment framework is integrated into the Bank's various management and decision-making processes by means of various devices such as crisis scenario sensitivity analyses or committees such as the Credit Committee or ALM ¹ Committee.

3.2 Organisation of risk management

The Bank has had a centralised risk management department since March 2008.

This department was created with three objectives:

- To adapt the risk management framework (risk policy, process, methodologies and tools) to expected changes in the Bank's activities and risks;
- To participate in the day-to-day management of risks in collaboration with the Bank's various business areas and departments;
- To advise the Management Committee and Board of Directors in the fields of risk management and capital planning.

As part of an efficiency and cross disciplinary process, the Risk Management Department is located at the very heart of the Bank's management and control framework. This position enables it, among other things, to have direct access to the Bank's various management bodies, the Board of Directors and even the Parent Company's Risk Management Department.

Furthermore, the Risk Management Department Manager is a member of the Group's Risk Committee.

¹ Asset Liability Management.

3.3 Capital management and capital adequacy

3.3.1 PRUDENTIAL OWN FUNDS

The Bank's prudential own funds are calculated in accordance with the requirements of CSSF Circular 06/273 and comprise the following elements:

- The original own funds which make up the paid-up capital, profits brought forward, eligible reserves and valuation adjustments similar to basic capital and reserves;
- Additional own funds which are limited to valuation adjustments similar to additional own funds;
- Deductions which consist of 5 holdings in financial establishments in which the Bank holds more than 10% of the capital.
- As in 2009, the prudential own funds are mostly composed of original own funds (Core Tier I).

Eligible capital and reserves (in millions of euros)	31.12.2010	31.12.2009
Original own funds	179.9	165.7
- Paid-up capital	31.5	31.5
- Reserves	101.6	88.5
- Profit brought forward	14.9	15.0
- Revaluation reserves	31.9	30.7
Additional own funds	7.2	6.1
- Capital gains on shares	5.9	4.8
- Special items with quota share of reserve	1.3	1.3
Items to be deducted from own funds	-4.5	-3.7
- Pri advisory Holding (100%)	-2.4	-2.5
- EdR Investment Advisors* (99.92%)	-1.2	-0.6
- Edmond de Rothschild Intl Fund Bermuda (14.75%)	-0.8	-0.4
- LCF Edmond de Rothschild Conseil (99.99%)	-0.1	-0.2
- Iberian Renewable Energies S.à.r.l. (100%)	-0.01	-0.01
Total	182.6	168.1

* Formerly Pri Investment

3.3.2 PRUDENTIAL OWN FUNDS

Within the framework of Pillar I of Basle II, the Bank must calculate its minimum regulatory capital requirement to cover three types of risk: credit, market and operational risks respectively.

To this end, the Bank has selected the most appropriate regulatory methodologies for its organisation and activities; namely:

Type of risk	Methodology used
Credit risk	Standard approach
Market risk	Standard approach
Operational risk	Standard approach

In addition, within the framework of the appreciation of credit risk mitigation techniques, the Bank has selected the general method, except for personal guarantees in respect of which the Bank uses the substitution method.

The following tables detail the Bank's regulatory capital requirement by type of risk and class of exposure as at 31st December 2010 and 2009.

31st DECEMBER 2010

Type of risk	Basle II approach	Class of exposure	Weighted risk after mitigation*	Capital requirement*
Credit risk	Standard	Central governments and central banks	0.0	0.0
		Public sector entities	0.0	0.0
		Institutions	167.9	13.4
		Corporates ²	289.8	23.2
		Shares of UCIs	5.4	0.4
		Other	68.8	5.5
		Total		531.9
Market risk	Standard	Exchange risk	13.8	1.1
Operational risk	Standard		323.7	25.9
Total			869.4	69.5

*in millions of euros

31st DECEMBER 2009

Type of risk	Basle II approach	Class of exposure	Weighted risk after mitigation*	Capital requirement*
Credit risk	Standard	Central governments and central banks	0.0	0.0
		Public sector entities	0.0	0.0
		Institutions	106.9	8.6
		Corporates ²	272.7	21.8
		Shares of UCIs	8.9	0.7
		Other	67.1	5.4
		Total		455.6
Market risk	Standard	Exchange risk	31.8	2.5
Operational risk	Standard		313.2	25.1
Total			800.6	64.1

*in millions of euros

² The "Corporates" exposure class consists essentially of exposures to private clients and investment funds.

