Capital Management Standard – Banco Standard de Investimentos S/A

Level:	**Entity**
Type:	**Capital Management**
Owner :	**Financial Director**
Approved by:	**Board of Directors and Brazilian Management Committee (Manco)**
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Review Date:	**Annual review required**

CAPITAL MANAGEMENT – BANCO STANDARD DE INVESTIMENTOS S/A

PART A – GOVERNANCE AND GENERAL

1 - Purpose

The purpose of this standard is to establish mechanisms and procedures to ensure the appropriate level of capital, considering the strategic objectives and the risk-taking by the Entity.

2 – Application

a) All Business Units and Support Functions within the BSI are covered by this standard;

b) All forms of risk and risk-taking by Entity, which might conceivably lead to an variation in the BSI's capital are covered by this standard;

c) Capital management should have a prospective vision to anticipate changes in the market conditions;

d) Responsible for Risk and Finance areas must assess proactively whether the policy is being properly applied;

3 – Approval and awareness

a) This standard is to be maintained and reviewed annually by the Board of Directors of BSI;

b) In case of doubt, the Financial Director, determines how to comply with this standard. To the extent required, the standard will be amended to clarify;

c) Permanent or temporary exceptions to this standard are to be approved by Management Committee ("MANCO"), documented, and reported to the next Board of Directors for noting and ratification.

4 – Responsibility

The responsibility to comply and accomplish with the processes and controls relating to the Structure are defined as follows:

<u>Board of Directors</u>

The Board of Directors is ultimately responsible for Standard Bank's capital management policies and strategies, as well as for Standard Bank's Capital Plan. The Board of Directors approves and reviews policies and procedures in order to determine its compatibility to Standard Bank's strategic planning and market conditions. The Board of Directors shall have a broad and integrated comprehension of the risks that may impact capital.

<u>Board of Officers (ManCo)</u>

To determined institutional guides for monitoring and controlling capital, based on the regulations in full force and effect, as well as on the best market practices. ManCo is responsible for getting involved in all initiatives relating to risk management and evaluation, including: (i) capital contingency plans; and (ii) evaluation and identification mechanisms of risks incurred by Standard Bank with the aim of determining the adequate capital level to affront such risks. ManCo is also responsible for appointing ALCO members and supervise its performance through policies and procedures. ManCo may internally delegate its functions to committees, Executive Officers/specialized senior employees, as appropriate, provided, however, it will still be fully responsible for the Structure management.

ManCo may also promote the awareness of the capital use optimization by Standard Bank.

ALCO Committee

Standard Bank has committees which develop technical actions aiming at assisting the decisions issued by ManCo and the Board of Directors, when applicable, to minimize the losses and eliminate the impacts over the businesses, prioritizing the prudence of high returns, without compromising Standard Bank's profitability.

ALCO is responsible before ManCo by managing all issues relating to capital, financings, liquidity and market risk. ALCO is also responsible for ensuring an effective capital utilization within the regulatory bounds, as well as within the tax rules concerning balance sheet and/or portfolios. Additionally, ALCO prepares policies, strategies, simulations and processes.

Finance Department

Finance Department is responsible for developing capital evaluation procedures and monitoring in order to provide reliable information to ALCO and ManCo for the correct capital evaluation and management. Among its duties, it is important to highlight: (i) preparation of periodic managerial reports; (ii) simulations; (iii) regulatory requirements verification; and (iv) evaluation of occasional issued appointed by the external or internal audit about the capital management.

Risk Department

Risk Department provides advisory and technical support necessary to Standard Bank as a whole, analyzing sceneries, financial trends to funding allocation among the assets and liabilities of Standard Bank's balance sheet. Risk Department is also responsible for understanding the applicable rules and its application to Standard Bank's reality.

Standard Bank Group Internal Audit

To evaluate the quality, operation and effectiveness of Standard Bank's processes in this Structure.

5 – Risk assessments

This standard should be read together with other risk management policies of the Entity, including, but not limited to:

a) Policy Group;

b) Market Risk: Market risk manual, stop loss, stress testing, trading book and bank booking and price verification test;

c) Liquidity risk: Liquidity policy and contingency plan for liquidity;

d) Credit Risk: Credit policy, risk rating policy, provisioning for loan losses policy;

The concept of materiality shall be taken into account in interpreting and implementing the requirements of this standard.

