Banca Sistema Group

THIRD PILLAR
PUBLIC DISCLOSURE

31 December 2013

BANCA
SISTEMA

CONTENTS

INTRODUCTION

This document complies with the provisions of Prudential Supervision which states that the following must be disclosed to the public (known as the Third Pillar):

- capital adequacy;
- exposure to risks;
- and the general characteristics of the systems established to identify, measure and manage these risks.

The information that must be published is quantitative and qualitative and classified in synopses ("tables"), with each referring to a certain disclosure area.

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In this document, the information requested by the following tables: 7 "Credit risk: disclosure on the portfolios for which the IRB approaches apply"; 10 "Securitisation transactions"; 11 "Market risk: information for banks that use the internal model method for position risk, exchange rate risk and market position risk (IMA)", is not provided since it do not relate to the range of operations, the risks taken or the methods used.

Banca Sistema publishes this disclosure for the public and any updates on its internet site www.bancasistema.it, in the Pillar 3 section.

TABLE 1 - GENERAL DISCLOSURE REQUIREMENT

QUALITATIVE DISCLOSURE

Organisational structure

Banca Sistema has set up a risk management system that reflects the characteristics, size and complexity of the operations in order to manage the significant risks to which it is or could be exposed.

The framework to protect against risks provides for three separate levels of control:

- **first level controls**: the first level (or line) controls comprise a control system put in place by the operational departments that are the source of the risks;
- **second level controls**: the second level controls are the controls carried out by the Risk and Compliance Divisions;
- **third level controls:** the third level controls are the controls carried out by the Internal auditing Department, and relate to the risk management procedures.

A summary of the main roles and responsibilities of the company bodies/departments involved in the management and control of risks, as defined in the "General Company Rules" approved by the Board of Directors of Banca Sistema S.p.A. in its meeting of 9 March 2012 is provided below.

The **Board of Directors** will do the following in its capacity as the **Body in charge of strategic supervision** in order to ensure an efficient and effective risk management and control system: identify the goals, strategies, profile and risk levels of the Bank, establishing the company policies and those of the risk management system in accordance with the development of the company business activities.

In addition, the body with strategic supervision powers will check that the information system regarding risk management and control is adequate, complete and timely.

In order to assess the adequacy, efficiency and effectiveness of the system used to manage the risks to which the bank is exposed, the Board of Directors established the **Internal Control Committee,** which will:

- define the guidelines relating to the Internal Control system and assess their adequacy at least once a year, ensuring that all the risks to which the Bank is exposed are adequately identified, measured, managed and monitored;
- define the criteria to ensure the sound and prudent management of the bank, supervising the work of the legal, compliance and company affairs divisions.

The **body with management powers** is in charge of the establishment and maintenance of an efficient risk management and control system, in accordance with the strategic policies.

In accordance with what has been established by law and the internal power and authorisation system, the **CEO**, in implementation of the General Rules and within the scope of the various authorisations, will approve specific guidelines, in line with the strategic policies, aimed at ensuring an efficient risk management system; he will also supervise the risk management and control system, continuously checking the overall efficiency and effectiveness, in compliance with the business model, and the level of exposure defined by the Board of Directors; he will manage the problematic issues and critical issues relating to the organisational aspects, making any adjustments if anomalies are found or changes are made to the applicable context or following the introduction of significant new products, activities or processes.

The **body with control powers** monitors the adequacy of the risk management and control system within the scope of its corporate supervisory duties. The **Board of Statutory Auditors**, assesses the operation and adequacy of the risk management system with the support of the internal control departments.

The **Internal Auditing Department** carries out independent auditing (third level control) on the work carried out by the departments involved in risk management, providing assurance on the risk management activities. The Internal Audit Department, in execution of its responsibilities, will also do the following:

- review the ICAAP on an internal basis, identify the areas for improvement of the process and ensure that any corrective actions necessary are taken;
- propose improvement plans for the internal control and risk management system, ensuring that it is sent for approval to the Board of Directors and the Board of Statutory Auditors.