3.3.3 CAPITAL ADEQUACY RATIOS

In accordance with the requirements of CSSF Circular 06/273, the Bank is authorised to calculate a simplified capital adequacy ratio.

The following tables summarise the elements making up the simplified capital adequacy ratio and the Tier I ratio.

	31.12.2010 (in millions of euros)	31.12.2009 (in millions of euros)
Prudential own funds	182.6	168.1
Minimum requirement to cover		
- Credit risk	42.5	36.5
- Market risk	1.1	2.5
- Operational risk	25.9	25.1
Simplified adequacy ratio (%)	21.00	20.99
Tier I Ratio (%)	20.44	20.50

The minimum capital adequacy ratio to be adhered to by any credit institution is set by regulations at 8%.

The two ratios mentioned above place the Bank among the best players in the Luxembourg financial market and reflect a prudent risk management policy dedicated to protecting the interests of clients and shareholders.

3.3.4 INTERNAL CAPITAL

In accordance with the requirements of Pillar II of Basle II, the Bank has defined its internal capital on the basis of the prudential own funds adjusted by a percentage of current earnings, in line with the Bank's dividend payment policy.

Changes in regulatory and internal capital as well as capital requirements are assessed on the basis of a three year plan comprising the strategic development plan, capital sources and expected changes in the Bank's risk profile.

3.3.5 PILLAR I RISKS

Credit and counterparty risk

Definition of the risk

Credit and counterparty risk (jointly referred to as "credit risk") is defined as the risk of deterioration of the quality or default of a counterparty resulting in the latter not meeting its contractual obligations towards the Bank.

Management of the credit and counterparty risk

As credit risk covers a wide range of sub-categories of risks and activities, the analysis of this risk is structured below according to the two major credit activities carried out by the Bank; namely client credit business and interbank business.

Client credit business

Positioning credit as non-core among the products and services offered to clientele as well as a very strict and prudent credit granting policy are a reflection of the Bank's limited appetite for credit and counterparty risk.

Furthermore, any credit granted by the Bank must be secured with financial collateral meeting draconian criteria in terms of diversification, liquidity, valuation, rating and geographic coverage or by personal guarantees (exclusively transfers of life insurance policies or bank guarantees payable upon first call issued by first class credit institutions).

An analysis of the quality of the collateral by assigning a Lombard or equivalent-risk valuation is carried out by a specific unit within the Risk Management Department. Each item of financial collateral is subject to a different analysis according to the type of asset, which covers a wide range of criteria such as liquidity, the existence of a reliable valuation, rating of the asset (e.g. debt instruments), residual life (e.g. debt instruments), type of issuer (e.g. debt instruments), nationality of the issuer, currency, geographic coverage (e.g. investment funds), diversification (e.g. investment funds) or even the level of indebtedness (e.g. investment funds).

Analyses of investment fund, derivative and structured product type assets are routinely subject to review and validation by the multi-disciplinary Lombard Weightings Committee.

Apart from meeting individual eligibility criteria, financial collaterals and personal guarantees securing credit must also comply with strict rules in terms of diversification such as the absence of any correlation between the debtor and the financial collaterals personal guarantees or even a minimum number of different securities.

The transposition of this strict policy leads the Bank to require routine over-collateralisation, the percentage of which varies according to the type of financial collateral and/or personal guarantees and their level of diversification.

