



SCOTIABANK (IRELAND) LIMITED

Basel II - Pillar 3 Disclosures

1. Background

Scotiabank (Ireland) Limited (SIL) is subject to revised capital adequacy requirements based on the “International Convergence of Capital Measurement and Capital Standards: A Revised Framework”, commonly known as Basel II as implemented through the Capital Requirements Directive (CRD). The new Framework is designed to reflect more risk-sensitive capital requirements and to strengthen soundness and stability of banks by promoting adoption of stronger risk management practices.

The Basel II Framework introduces the concept of 3 Pillars:

- Pillar 1 – the actual methodologies that must be applied to calculate the minimum capital requirements.
- Pillar 2 – the requirement that banks have internal processes to assess their capital adequacy in relation to their strategies, risk appetite and actual risk profile. Regulators are expected to review these internal capital adequacy assessments.
- Pillar 3 – reflects the market disclosures required by banks to assist users of the information to better understand the risk profile.

This Appendix reflects the Pillar 3 market disclosures based on information gathered as part of the Pillar 1 process, and should assist users in understanding the changes to the risk weighted assets and capital requirements arising from the new Framework.

Basel II vs. Basel I:

Basel II classifies risk into three broad categories: credit risk, market risk and operational risk, while Basel I had only two categories: credit risk and market risk. SIL utilizes the Standardised Approach in relation to credit and market risks and the Basic Indicator Approach in relation to operational risk.

These Pillar 3 disclosures will be made on an annual basis. As this is the first report prepared in accordance with Pillar 3, no comparative information has been disclosed. All amounts are expressed in millions of Euros, unless otherwise specified.

The Pillar 3 disclosures have been subject to internal SIL and Scotiabank Group review procedures consistent with other regulatory reporting requirements.

2. Scope and Basis of Consolidation

The disclosures in this document are made in respect of the group of companies consolidated under Scotiabank (Ireland) Limited (SIL). SIL, which holds a banking licence, is incorporated in Ireland and is a wholly owned subsidiary of The Bank of Nova Scotia International Limited (“BNSI”), Nassau, Bahamas which is in turn wholly owned by The Bank of Nova Scotia, Toronto, Canada (“BNS”). All of SIL’s subsidiaries are fully consolidated and there is no difference between the basis of consolidation for accounting and prudential purposes. SIL’s subsidiaries are unlimited liability nominee companies incorporated in Ireland with their registered office at IFSC House, Custom House Quay, Dublin 1. There is no material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities among the parent undertaking and its subsidiaries.

3. Risk Management Framework

3.1 Business Objective

SIL's prime business objective is the proactive management of a fixed income Securities Portfolio as well as Money Market, Trading, Foreign Exchange and Capital Market activities, all of which include the use of derivative instruments. The aforementioned are complemented by SIL's corporate lending operation and investing in floating rate securities. SIL's financial objective is to generate a stable source of income while minimizing risk. SIL engages in risk-taking activities that are, in the main, predictable and consistent with its objectives and risk tolerance, ensuring an appropriate balance between risk and reward in order to maximize shareholder returns.

3.2 Risk philosophy and appetite

SIL recognises that sound internal risk management is essential to its prudent operation, particularly with the growing complexity, diversity and volume of business. The risks of all existing businesses are assessed on an ongoing basis with reference to the policies and metrics set out by the Board. Investments in new products, and participation in new markets is conducted only after a complete evaluation of the activity to determine whether it is within SIL's overall risk tolerance and specific business mission and appropriate controls and limits on the activity are established in accordance with established procedures.

SIL's Board articulates its appetite for risk through the approved Profit Plan, individual approved Policies, the risk limits it sets and the decisions it makes on major transactions. SIL's appetite for risk is low. There is a strong ethos of capital preservation.

3.3 Governance and Risk management

Senior Management is responsible for implementing the Board's risk strategy in day to day operations. SIL's Risk Committee comprising Senior Management Officers, Head of Risk and Front Office Management meets weekly to review and discuss risk measures, levels of risk and consistency with Board and Senior Management strategy. At the weekly meetings of the Asset & Liability Committee (ALCO) an assessment is made of principal risks such as interest rate and liquidity risk. The Risk Management & Compliance group is responsible for independent oversight of all risk activities. The Head, who has a dual reporting relationship to SIL's Audit Committee and SIL's Senior Management, is also a member of the ALCO. Product and risk limits are monitored daily by Operations and are subject to Risk Management and Senior Management review.