The mission of the **Risk Division** is to oversee operation of the risk management system, by constantly ensuring that it has sufficient capital adequacy with respect to its business. To that end it will do the following:

- submit the methods, instruments and procedures used within the scope of the risk management and control for approval by the Board of Directors;
- continuously identify risks, with special reference to developments in the context in which the Bank operates, and developments in its business dealings;
- measure and assess the risks on a pre-defined, recorded basis, assessing the ongoing effectiveness of the methods used with respect to any significant developments in the applicable context or business dealings, and if necessary, proposing more suitable corrective measures. More specifically:
  - calculate the internal capital generated by the Second Pillar risks;
  - calculate the total current and prospective internal capital;
  - carry out stress tests.
- help design the mitigation system for the risks that the Bank is exposed to and assess their continued effectiveness and adequacy, proposing any more suitable corrective measures if necessary;
- continuously monitor development of the material risks to which the Bank is exposed in the exercise of its business dealings, and if there are any material changes for the worse in the risk profile, inform, via the Risk Committee, top management and the departments that are at the source of the risk in question;
- prepare specific reports on the risk profile generated by the current business dealings on a regular basis;
- monitor and coordinate the drafting of the Public Disclosure (Pillar III), using the support of the competent operational departments where necessary;
- propose the organisational model on which the ICAAP is based for subsequent approval by the Risk Management Committee and approval by the Board of Directors;
- monitor proper execution of the ICAAP and oversee the drafting of the related report.

In order to ensure the integrity of all the activities carried, the Risk Division will report directly to the CEO, and is therefore completely separate from the operational departments that are the source of the risks to which the Bank is exposed in the exercise of its activities.

The Risk Management Committee, within the capacity of its corporate duties, will do the following:

- support the CEO in defining strategies, risk policies and profitability targets, by proposing interventions and adjustment tactics;
- monitor capital adequacy with regard to the risk/yield objectives, taking into account the various types of risks and the correlations between them;
- continuously supervise compliance with the capital limits per area/type of risk;
- assess and give a technical opinion on the related proposals;
  - grant and renew credit facilities;
  - classify the impaired loans and their related values;
  - financial investments and short-term investments;
  - funding policies and instruments;
  - new products and services;
- monitor compliance of the regulatory provisions in terms of risk management and relative disclosure transparency;
- guarantee the organisational model on which the ICAAP is based and the methods for measuring, assessing and monitoring the different types of risk for subsequent approval by the Board of Directors;
- examine the ICAAP findings for subsequent approval by the Board of Directors.

The Risk Management Committee meets on a monthly basis at least.

Mapping the material risks

On the basis of the analysis carried out, in view of its current and future business dealings, the Bank is exposed to the following risks as at 31 December 2013:

First Pillar Risks

- credit risk
- counterparty risk
- market risk
- operational risk.

Second Pillar Risks

- concentration risk
- liquidity risk
- interest rate risk on the banking book;
- strategic risk
- reputation risk
- compliance risk.

On the other hand, the Bank is not exposed to residual risks, investment risks or securitisation risks.

Risk management and hedging policies

Pillar I

Credit risk is the risk that the counterparty cannot meet its contractual commitments, thereby resulting in unexpected loss for the Group which could put its financial stability at risk in the immediate future. In this case, the risk in question is one of the main components of overall exposure; however, the specific composition of the credit portfolio was designed to significantly reduce the percentage of credit risk over the entire absorption. The counterparties mainly include Public Administration entities such as local Healthcare facilities, hospitals, Municipalities, Regions, Provinces and Ministries that have a very low risk of default by definition.

The operating components of Banca Sistema that give rise to credit risk are described below:

a. factoring activities;
b. financial instruments held in own accounts;
c. supervised intermediaries.

The Bank uses the standardised method provided to calculate the regulatory requirements with respect to credit risk to calculate the internal capital with respect to the credit risk[1].