This prudent policy is strengthened by the governance mechanism introduced at the various stages of the life cycle of credits with a set of controls carried out by the various players within the Bank, including the Credit Committee, the keystone of the mechanism.

Interbank business

The Bank has a limited appetite for credit and counterparty risk in interbank business. This interbank business, essentially deposits and spot and forward exchange transactions, is simply to support the needs of clients.

Counterparty selection, carried out in collaboration with the Parent Company, is based on qualitative and quantitative criteria in line with best market practice.

Furthermore, the Bank makes substantial use of credit risk mitigation techniques such as tripartite reverse repurchase agreements, reverse repurchase agreements done with central counterparties, deposits with the Central Bank of Luxembourg and/or master netting agreements.

Within the framework of tripartite reverse repurchase agreements, the Bank seeks to optimise the balance between diversification of the counterparties and the quality of the basket of eligible securities. The latter are limited exclusively to debt instruments issued by central administrations³, central banks³, multilateral development banks and international organisations⁴. For the reverse repurchase agreements done with Eurex Repo, a German central counterparty, the basket of financial collateral is the EUR GC Pooling ECB⁵ basket. This basket enables the re-use of collateral received for refinancing within the framework of European Central Bank open market operations. The securities received are checked on a daily basis so as to ensure that they comply with criteria of eligibility and quality. In addition, these securities are valued at their market value and readjusted on a daily basis.

In order to minimise the counterparty risk of non-secured deposits, the policy implemented by the Bank is designed to diversify counterparties by means of very low, regularly updated limits and dynamic management of the use of those limits in close collaboration with its Parent Company.

Banking counterparty limits by type of instrument (interbank deposits, reverse repurchase agreements, fiduciary deposits, spot forex transactions and forward exchange transactions) are set by the Board of Directors Committee of the Bank and its Parent Company for the whole Group. They are subject to regular review at the initiative of the Parent Company or at the Bank's request.

Use of external credit rating agencies

As regards quantifying capital requirements in respect of the credit risk risky assets, the Bank uses ratings from two external credit rating agencies, namely Moody's and Standard & Poor's, in respect of the following exposure classes:

- Central governments and central banks;
- Public sector entities;
- Institutions;
- Corporates.

The Bank has mapped the ratings of these two external rating agencies to internal ratings using the same criteria as set out in CSSF Circular 06/273. These mappings are shown in the table below.

Credit quality rankings	1	2	3	4	5	6
Moody's rating	Aaa to Aa3	A1 to A3	Baa1 to Baa3	Ba1 to Ba3	B1 to B3	Caa1 and below
Standard & Poor's rating	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	B+ to B-	CCC+ and below

³ Central administrations and central banks must have a Standard & Poor's rating of at least "A".

⁴ Eligible multilateral development banks and international organisations are only limited to those with a 0% rating within the framework of CSSF Circular 06/273 relating to capital adequacy.

⁵ The EUR GC Pooling ECB basket which comprises around 8'000 European Central Bank (ECB) eligible securities: Around 3'000 debt instruments issued by central banks, central governments and supranational organisations with a Standard & Poor's rating of at least "A-". Around 5'000 traditional and jumbo covered bonds issued by credit institutions and agency credit institutions with a Standard & Poor's rating of at least "A-".

Exposure to counterparty credit risk

The over-the-counter derivative financial instruments used by the Bank are limited to forward forex contracts and are solely designed to hedge forex risk (hedging of forex transactions initiated by clients).

The evaluation of the counterparty credit risk related to these financial instruments is carried out using the original exposure method in accordance with current regulations.

The following table shows the Bank's exposure to counterparty credit risk as well as the impact of mitigation techniques on that risk as at 31st December 2010 and 2009.