SIL has an independent Internal Audit function which has a dual reporting function to SIL's Board Audit Committee and to the Audit Department of SIL's ultimate parent, BNS. In addition to the review function performed by the local Internal Audit function, the BNS Group Audit team carries out an annual review focussing on internal controls for management of risk and also encompassing a bi-annual review of SIL's Internal Capital Adequacy Assessment Programme (ICAAP). SIL executes Technical Service Agreements (TSAs) with its parent under which it outsources responsibility for areas such as IT support and certain back office functions, in order to avail of expertise or "centres of excellence" at group level. Under these TSAs SIL also avails of technical advice from specialist BNS departments such as Global Risk Management. In return SIL pays fees at arms length rates.

SIL has the facility to utilise products such as interest rate swaps, credit default swaps and total return swaps to hedge or eliminate market or credit risk.

4. Risk Management – Individual Risk Categories

Pillar 2 of Basel II sets out the requirement that banks have internal processes to assess their capital adequacy in relation to their strategies, risk appetite and actual risk profile. SIL's Internal Capital Adequacy Policy (ICAAP) document sets out the processes by which SIL's Board and Senior Management assess the adequacy of SIL's capital for the existing and future planned business activities. The ICAAP process involves the identification of the main risks faced by the company, those specifically identified in Pillar 1 and any other significant risks, and assesses the impact these risks have on the internal capital requirement. This section provides details of the risks identified, the measurement, monitoring and mitigation of the risks and the capital implication.

4.1 Credit Risk

Credit Risk is defined as the current or prospective risk to earnings and capital arising from an obligor's failure to meet the terms of any contract with the institution or its failure to perform as agreed.

SIL Front Office staff are charged with responsibility for assessing and controlling credit risk through the due diligence process. They are required to fully understand the risks inherent in any product, industry and country in which they deal. They must also maintain up-to-date information on the counterparties with whom they deal and keep the Credit Committee informed.

SIL's Credit Committee comprises the Chief Executive Officer, Managing Director & Deputy Head, Managing Director & Chief Financial Officer and the Managing Director Treasury Credit. The Committee considers the credit risk across all products and business lines on a weekly basis including analysis of positions based on highlighted price movements, rating changes, and market information as well as any advice & counsel received from BNS Global Risk Management. In addition to the processes described in the paragraphs above, the Committee reviews all new credit exposures for suitability and reputational risk.

Credit Risk at SIL is primarily controlled by means of counterparty limits. Senior Credit Officers, in conjunction with Front Office propose a limit level to the Credit Committee. If Credit Committee approves, advice and counsel is then sought from BNS Global Risk Management. This process ensures that the BNS Group in aggregate controls its exposure to a given name. Limits are then proposed to SIL's Board. All counterparty limits are subject to an annual review whereby all are assessed as to continued appropriateness and revised if necessary. In addition SIL has established industry and country limits. SIL's overall approach to Credit Risk is articulated in its Credit Risk Policy. This and the Impairment Review Policy is reviewed annually by the BNS Risk Policy & Compliance (RP&C) department, incorporating the input of Senior Management, and approved by the Board.

Counterparty exposure is measured per transaction type and independently monitored by the Back Office against the appropriate limit. Exception exposure reports are generated daily and are reviewed by Back Office, Risk Management and Senior Management officers in the Credit area. Back Office and Risk Management staff investigate any apparent breaches and report their occurrence immediately to the CEO and for information purposes to BNS Global Risk Management. Any breaches are also reported to the Credit Committee members daily and to the Audit Committee of the Board at the next meeting.

SIL manages Credit Risk by dealing almost exclusively with high quality counterparties and diversifies its exposure across counterparties and industries. Standard market agreements including netting are used when ever possible. These are supported with Credit Support Annexes where appropriate. Security is taken as and when it is deemed appropriate. SIL also has the ability to hedge credit risk through the use of Credit Default Swaps.