PART B – IDENTIFICATION OF CAPITAL

6 – General definitions

a) Capital is the amount consumed by a transaction or a Business Unit to deal with potential losses that may be generated by that risks from exposure over a given durations. In reference of capital allocated, the Entity expect a minimum return sufficient to cover the economic risks involved as well as shareholder remuneration;

b) Risk appetite is the amount, type and level of risk which a entity is willing to take in pursuit of their strategic and financial objectives, reflecting its ability to tolerate losses and continue to meet its obligations on maturity dates, under a normal conditions and also adverse market scenarios.

c) It is expressed by balancing:

   a. Budget consistent with the risk appetite implied by the business plans;

   b. An agreed tolerance for P&L volatility – an acceptable scenario that is lower than budget by an amount that is consistent with the risk appetite implied by the business plans;

   c. The economic capital requirement implied by the business plans being consistent with the available capital;

   d. The risk adjusted returns generated from risk-taking;

   e. Stress tests, portfolio analyses and concentration limits, risk assessments, risk indicators and other measures devised by the Business Unit risk function which serve to identify and constrain threats to earnings volatility, capital adequacy, or concentration risks not being disproportionate to the BSI;

d) Risk adjusted performance measures comprise the measurement of returns after taking risks into account. Capital is generally considered the appropriate measurement for risk in this regard;

7 – Risk Taxonomy

The following risk taxonomy forms the basis of capital measurement:

a) Credit risk is as defined in the relevant Credit Standards, and where appropriate includes country risk. It includes equity (investment) risk. Concentration risk (or where appropriate) diversification benefits are treated as an integral part of credit risk.

b) Market risk is as defined in the Group Market Risk standard, and includes banking book interest rate risk;

c) Liquidity risk is as defined in the Group Liquidity Risk standard;

d) Business Risk is the risk of loss due to adverse operating conditions such as decreased demand, competitive pressure, cost increases, Important risks that would manifest themselves as business risk include strategic risk and reputational risk;

e) Others risks: Any others risks involved in the negotiation which can impact the capital consumption;

8 – Ownership of the risk types

The Business Units Heads of Risk and Heads of Finance, or it there is none, the Chief Executive, are responsible to devise and operate assessment processes that ensure risks are identified and that risks not in the above taxonomy are reported to the ALCO, MANCO and Board of Directors.

9 – New Products

New products which are new risks involved or there is significant impact in the capital consumption will be necessary the approval of the New products committee

(BIC), that has the function of valuate, otherwise the balance between the risk and return;

PART C – MEASUREMENT OF ECONOMIC CAPITAL

In the process of evaluating the capital necessity, the Entity should consider credit risks of assets, counterparty credit risk, market risk in the trading portfolio, market risk in the deals not classified as banking book, operational risk, concentration risk exposures. Additionally should be consider other relevant risks which the Entity can risk-taking, even if no defined models of calculation, such as liquidity risk, strategy risk, reputational and environmental damage caused by its activities;

10 – Data integrity

The responsibility for reconciliation processes with accounting data lies with Business Unit Heads of Finance;

11 – Measuring of Capital

a) Head of Risk is responsible to devise and operate the statistical modeling or other quantifications techniques for capital in their Business Units for the following risk types; or to provide comprehensive justification why no capital is considered necessary for these risks (or components thereof):

    a. Credit Risk;

    b. Market risk;

    c. Liquidity risk;

    d. Operational risk;

b) The way capital is measured for each risk type must be agreed between Risks and Finance and, as appropriate, valuate by MANCO and ALCO. IF material, concentration risks shall be addressed, both within and across the risk types;

12 – Stress-testing the calculations

a) Risk area is in charge of to devise and operate meaningful scenario tests and sensitivity analysis to validate, supplement, and probe the results of the capital calculations, and to gauge BSI’s vulnerability to capital adequacy problems in exceptional but plausible events. These stress-tests should provide insights into:

    a. The impact of erros in the model parameter adopted;

    b. The impact of model weaknesses, e.g. linearity assumptions or missing risk factors;

    c. The impact of adverse economic or market scenarios, including correlation changes, concentration risks, illiquidity, market or economic crises;

    d. Analyze possible risks that may not be covered for the calculation of capital consumption;

b) Stress testing approaches, models and parameters must be approved in appropriately mandated committees.

13 – Forecasting – Capital Consumption

a) Finance Director is responsible to provide a forecast of capital usage based on business plans, strategies, the state of the economic cycle, and expected changed in external risk drivers. They should specifically cover asset growth, planned changes in portfolio compositions, and changes in economic factors;

b) At a minimum, the following information must be provided during the budget process:

   a. Forecast of assets and liabilities classified by type of risk;

   b. Expected revenues, expenses and net income based in the forecast of assets and liabilities;

   c. External macroeconomic variables;

c) Where necessary, Heads of Risk are responsible to provide appropriate information on expected risk parameters and changes therein;

PART D – MANAGEMENT OF CAPITAL CONSUMPTION

14 – Optimization of capital usage

a) Whilst it is mandatory to have enough actual capital to support the risks being taken, the objective of capital management is to ensure that capital is allocated and used to generate a return that appropriately compensate shareholders for risks incurred;

b) Capital planning is a crucial element of BSI achieving its strategic objectives and the forecast capital usage in the annual budget cycle is to be considered by MANCO and ALCO;

c) The allocation of actual capital to the Business Units and the return generated thereon is to be reviewed and monitored by MANCO and ALCO;

d) The optimization of capital usage within the Business Unit is their responsibility and they should deploy appropriate tools, such as credit portfolio management;