Derivative instruments	31.12.2010 (in millions of euros)	31.12.2009 (in millions of euros)
Notional amount	13 765.0	9 381.0
Gross positive fair value	176.3	71.6
Gross value exposed to risk	277.1	189.1
<i>with a maturity period of < 1 year</i>	<i>274.1</i>	<i>189.1</i>
Net value exposed to risk	142.4	94.9
Risk-weighted assets	33.9	24.7
Capital requirements	2.7	2.0

The use of counterparty credit risk mitigation techniques enables the Bank to reduce the gross value exposed to risk by 50%. In addition, the Bank has introduced margin call mechanisms with the main banking counterparties with which it works.

Exposure to credit and dilution risks

The exposure published in the various tables in this section covers:

- The net amounts of balance sheet items;
- The gross amounts of the off-balance-sheet commitments, namely the undrawn committed credit lines and the amount of guarantees issued by the Bank in favour of third parties;
- The equivalent-risk amount of forward exchange transactions.

Exposure by exposure class

The following tables show all exposures split by exposure class as at 31st December 2010 and 2009.

31st DECEMBER 2010

Exposure class	Weighting %	Annual average of exposed value*	Exposed value before mitigation*	Exposed value after mitigation*	Risk-weighted assets*	Capital requirements*
Central governments and central banks	0	160.9	176.6	176.6	0.0	0.0
Public sector entities	0	22.4	21.8	21.8	0.0	0.0
Institutions	20	3 007.2	3 429.6	978.0	167.9	13.4
Corporates ⁶	20	0.013	0.011	0.011	0.002	0.002
	100	1 159.5	1 205.5	289.8	289.8	23.2
Shares of UCIs	100	5.4	5.4	5.4	5.4	0.4
Other exposures	0	2.6	2.9	2.9	0.0	0.0
	100	126.7	126.9	68.8	68.8	5.5
Total		4 484.7	4 968.7	1 543.3	531.9	42.5

*in millions of euros

⁶ The "Corporates" exposure class consists essentially of exposure to private clients and investment funds.

31st DECEMBER 2009

Exposure class	Weighting %	Annual average of exposed value*	Exposed value before mitigation*	Exposed value after mitigation*	Risk-weighted assets*	Capital requirements*
Central governments and central banks	0	360.7	395.7	395.7	0.0	0.0
Public sector entities	0	21.5	22.4	22.4	0.0	0.0
Institutions	20	2 927.9	2 602.2	534.5	106.9	8.6
Corporates ⁶	20	18.6	0.007	0.007	0.001	0.0001
	100	1 054.8	1 067.8	272.7	272.7	21.8
Shares of UCIs	100	6.1	8.9	8.9	8.9	0.7
Other exposures	0	2.6	2.3	2.3	0.0	0.0
	100	119.4	119.4	67.1	67.1	5.4
Total		4 511.6	4 218.7	1 303.6	455.6	36.5

*in millions of euros

⁶ The "Corporates" exposure class consists essentially of exposure to private clients and investment funds.

Exposure by exposure class and credit quality ranking

The following tables show all exposures split by exposure class and credit quality ranking as at 31st December 2010 and 2009.

31st DECEMBER 2010

Exposure class	Credit quality ranking ⁷	Exposed value before mitigation*	Exposed value after mitigation*	Risk-weighted assets*	Capital requirements*
Central governments and central banks	1	176.6	176.6	0.0	0.0
Public sector entities	1	21.8	21.8	0.0	0.0
Institutions	2	3 429.6	978.0	167.9	13.4
Corporates ⁸	1	0.011	0.011	0.002	0.002
	NA ⁹	1 205.5	289.8	289.8	23.2
Shares in UCIs	NA ⁹	5.4	5.4	5.4	0.4
Other exposures	NA ⁹	129.8	71.8	68.8	5.5
Total		4 968.7	1 543.3	531.9	42.5

*in millions of euros

⁷ Use of ratings of external credit rating agencies. See table for matching ratings to credit quality rankings.

⁸ The "Corporates" exposure class consists essentially of exposure to private clients and investment funds.

⁹ No rating available.