On a quarterly basis the Board and Audit Committee review reports provided that reflect SIL's overall credit risk profile by product, credit risk rating, industry, and country as well as the results of the credit and concentration stress tests. A commentary is provided whereby exposures of concern would be

highlighted and reviewed. All Credit Risk exposures are presented to the Board at least annually, for their review and confirmation in addition to as and when they occur.

Notwithstanding the high quality of SIL's credit portfolio SIL has a credit and an industry concentration stress testing programme in place for estimating potential capital and general allowance requirements for the corporate loan portfolio under various stress scenarios. The programme is based on stress tests developed by BNS and adopted by SIL following a review by Risk Management and approval by the Credit Committee. The industry concentration stress tests are developed and applied to the industries to which the portfolio is most exposed. The stress test results are provided to SIL's Board at each meeting.

SIL undertakes periodic stress testing of its Corporate Lending and Investment Portfolios using a global credit shock scenario. Given that SIL's policy is to extend credit to high quality counterparties only the results of this stress test show a minimum impact on capital.

SIL also has considered a scenario whereby its Bank and Corporate positions suffers a one notch decline in rating across the board which, because of the high quality of the assets had no impact as to weighting for a significant portion of the book.

Concentration Risk

As part of credit risk, concentration risk includes (i) large connected individual exposures and (ii) significant exposures to groups of counterparts whose likelihood of default is driven by common underlying factors.

SIL has a range of limits in place to restrict over-concentration in any given name, industry or geographic area. For the Banking Book SIL's concentration limits are quite conservative, given that the assets are generally in highly rated entities where probability of default is low.

In circumstances where SIL's exposure to the BNS group exceeds guidelines SIL provides the appropriate level of additional regulatory capital.

Settlement Risk

Settlement Risk is the risk that the credit institution will deliver the sold asset or cash to the counterparty and will not receive the purchased asset or cash as expected. As such settlement risk comprises credit risk and liquidity risk.

SIL deals with high quality counterparties, has settlement limits in place and has no experience of settlement default issues. On the basis of the significant Capital held for both Credit and Operational risk it is not considered appropriate to add further Internal Capital for this risk.

4.2 Market Risk (Trading Book)

SIL utilizes VaR to measure market risk. A VaR limit of CAD\$500,000 applies. Trading Book stop loss limits are in place for outright positions.

SIL believes that the regulatory capital amount under the Standardised Approach more than adequately meets SIL's Internal Capital requirement for Market Risk.

4.3 Operational Risk

SIL's Risk Management has identified key indicators to measure and monitor SIL's operational risk. On a monthly basis, these items are reviewed and consolidated. On a quarterly basis, the key indicators are expanded to include quarter over quarter comparisons with the report being provided to the Audit Committee at each quarterly meeting.

SIL Risk Management prepares a monthly report for review by Senior Management which shows the incidence of the events above which have been deemed to be indicators of Operational Risk. Every effort is made to keep all of these items to a minimum.

While certain elements such as external events are outside of SIL's control, management endeavours to mitigate as far as possible the operational risks that exist through control processes and back ups. While human error or uncontrollable events may result in some items, a pattern or escalation in occurrence may indicate a control or process weakness. Should such an occasion arise Senior Management would take urgent remedial action.

A range of controls exist for example over payments to reduce the risk of material loss through fraud or error. In general the application of strict segregation of duties and Risk Management, Audit and Senior Management oversight helps to mitigate such risks.

IT

On a day to day basis SIL has extensive controls over its IT systems to ensure the reliability and integrity of the information generated by them. All permissions are granted on a "least privilege" basis. These are subject to SIL and BNS Group Audit review. All systems access is controlled by user passwords which must be changed regularly. Strict change control policies are in place over amendments to live systems and changes are tested in User Acceptance Testing (UAT) environments prior to being promoted. All systems data is backed up to tapes each night either at SIL's office or at BNS and stored off-site. SIL has a Disaster Backup & Recovery site as well as having recourse to the BNS Group facilities. The disaster backup protocol is tested twice a year.

The operational risk capital charge under Basel II has been calculated based on Gross Operating Income for the years ending 31 October 2006 to 2008. SIL has elected to use the Basic Indicator approach and, in keeping with the CRD, a flat 15% has been applied to the operating income resulting in a capital requirement of €16mm.