PART E – REPORTING OF CAPITAL

15 – Production responsibility

a) The reporting cycle is in a monthly basis to correspond with dates of meetings of MANCO and ALCO committees;

b) Heads of Risk and Finance are jointly responsible for reports;

16 – Reporting content

At a minimum, the information on the categories should be provided in a monthly basis:

a. Use of capital by Business Units, assessed by risk category, allowing the identification of concentration and diversification effects and allowing a review and explanation of the tendency to use and adequacy of allocations;

b. Stress testing the use of capital by Business Unit and Entity, identifying any threats to correct allocation of regulatory capital and allowing a proper assessment of excess or lack of capital;

c. Performance measures of risk-adjusted results by Entity and Business Units, allowing to evaluate whether capital allocations were well made and the use of capital in the business units are generating adequate profit.

17 – Reports to the Executive Management and other stakeholders

ALCO e MANCO will assess the consistency of all reports for the following third-party:

a. Shareholder – Annual Financial Statements;

b. Brazilian Central Bank (BACEN);

c. Board;

d. Risk assessment agencies;

e. South African Central Bank (SARB);

f. Financial Services Authority (FSA);

PARTE F – REFERENCE

a) Resolution 3.988 – Banco Central do Brasil;

b) Circular 3.398 as of 23/06/2008;

c) Circular letter 3.471 as of 11/11/2010;

d) Resolution 3.897 as of 25/08/2010;

e) Circular 3.508 as of 19/10/2010;

f) Circular 3.509 as of 19/10/2010;

g) Circular letter 3.471 as of 11/11/2010;

h) Comunication 20.307 as of 12/11/2010.

METHODOLOGY TO EVALUATE THE SUITABILITY OF SHAREHOLDERS OF REFERENCE TO PRINCIPAL MARKET RISK

1. Purpose

The purpose of the methodology is to ensure that the Entity's capital is sufficient to absorb losses resulting from adverse movements in market variables jerky which Bank is exposed.

2. Confidence level

Overall, the losses which the Bank is exposed can be classified into (1) expected losses, in the other words, equivalent to a normal expectation of the portfolio and, thus, would already be built into the pricing of operations and (2) unexpected losses representing the volatility or uncertainty about the expected level of losses, as illustrated in figures (Fig.1) below:

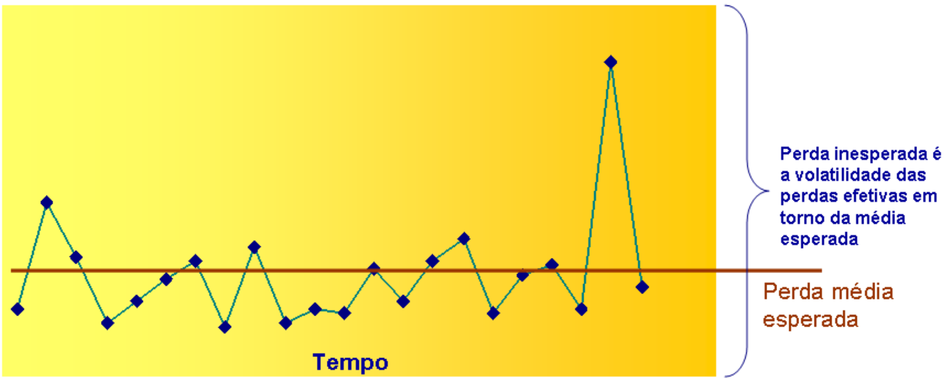

Figure 1 - Illustration of expected loss and unexpected loss

To avoid insolvency, the economic capital should be sufficient to cover unexpected losses with a high level of trust, commonly associated with the level of trust implicit in the credit rating of the Entity, as illustrated by Figure 2:

Figure 2 - Illustration of maximum loss level x rating

Thus, considering the bank's internal rating (SB09), we arrive at a probability of insolvency on a one-year horizon equivalent to 0.1602%, which is equivalent to a percentage of 99.8398% confidence.

3. Holding Period

Holding Period is a term in English, used in the language risk to expressing the period of time that a driver remains exposed to stress market movements by the exposure is reduced. It is common to adopt a period of 10 days.

Our methodology for assessing the adequacy of risk capital allocated to be based on a holding period of 10 days, which usually coincides with the methodology used by regulators.

4. Test Methodology

Two tests are performed:

First test is to compare the daily allocation of capital for market risk with the maximum expected loss for the trust level set, as detailed in item 2. Results will be considered satisfactory if the allocated capital is on average at least three times the estimated maximum loss for the holding period of 10 days.