31st DECEMBER 2009

Exposure class	Credit quality ranking ⁷	Exposed value before mitigation*	Exposed value after mitigation*	Risk-weighted assets*	Capital requirements*
Central governments and central banks	1	395.7	395.7	0.0	0.0
Public sector entities	1	22.4	22.4	0.0	0.0
Institutions	2	2 602.2	534.5	106.9	8.6
Corporates ⁸	1	0.007	0.007	0.001	0.00001
	NA ⁹	1 067.8	272.7	272.7	21.8
Shares in UCIs	NA ⁹	8.9	8.9	8.9	0.7
Other exposures	NA ⁹	121.7	69.4	67.1	5.4
Total		4 218.7	1 303.6	455.6	36.5

*in millions of euros

⁷ Use of ratings of external credit rating agencies. See table for matching ratings to credit quality rankings.⁸ The "Corporates" exposure class consists essentially of exposure to private clients and investment funds.⁹ No rating available.

Exposure by exposure class and geographic area

The following tables show all exposures split by exposure class and geographic area as at 31st December 2010 and 2009.

31st DECEMBER 2010

Exposure class	Europe*	Americas*	Rest of the world*	Total*
Central governments and central banks	176.6	0.0	0.0	176.6
Public sector entities	21.8	0.0	0.0	21.8
Institutions	3 377.2	24.7	27.7	3 429.6
Corporates ⁸	1 055.6	82.2	67.7	1 205.5
Shares in UCIs	4.5	0.0	0.9	5.4
Other exposures	129.3	0.0	0.5	129.8
Total	4 7645.0	106.9	96.8	4 968.7

*in millions of euros

More than 95% of the Bank's exposure is concentrated in Europe and more specifically within the Eurozone.

⁸ The "Corporates" exposure class consists essentially of exposure to private clients and investment funds.

31st DECEMBER 2009

Exposure class	Europe*	Americas*	Rest of the world*	Total*
Central governments and central banks	395.7	0.0	0.0	395.7
Public sector entities	22.4	0.0	0.0	22.4
Institutions	2 575.8	19.5	6.9	2 602.2
Corporates [§]	907.9	71.6	88.3	1 067.8
Shares in UCIs	3.7	0.0	5.2	8.9
Other exposures	121.3	0.0	0.4	121.7
Total	4 026.8	91.1	100.8	4 218.7

*in millions of euros

[§] The "Corporates" exposure class consists essentially of exposure to private clients and investment funds.

Exposure by exposure class and economic sector

The following tables show all exposures split by exposure class and economic sector as at 31st December 2010 and 2009.

31st DECEMBER 2010

Exposure class	Central banks*	Banks*	Corporates*	Investment funds*	Households*	Other exposures*	Total*
Central governments and central banks	176.6	0.0	0.0	0.0	0.0	0.0	176.6
Public sector entities	0.0	0.0	0.0	0.0	0.0	21.8	21.8
Institutions	0.0	3 428.2	1.4	0.0	0.0	0.0	3 429.6
Corporates ¹⁰	0.0	0.0	393.3	554.3	257.9	0.0	1 205.5
Shares of UCIs	0.0	0.0	0.0	5.4	0.0	0.0	5.4
Other exposures	0.0	0.3	16.3	0.0	0.0	113.2	129.8
Total	176.6	3 428.5	411.0	559.7	257.9	135.0	4 968.7

*in millions of euros

The "Corporates" economic sector consists essentially of wealth management holdings.

¹⁰The "Corporates" exposure class consists essentially of exposure to private clients and investment funds.