Given that SIL is using the Basic Indicator approach it is concluded that it is unnecessary to set any additional Internal Capital against this risk.

4.4 Market Risk in the Banking Book – Interest Rate Risk

A primary aspect of SIL's business activities is the taking of Interest Rate Risk in its Banking Book. The greater risk is assumed where SIL is exposed to outright fixed positions, rather than floating rate based positions which reset to market frequently. All aspects of this risk are closely monitored and controlled. By setting limits and approving the annual Profit Plan and Structural Interest Risk policy the Board articulates its appetite for this risk.

Interest rate risk is controlled by specific Gap (asset/liability mismatch ladder) limits which are set by maturity bucket, by currency and in aggregate as well as by Economic Value and Income stress limits. Advice and counsel is sought from BNS Global Risk Management on the appropriateness of the limits and they are presented for Board approval. SIL's systems enable Front Office to review gap positions by portfolio. In addition Operations utilises a complementary interfaced system to calculate and report all exposures against Gap limits. Reports are circulated daily to Front Office and Risk Management for review and sign-off and SIL's Senior Management and ALCO are advised of all breaches on a summary basis. Any reported breach is investigated by Risk Management and reported to the CEO, SIL's Board and advised for information to BNS Global Risk Management.

Interest Rate strategy is discussed weekly at the ALCO meeting with decisions minuted. There is continuous contact between the CEO and the Front Office on developments in the market. SIL actively utilizes derivatives to hedge its interest rate exposure when deemed necessary. The primary derivative instruments used for this purpose are swaps and futures.

SIL Risk Management executes daily stress tests on the Banking Book interest rate portfolios. A shock 1% move in rates is applied to the portfolios and the impact on Economic Value and Income assessed. Board approved limits are set controlling the maximum exposure allowed under these stressed conditions. Additional stress tests are also conducted. Senior Management and Front Office management review results of all stress tests daily. At SIL's request BNS Global Risk Management calculates the Value at Risk (VaR) for its securities positions. These VaR results are reviewed by Senior Management and are reported to SIL's Board quarterly.

Management's assessment is that a multiple of twice the VaR figure is the most appropriate proxy for assessing the requirements for additional capital.

4.5 Liquidity Risk

SIL has a detailed Board approved policy outlining how it manages its liquidity and funding positions on a day to day basis. This policy also outlines the steps SIL would take in a liquidity crisis and the responsibilities of key Senior Management officers should such events occur.

SIL has Board approved limits, by currency on the maximum mismatch permitted between inflows and outflows and the minimum level of Core Liquid Assets. The limits are set for Euro and USD which includes dollar equivalent of all other currencies. Euro and USD are the major currencies in which SIL operates.

On a daily basis SIL monitors the FR Liquidity Ratios and Risk Management monitors the internal liability cashflow gap and minimum core liquid assets limits. Front Office and Senior Management review these exposures and ratios. Internal thresholds have been established also for the regulatory limit requirements. A range of liquidity measures are reviewed at the weekly ALCO Committee meeting.

SIL Senior Management and the MD Treasury & Capital Markets manage SIL's liquidity situation very closely. BNS has provided a letter of comfort to the Financial Regulator. SIL's large pool of quality bonds enables it to raise substantial amounts of funds through the wholesale banking repo markets and the European Central Bank (ECB).

Risk Management conduct regular stress testing of the cashflow positions and available liquid assets. These stress tests include a global systemic crisis and a BNS specific situation and all stress test assumptions are reviewed and updated at least annually. The results of these tests are provided quarterly to the Audit Committee of the Board.

Liquidity is discussed at both the Audit Committee and the Board Meeting. Results of the Stress Tests and the Liquidity Status Report are presented and reviewed. Since SIL's Chairman is also BNS Group Treasurer, the interaction between SIL and its parent in respect of funding can be fully explored. SIL's CEO maintains regular contact with SIL's Chairman with regard to liquidity.