To complement the tests will also be performed more conservative analysis, assuming that in times of crisis (stress scenarios), the movements tend to be highly correlated, thus greatly reducing the risk mitigation due to diversification.

For this test is made a projection of results through an analysis of the worst impacts resulting movements observed in the major risk factors to which the bank's portfolios are exposed, using history for the last 5 years of data.

5.Responsibilities

The tests described in the previous item shall be made by the Market Risk area and the results shared with the finance area.

6. Periodicity

Tests will be conducted semiannually.

7. Systems

The systems used to perform the tests are the same systems that produce information for monitoring market risk. We currently use internal systems (BSI-Comp) with spreadsheets. In the second half of 2012 will be implemented the system Integral Trust.

These systems provide the time series of market prices of key variables to which the BSI is exposed, as well as the sensitivity of the portfolio to each of these variables.

PROCEDURE FOR TESTING THE ADEQUACY OF CAPITAL ALLOCATED FOR CREDIT

The stress test operations with credit risk is conducted on a semiannual basis and relies on an exercise led by Credit responsible for the BSI.

The assumptions to be used in the stress test are defined responsible for credit risk and the Chief Risk Officer of BSI.

The responsible for the market risk of BSI is involved in the process by providing the simulations of the mark to market of derivative operations of the bank taking into account the assumptions previously defined.

In possession of the simulations the area of credit risk of BSI applies the methodology of stress and estimates the expected loss (Expected Loss) per customer. The expected loss comes from the probability of default (Probability of Default) intrinsic to each internal rating and loss in the event of default (Loss Given Default).

The total expected loss on transactions with credit risk is then compared with the regulatory capital allocated to credit risk, allowing the BSI attesting to the adequacy of the capital allocated.

The stress test is presented biannually to the Credit Committee of BSI.

The Bank's loan portfolio is presented in the Credit Committee of BSI on a monthly basis, where the client concentration, exposure ratings and industry levels are closely monitored and discussed.

METHODOLOGY TO OPERATIONAL RISK

The Operational Risk management is done by each of the business areas and support the bank.

Operational Risk is responsible for facilitating this through their management tools:

- Collect Incident Operational Risk;
- Self-Assessment and measurement of critical processes in each area;
- Definition of Key Risk Indicators.

The recording of information relating to operational risk is done in system global platform.

This way it is possible to produce management reports to facilitate the process of risk management. Reports of activities of Operational Risk Management are presented monthly to the Board on the Executive Committee of infrastructure, BIC.

Policies used in Operational Risk Management are as follows:

- Principles for Operational Risk Management;
- Policy Key Risk Indicators;
- Incident Reporting Policy for Operational Risk;

- Politics of Self-Assessment of Operational Risk.

Risk Appetite and Tolerance

A principle which must be above all in operational risk management is that the total elimination of all risk exposure of operating is not a goal to be achieved.

The process of decision making then the identification and risk assessment should be based on consideration of risk exposure in relation to appetite and risk tolerance.

The Board sets the overall levels of appetite and risk tolerance, which are monitored and managed regularly. These risks should be distributed regressively to the levels at which the risk owner is responsible for managing its risk exposure.

BUDGET PROCESS

BSI manages the capital including planning goals and capital needs on an annual basis, considering the strategic objectives of the institution.

The plan will be used as a tool to anticipate the need for capital arising from changes in the balance sheet (assets and liabilities), as well as in its Equity (results and dividends), as well as changes in macroeconomic variables (market) and regulatory (BCB).

Will be established on an annual basis:

I - goals and projections of capital;

II - major sources of capital of the institution, and

III - capital contingency plan.

In preparing the capital plan should be considered as a minimum:

I - threats and opportunities related to the economic environment and business (macroeconomic variables);

II - projections of the values of assets and liabilities, and revenues and expenses;

III - goals for growth or market share, and

IV - distribution policy results.

<u>Methodology for preparation of the capital budget</u>

Finance is responsible for the budget with the help of the other areas of the Bank. The budgeting process consists of the preparation of the budget within a perspective of three years and periodic revisions that occur every six months.

The following steps are followed to define the budget:

a) Definition of economic indicators such as interest rates, exchange rates and growth cycles in the markets that the Bank operates;

b) Preparation of plan revenue by business unit in conjunction with local officials in the areas of business;

c) Plan preparation expenses and taxes with the collaboration of the areas of human resources, technology, business services, operations and risk;

d) Compilation and analysis of the information captured to ascertain and determine the amount of capital compared to the expected results. This step is also defined capital allocation between the business areas;

The budget information is presented to the Corporate Management Committee ("Manco") for approval;

After approval, the budget is drawn up in the global system of the Entity called TM1.

This system enables reporting of performance analysis of revenues, expenses and capital consumption and confront them with the budget. These analyzes are also used in periodic reviews of the budget.