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Exposure class	Central banks*	Banks*	Corporates*	Investment funds*	Households*	Other exposures*	Total*
Central governments and central banks	395.7	0.0	0.0	0.0	0.0	0.0	395.7
Public sector entities	0.0	0.0	0.0	0.0	0.0	22.4	22.4
Institutions	0.0	2 599.8	2.4	0.0	0.0	0.0	2 602.2
Corporates ¹⁰	0.0	0.0	386.1	421.0	260.7	0.0	1 067.8
Shares of UCIs	0.0	0.0	0.0	8.9	0.0	0.0	8.9
Other exposures	0.0	103.7	15.4	0.0	0.0	2.6	121.7
Total	395.7	2 703.5	403.9	429.9	260.7	25.0	4 218.7

*in millions of euros

¹⁰The "Corporates" exposure class consists essentially of exposure to private clients and investment funds.

Exposure by exposure class and residual maturity

The following tables show all exposures split by exposure class and residual maturity as at 31st December 2010 and 2009.

31st DECEMBER 2010

Exposure class	< 3 months*	> 3 months but < 1 year*	> 1 year but < 5 years*	> 5 years*	No maturity*	Total*
Central governments and central banks	176.6	0.0	0.0	0.0	0.0	176.6
Public sector entities	21.8	0.0	0.0	0.0	0.0	21.8
Institutions	3 419.5	10.1	0.0	0.004	0.0	3 429.6
Corporates ¹⁰	978.3	218.4	2.8	6.0	0.0	1 205.5
Shares of UCIs	0.0	0.0	0.0	0.0	5.4	5.4
Other exposures	113.5	0.0	0.0	0.0	16.3	129.8
Total	4 709.7	228.5	2.8	6.0	21.7	4 968.7

*in millions of euros

More than 90% of exposure has a residual maturity of less than 3 months.

¹⁰ The "Corporates" exposure class consists essentially of exposure to private clients and investment funds.

31st DECEMBER 2009

Exposure class	< 3 months*	> 3 months but < 1 year*	> 1 year but < 5 years*	> 5 years*	No maturity*	Total*
Central governments and central banks	395.7	0.0	0.0	0.0	0.0	395.7
Public sector entities	22.4	0.0	0.0	0.0	0.0	22.4
Institutions	2 594.6	7.6	0.0	0.004	0.0	2 602.2
Corporates ¹⁰	855.6	209.7	0.4	2.1	0.0	1 067.8
Shares of UCIs	0.0	0.0	0.0	0.0	8.9	8.9
Other exposures	102.7	0.0	0.0	0.0	19.0	121.7
Total	3 971.0	217.3	0.4	2.1	27.9	4 218.7

*in millions of euros

¹⁰ The "Corporates" exposure class consists essentially of exposure to private clients and investment funds.

Depreciation and provisions for exposure to credit and dilution risks

In the context of its policy for depreciating and accruing for the impaired exposures the Bank has implemented dedicated identification, quantification and monitoring processes. A specific report is prepared on a monthly basis by the Credit Department for review and validation by the Credit and Management Committees.

Any past due exposure or exposure not covered by collateral expressed in Lombard value (risk equivalent) is covered by an accrual.

The Bank accounts for interest revenue in relation to credit granted only when the interest is actually paid. Interest revenue on partially settled credit is, in principle, recorded in full. Interest arrears are not subject to any specific treatment when determining accruals for credit.

In respect of impaired exposures interest continues to be calculated on a pro rata basis, interest due but not paid is added to the principal but funded up to the full amount and is not accounted for as revenue.

As at 31st December 2010, the Bank had a single substantial impaired exposure on its books where recovery of some of the interest (2.7 million euros) was considered to be doubtful and this sum has therefore been covered by an accrual. No accrual on the capital has been accounted for as there is a guarantee covering this credit.

The following table shows changes in impaired and past due exposures in 2010 and 2009.

Impaired and past due exposures	31.12.2010 (in millions of euros)	31.12.2009 (in millions of euros)
Balance as at 1 st January	2.7	2.6
Reversal of provision	-0.1	-0.2
Appropriation	0.5	0.3
Balance	3.1	2.7

The following table shows the distribution of value adjustments by geographic area as at 31st December 2010 and 2009.