On a weekly basis, SIL's Senior Management and Front Office discuss with BNS Global Funding units and BNS Group Treasury the overall and unit specific funding requirements. In order to satisfy both the regulatory and its own safeguard requirements SIL maintains a large pool of liquid assets in excess of regulatory requirements. Relationships with external counterparties are managed and refreshed to ensure facilities remain in place. SIL has recourse to BNS in the case of a crisis as well as access to the ECB liquidity facilities. The company's Stress Testing indicates that its liquid assets are sufficient to weather a liquidity shock. It is management's view that there is an alternate framework in place to provide the necessary safeguards as to liquidity and that duplication through allocating additional Internal Capital is not appropriate.

4.6 Legal & Compliance Risk

SIL's Board has approved a Compliance policy. One of the core principles of BNS and its subsidiary operations is to "follow the law wherever you do business and to act with honesty and integrity." This "tone from the top" influences the attitude of employees and reinforces the standard of behaviour and ethics expected. SIL has put in place processes and procedures that are documented in the policy to explain to all employees, officers and directors their individual responsibilities. Where incidences of non-compliance, problems or perceived deficiencies have been identified, the recipient of the information has a responsibility to take prompt remedial action and resolve the matter, or if outside their authority to further escalate the matter appropriately. Management has a responsibility to ensure that all staff have knowledge of applicable laws and regulations sufficient for them to carry out their duties properly. To this end attendance at training courses and industry association meetings and focus groups is encouraged. Staff has also been supported to complete the Diploma in Compliance, the industry standard qualification.

SIL utilises industry standard documentation where possible which is subject to advice and counsel from the BNS Documentation Group, a part of the BNS Legal Group. This group also provides advice and counsel and assistance in drafting documentation for OTC and/or structured transactions.

SIL Management ensures that appropriate legal advice is taken on any issues that may be unclear from a legal perspective, particularly if transactions are with parties outside of this jurisdiction. Care is taken to ensure that transactions are properly confirmed with counterparties and that transaction matching processes are in place. These processes are subject to Internal Audit review.

The Compliance Function undertakes a programme of review, as agreed by the Board, across a range of areas to confirm compliance with laws and regulations and to identify any deficiencies so that they can be brought to Senior Management's attention and remedial action can be taken.

4.7 Reputational Risk

SIL's Board has adopted the BNS Group Reputational Risk and the Scotia Capital Suitability Policies. It is incumbent on Senior Management to ensure that SIL's reputation is maintained in the local market whether it is with clients or the Financial Regulator.

By the nature of its business, SIL has a minimal Reputational Risk profile given its activities are predominantly vanilla in nature and it does not have any retail/consumer clients. For new credit exposures, SIL, with advice & counsel from BNS, determines the nature of the client and the level of due diligence required to determine whether the product offered is suitable for the client.

All new complex or structured deals are referred to the BNS Reputational Risk Committee for advice and counsel prior to execution. Reputational risks are also mitigated by the use of standardised industry documentation and by seeking the appropriate external legal or other professional advice in relation to complex or structured deals. Additionally, each staff member and Director is required to review and acknowledge the Scotiabank Guidelines for Business Conduct which outlines the manner in which business must be conducted both ethically and within the law on an annual basis.

SIL believes that no specific Internal Capital charge is required and that the Operational Risk charge encompasses potential reputational issues.

5. Components of Capital Base

5.1 SIL's own funds consist of

Tier 1 Capital

- Audited Retained Earnings
- Ordinary Shares:- 39,999,864 ordinary shares of US\$1 each allotted and fully paid
- Preference shares:- 40,000,000 perpetual non-cumulative preference shares of US\$1 each allotted and fully paid. The perpetual non-cumulative preference shares are redeemable at par, at the option of the Company but subject to the consent of the Financial Regulator, at any time after 7 July 2015.
- Capital contribution reserve
- Deduction for Intangible Fixed Assets

Tier 2 Capital

- Subordinated Loan Note:- Subordinated loan note 2015 (non interest bearing) – due to group undertakings. The subordinated loan note is convertible at the discretion of the note holder into fully paid perpetual non-cumulative preference shares of the Company at a rate of one such share for every US\$1 of principal sum. It is subordinated in right of payment to the claims of depositors and other creditors including holders of other loan notes, ordinary capital and preference capital.
- Loan Note:- Perpetual loan note (non interest bearing) – due to group undertakings. The perpetual loan note is convertible at the discretion of the note holder into fully paid perpetual non-cumulative preference shares of the Company at a rate of one such share for every US\$1 of principal sum.

Tier 3 Capital

- Trading Book P&L

5.2 Components of Capital Base

| 31 December 2008 | | €mm's |
|--------------------------------------|--|--------------|
| Tier 1 | | |
| Ordinary Share Capital | | 29 |
| Non-cumulative preference shares | | 29 |
| Capital contribution reserve | | 576 |
| Audited Retained earnings | | 742 |
| Deductions | | |
| Intangible Fixed Assets - Software | | (1) |
| | | 1,375 |
| Tier 2 | | |
| Subordinate Loan Note | | 36 |
| Prep Loan Note | | 36 |
| | | 72 |
| Tier 3 | | |
| Trading book profit | | 3 |
| | | 3 |
| Total regulatory capital base | | 1,450 |

SIL's minimum capital requirement in accordance with Article 75 points (b) and (c) is €6mm.

5.3. Capital Requirement by Risk type

| 31 December 2008 | | €mm's |
|----------------------------------|--|------------|
| Credit Risk | | 240 |
| Market Risk (incl FX) | | 7 |
| Operational Risk | | 16 |
| Total Capital Requirement | | 263 |

6. Counterparty Credit Risk

6.1 Credit Risk Standardised Approach

Using the Standardised approach, set out below are SIL's exposures on a risk weighted basis.

| 31 December 2008 | €mm's | €mm's |
|---|----------------------|---------------------|
| | Risk Weighted Amount | Capital Requirement |
| Central governments or central banks | - | - |
| Regional governments or local authorities | 13 | 1 |
| Administrative bodies and non-commercial undertakings | - | - |
| Multilateral Development Banks | - | - |
| International Organisations | - | - |
| Institutions | 1,168 | 93 |
| Corporates | 1,307 | 105 |
| Retail | - | - |
| Secured on real estate property | - | - |
| Past due items | - | - |
| Items belonging to regulatory high-risk categories | - | - |
| Covered bonds | 25 | 2 |
| Securitisation positions (investor) | 160 | 13 |
| Short-term claims on institutions and corporate | - | - |
| Collective investments undertakings (CIU) | 58 | 5 |
| Other items | 152 | 21 |
| | 2,883 | 240 |

6.2 Counterparty Credit Risks

In its trading book SIL is exposed to counterparty credit risk through its credit derivative and borrowing & lending activities. Counterparty Credit Exposure (CCE) consists partly of current replacement cost (or mark-to-market) of the contracts and partly of potential future exposure. The potential future exposure component is an estimate representing possible changes in market values during the remaining life of the specific contract.

Prior to engaging in these types of contracts SIL ensures that appropriate documentation such as netting agreements or International Swaps and Derivatives Association ("ISDA") agreements are in place.

6.3 The exposures below have been arrived at using the "mark-to-market" method as set out in Parts 3 to 6 of Annex III to the CRD.

Derivatives

| 31 December 2008 | €mm's | €mm's | €mm's |
|--|--------------|-----------|--------------|
| | BNS | Other | Total |
| Positive replacement cost | 1,628 | 48 | 1,676 |
| Result of netting including Future Credit Exposure | 290 | 32 | 322 |
| | 1,918 | 80 | 1,998 |

6.4 Policies for securing collateral

SIL routinely obtains collateral and security to mitigate credit risk and ensures that any collateral held is sufficiently liquid, legally effective, enforceable and regularly reassessed. When deemed appropriate the ISDA documentation referred to above is supplemented with a Credit Support Annex to effect the reduction of net exposure on an agreed basis, and in keeping with market practice, by way of transferring a margin account, usually cash.

7. Credit Risk Analysis & Impairments and Provisions

7.1 Corporate Loan Portfolio

For accounting purposes “past due” and “impaired” are defined as follows:

An account is classified as past due when payment is not made as of the scheduled payment date. An account is classified as impaired when the account no longer evidences a reasonable assurance of timely collection of the full amount of principal and interest. As at 31 December 2008 no loans or advances were past due or impaired.