Geographic area	31.12.2010 (in millions of euros)	31.12.2009 (in millions of euros)
Europe	3.0	2.6
Americas	0.0	0.0
Rest of the world	0.1	0.1
Balance	3.1	2.7

Credit risk mitigation techniques

As described in previous sections, the Bank's risk management policy is to maximise the use of credit risk mitigation techniques with routine use of financial collaterals and personal guarantees within the framework of its client credit business.

As far as interbank business is concerned, the techniques used include reverse repo transactions as well as deposits with the Central Bank of Luxembourg.

As at 31st December 2010 and 2009, the impact of credit risk mitigation techniques on exposure was as follows:

31st DECEMBER 2010

Exposure class	Exposure before mitigation*	Exposure after mitigation*
Central governments and central banks	176.6	176.6
Public sector entities	21.8	21.8
Institutions	3 429.6	978.0
Corporates ¹¹	1 205.5	289.8
Shares in UCIs	5.4	5.4
Other exposures	129.8	71.8
Total	4 968.7	1 543.3

*in millions of euros

31st DECEMBER 2009

Exposure class	Exposure before mitigation*	Exposure after mitigation*
Central governments and central banks	395.7	395.7
Public sector entities	22.4	22.4
Institutions	2 602.2	534.5
Corporates ¹¹	1 067.8	272.7
Shares in UCIs	8.9	8.9
Other exposures	121.7	69.4
Total	4 218.7	1 303.6

*in millions of euros

¹¹The "Corporates" exposure class consists essentially of exposure to private clients and investment funds.

The personal guarantees taken into consideration within the framework of credit risk mitigation techniques consist exclusively of bank guarantees payable upon first call issued essentially by Group entities representing a total amount of 28.5 million euros as at 31st December 2010.

The collateral received in the framework of the credit risk mitigation techniques is diversified and of high quality. There are no market or credit risk concentrations within the collateral basket.

The following tables show the split of interbank deposits as at 31st December 2010 and 2009.

31st DECEMBER 2010

Interbank deposits	Amount (in millions of euros)	Amount (as percentage)
Deposits with the Central Bank of Luxembourg ¹²	171.0	4.9
Deposits with Belgian, Italian, Spanish and Portuguese Central Banks ¹²	5.7	0.2
Deposits secured by reverse repurchase agreements	2 590.4	74.7
Unsecured deposits	699.3	20.2
Total	3 466.4	100.0

31st DECEMBER 2009

Interbank deposits	Amount (in millions of euros)	Amount (as percentage)
Deposits with the Central Bank of Luxembourg ¹²	390.9	13.5
Deposits with Belgian, Italian, Spanish and Portuguese Central Banks ¹²	4.8	0.1
Deposits secured by reverse repurchase agreements	2 250.0	77.6
Unsecured deposits	253.9	8.8
Total	2 899.6	100.0

¹²Including mandatory reserves.

Market risk

Definition of the risk

Market risk is defined as the risk of loss stemming from an unfavourable development in market conditions having a negative impact on the Bank's positions.

The Bank distinguishes three categories of market risk:

- Interest rate risk is the risk of loss resulting from an unfavourable movement in interest rates affecting the Bank due to mismatching of its assets, liabilities and off-balance sheet undertakings relating to non-congruent rates and interest rate reference systems;
- Forex risk, resulting from an unfavourable change in the price of a currency affecting the Bank due to mismatching of its assets, liabilities and off-balance sheet undertakings denominated in currencies other than the currency of the capital;
- Securities position risk, related to unfavourable changes in the value of securities held in the Bank's securities portfolio.

Market risk management

The three categories of market risk are subject to a very prudent management policy by the Bank by means of strict limits and a daily control mechanism.

In addition to the various monthly stress tests relating to interest rates prescribed by the Bank's ALM Committee, the latter applies those defined by CSSF Circular 08/338; namely half-yearly quantification of the impact of an upward or downward variation of 200 basis points of parallel interest rate curves on the intrinsic value of the Bank's assets.

As at 31st December 2010, the results of that stress test were 1.6% of the Bank's capital and reserves for all currencies (0.6% for the euro and 0.8% for the US dollar respectively); well below the regulatory threshold of 20% considered to be the critical threshold.

This excellent result again reflects the Bank's desire to keep its exposure to the interest rate risk to the absolute minimum.

Operational risk

Definition of the risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

The Bank includes legal risk and reputation risk within this definition where they occur as a consequence of an operational risk event.

In order to simplify the analysis and management of operational risks, the Bank has split these risks into three categories linked to the types of loss events defined by the Basle Committee.

Types of loss events	Categories of operational risk	Definition
Employment practices and workplace safety	Other operational risks	Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from discrimination events punishable under a law or regulation, and excluding sexual harassment and mobbing.
Clients, products and business practices		Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product
Execution, delivery and process management		Losses from failed transaction processing or process management, from relations with trade counterparties and vendors.
Internal fraud	Fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding discrimination events, punishable under a law or regulation, and excluding sexual harassment and mobbing, and which involves at least one internal party
External fraud		Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party.
Damage to physical assets	Security	Losses arising from loss or damage to physical assets from natural disaster or other events.
Business interruptions and system failures		Losses arising from disruption of business or system failures.

Operational risk management

The Bank has introduced a methodology for operational risk management based on strong, constant management involvement and numerous control, information and monitoring activities.

This methodology includes, among other things, mapping operational risks as well as incident collection processes.

Risks are assessed according to two criteria: frequency and impact. This involves estimating the occurrence of the risk on the one hand, in other words the number of times the risk is likely to occur within a given period, and the severity of the risk on the other, i.e. the estimated probable cost of the risk when it occurs. This impact is not only assessed in monetary terms, it may be a question of damage to the Bank's image or reputation.

It should be noted that each risk is assessed twice: a gross assessment and a net assessment. The transfer from the first to the second is made by taking into account the internal control mechanism (level one and level two controls, procedures, etc.).

Furthermore, the Bank has introduced an overall business continuity plan under the responsibility of the "Business Continuity Manager". The main aim is to enable the Bank and the entities attached to it to operate at an agreed level of activity enabling it to respect the commitments made to clients even when the places in which it normally conducts its business and hosts its essential information systems are no longer accessible.

Software dedicated to operations and business continuity management, eBRP, enables all the information essential to business continuity to be consolidated. More than 500 employees, spread throughout the Luxembourg Head Office and foreign branches, have access to this software.

Every department manager has appointed teams responsible for identifying and documenting their critical processes and needs (IT resources and applications, specific office equipment, etc.) in eBRP. This constitutes a business impact analysis and enables the necessary information to be provided for designing appropriate business continuity strategies.

3.3.6 PILLAR II RISKS

Introduction

Within the framework of Pillar II, in addition to the risks described above under Pillar I, the Bank has introduced a process for identifying, quantifying, managing and reporting all the risks to which it is or might be exposed.

These risks are essentially:

- Liquidity risk;
- Strategic risk;
- Business risk;
- Reputation risk;
- Legal risk;
- Compliance risk;
- Concentration risk;
- Residual risk;
- Macro-economic and regulatory risk;
- Country risk;
- Settlement/delivery risk.

The methodology employed by the Bank to quantify internal capital requirements is primarily based on the measurements of the Pillar I capital adequacy ratio regime supplemented by prudent adjustments resulting from its internal process for assessing internal capital adequacy.

Stress tests

Out of a constant desire to perpetuate its business activities and its clients' interests, the Bank has developed a set of extreme but plausible crisis scenarios, combining idiosyncratic and systemic shocks.

These various scenarios enable the Bank to test its ability to withstand shocks and ensure that it has adequate capital and reserves. The assumptions of these various crisis scenarios are reassessed on a regular basis. In addition, the Bank performs reverse stress testings.



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