7.2 Allowances and provisions

SIL makes provision or allowance for credit losses on both a specific and an overall portfolio latent loss basis. Specific provisions are recommended by the Credit Committee and discussed at SIL’s Board.

The General Allowance for credit losses is established against the credit risk in the loan portfolio in respect of SIL’s business groupings where prudent assessment of past experience and existing economic and portfolio conditions indicate that it is probable that losses have occurred, but where such losses cannot be determined on an item-by-item basis.

For Corporate loans the General Allowance is underpinned by a risk rating process in which Internal Grading (IG) risk ratings are assigned at the time of loan origination, monitored on an on-going basis, and adjusted to reflect changes in underlying risk. The methodology is based on both Quantitative and Qualitative assessment.

The Quantitative Allowance is determined through the use of the BNS Group model. The model includes Risk Management’s predetermined computations for Probability of Default, Loss Given Default and Usage Given Default. SIL may recommend qualitative adjustments to the allowance to reflect inherent losses, which are probable as of the evaluation date even though they may not have been identified by the processes used for the quantitative portion of the allowance.

In considering qualitative-adjustments broad categories of adjustments that are considered, include:

1. Industry and country specific factors to reflect the lag between events and their impact on risk ratings;
2. Macroeconomic factors and business conditions e.g., interest rates, exchange rates, commodity prices, energy costs, unemployment, inflation as well as political and regulatory events.

7.3 Available for Sale Investments

SIL reviews Available-for-Sale (AFS) securities for other than temporary impairments on a quarterly basis under Canadian GAAP and annually under Irish GAAP. SIL classifies all investment securities under Canadian and Irish GAAP as available-for-sale, excluding those securities with embedded derivatives, which are considered either trading securities or fair value through profit and loss account.

Impairment of AFS securities occurs if the market/fair value is below carrying cost. Declines in fair values are generally presumed to be ‘other than temporary’ if conditions indicating impairment have persisted for a prolonged period of time or where management determine that there is no chance of full recovery. Assets that are considered to be impaired on an other than temporary basis are written down to fair value through the profit & loss Account. The standard for ‘temporary’ is based on expectations that recovery will be to book value within a reasonable period of time and not simply recovery above current market value.

The impairment review process is conducted once a quarter with impairment adjustments being recorded at the end of each quarter.

7.4 Geographic and Sectoral distribution of exposures

This table sets out SIL's exposures based on the geographical jurisdiction of the exposures' domicile and its sectoral classification.

| 31 December 2008 | €mm's | €mm's | €mm's | €mm's | €mm's |
|--|--------------|--------------|---------------|------------|--------------|
| | Canada | Europe | United States | Other | Total |
| Central governments or central banks | - | 1,138 | 86 | - | 1,224 |
| Regional governments or local authorities | 51 | 15 | - | - | 66 |
| Administrative bodies and non-commercial undertakings | - | - | - | - | - |
| Multilateral Development Banks | - | - | - | 32 | 32 |
| International Organisations | - | - | - | - | - |
| Institutions | 2,224 | 1,709 | 253 | 155 | 4,341 |
| Corporates | - | 998 | 151 | 346 | 1,495 |
| Retail | - | - | - | - | - |
| Secured on real estate property | - | - | - | - | - |
| Past due items | - | - | - | - | - |
| Items belonging to regulatory high-risk categories | - | - | - | - | - |
| Covered bonds | 40 | 86 | - | - | 126 |
| Securitisation positions | 9 | 35 | 416 | 9 | 469 |
| Short-term claims on institutions and corporate | - | - | - | - | - |
| Collective investments undertakings (CIU) | - | 27 | - | 22 | 49 |
| Other items | 143 | 9 | - | 0 | 152 |
| Total Exposures | 2,467 | 4,017 | 906 | 564 | 7,954 |

7.5 Maturity breakdown of Credit Risk exposures

| 31 December 2008 | €mm's | €mm's | €mm's | €mm's |
|---|--------------|--------------|--------------------|--------------|
| | Up to 1 Yr | 1 to 5 Yrs | Greater than 5 Yrs | Total |
| Central governments or central banks | 276 | 201 | 747 | 1,224 |
| Regional governments or local authorities | - | 66 | - | 66 |
| Administrative bodies and non-commercial undertakings | - | - | - | - |
| Multilateral Development Banks | - | - | 32 | 32 |
| International Organisations | - | - | - | - |
| Institutions | 1,191 | 2,961 | 189 | 4,341 |
| Corporates | 128 | 878 | 489 | 1,495 |
| Retail | - | - | - | - |
| Secured on real estate property | - | - | - | - |
| Past due items | - | - | - | - |
| Items belonging to regulatory high-risk categories | - | - | - | - |
| Covered bonds | - | 107 | 19 | 126 |
| Securitisation positions | 33 | - | 436 | 469 |
| Short-term claims on institutions and corporate | - | - | - | - |
| Collective investments undertakings (CIU) | - | 39 | 10 | 49 |
| Other items | 152 | - | - | 152 |
| Total Exposures | 1,780 | 4,252 | 1,922 | 7,954 |

7.6 Impaired Exposures & Provisions

| 31 December 2008 | €mm's | €mm's | €mm's | €mm's | €mm's |
|---------------------------------------|--------|--------|---------------|-------|-------|
| | Canada | Europe | United States | Other | Total |
| Exposure | - | 20 | - | 4 | 24 |
| Impaired Amount | - | 13 | - | 4 | 17 |
| Exposure Net of Impairment | - | 7 | - | - | 7 |
| Portfolio Impairment Provision | | | | | |
| Opening Balance | | | | | 1 |
| Charge during the year | | | | | - |
| Closing Provision | | | | | 1 |

8. Use of External Credit Ratings

8.1 SIL applies credit ratings to its exposures using ratings attributed by Standard and Poors or Moodys, whichever is the lower. These External Credit Assessment Institutions (ECAIs) are used for all exposures and SIL does not use internal credit ratings for Regulatory Capital purposes.

8.2 For regulatory reporting Credit risk is transferred by means of qualifying guarantees. In order to qualify for recognition as a guarantee in the regulatory returns a guarantor must meet the criteria set out in Annex VIII Part 1 Para 26. Also, the guarantee itself should meet the criteria set out in Annex VIII Part 2 sections 2.1 and 2.3. Internal controls verify this process.

9. Securitisation Activity

SIL is an investor only in securitised assets seeking to diversify its credit risk and earn enhanced yields. Risk weighted exposures are calculated based on credit ratings and are as follows:

Holdings are accounted for either as “Available for Sale” (AFS) assets or, in the case where there are embedded derivatives within the structures, as “Fair Value through Profit or Loss” where the mark to market on them is taken directly to the Profit & Loss account. In each case any gains or losses arising on a sale would also be taken to the Profit & Loss account.

Credit Risk on these structures is assessed using the ratings provided by Standard & Poors and Moodys.

SIL uses the Standardised Approach to calculate the risk-weighted exposure amount for securitisations. Weightings are allocated to tranches based on the external ratings applied by the above ECAIs. Where there is no ECAI rating SIL treats the tranche as unrated and applies a risk factor of 1,250%.

Securitisation as Investor

| 31 December 2008 | €mm's | €mm's | €mm's |
|---------------------------------|-----------------|-------------------|--------------------------|
| | <i>Exposure</i> | <i>Impairment</i> | <i>Recognised losses</i> |
| Synthetic transactions | 53 | - | (23) |
| Traditional transactions | 415 | - | - |
| | 469 | - | (23) |

Securitisation positions - total exposures

| 31 December 2008 | €mm's | €mm's | €mm's |
|-------------------------|-----------------|------------------|-------------------------------|
| Risk weight band | <i>Retained</i> | <i>Purchased</i> | <i>Risk Weighted Exposure</i> |
| 7 - 10% | - | - | |
| 11 - 19% | - | - | |
| 20 - 49% | - | 451 | 90 |
| 50 - 75% | - | - | |
| 76 - 99% | - | - | |
| 100% | - | 7 | 7 |
| 250% | - | - | |
| 350% | - | 9 | 32 |
| 425% | - | - | |
| 650% | - | - | |
| 1250% or Deducted | - | 2 | 31 |
| Total | - | 469 | 160 |