The internal capital with respect to credit risk is therefore equal to the capital requirements defined in accordance with the First Pillar. The capital requirements are calculated on a constant basis and a report is sent to the Bank of Italy every quarter.

In general, analyses and assessments are carried out for all credit risk exposure, aimed at classifying exposures, where considered necessary, among the problematic credit risk categories.

The paragraphs below provide a brief overview on the management and mitigation of credit risk, as specifically implemented with respect to the different types of business dealings.

a. Factoring: Banca Sistema policy mainly entails acquiring corporate receivables owed by central authorities, territorial entities and in general by the Public Administration, by non-recourse factoring, directly taking on the credit risk with respect to the end debtor. Credit risk is generated as a direct consequence of the acquisition of credit on a definitive basis from customer companies against the insolvency of the assigned debtor.

Maintenance of effective credit risk management is the strategic objective of Banca Sistema, and is pursued by adopting integrated instruments and processes to ensure correct credit management at all stages (preliminary, granting credit, monitoring and management, interventions on non-performing loans).

The credit risk management process involves various central Banca Sistema structures; this organisation of activities allows greater efficiency and standardisation in terms of tackling the credit risk and monitoring the individual positions, using specialised resources and separating the functions at each decision-making level.

(1) Ref: Bank of Italy Circular no. 263 of 27 December 2006 as amended - Title II, Chapter I, First Part.

The Board of Directors is responsible for providing guidance and specific functions to establish strategies and company control policies, with specific reference to the risk component.

The Underwriting office of Banca Sistema is set up to carry out the separate analysis and reliance on the counterparties (assignor, debtor/s) and the management of the related financial relationships. This is carried out at all the typical phases of the loan granting process, summarised as follows:

- “analysis and assessment”: the gathering of quantitative and qualitative information from the counterparties in question and the system in order to assess the reliability of the counterparty and to quantify the proposed lines of credit;
- “decision making and formalisation”: once the proposal has been made, the contractual documentation is prepared to be signed by the assigning counterparty;
- “relationship monitoring”: the continuous control of the counterparties, both in relations with the factor and the system, allows any anomalies to be identified leading to timely interventions; with specific reference to the non-performing receivables, there is first a “non-judicial” stage involving automatic, personalised reminders and if necessary and a “judicial” type stage if necessary, with the assistance of outside lawyers.

The Collection Division constantly and specifically monitors the factoring portfolio. This Division carries out checks and assessments on the factoring portfolio based on the guidelines defined in the “Collection policy”. The Collection Manager coordinates the monitoring and any non-judicial collections with the Collection Division or other external companies that have been engaged.

The Risk Division continuously monitors the credit risk in order to promptly identify any anomalies and/or discontinuities and ensure that a risk profile in line with the strategic indications provided is maintained.

With respect to credit risk mitigation of the factoring portfolio, in order to reduce exposure of the factoring portfolio, and more specifically its exposure with regard to the local health authorities (ASL), Banca Sistema has drawn up specific standard hedging contracts called credit linked notes (CLN), compliant with international ISDA derivative regulations (International Swaps and Derivatives Association).

The issue of these types of instruments allows the Bank to transfer the credit risk of the loans underlying the hedging contract, and therefore improve its capital ratios.

b. Financial instruments held in own accounts: the Bank has a limit system that is structured to guarantee the careful and balanced management of the operating independence within the the scope - among other things - of the transactions relating to financial instruments registered on the banking portfolio and held in own accounts.

The operations with Italian government securities means that it has a credit risk towards EU central authorities.

c. Exposures to supervised intermediaries: the deposits are only made on the interbank market, resulting in exposure to the credit risk of supervised intermediaries.

The so-called "hot money" transactions also generate exposures towards supervised intermediaries, i.e. short-term loans to leading financial institutions.

The Risk Division prepares specific periodic reports regarding credit risk. These reports are prepared at different levels of detail, and for different recipients (Risk Management Committee, the CEO and the Board of Directors).

Banca Sistema also performs stress tests in order to evaluate the impacts in terms of capital adequacy.

The stress test method employed uses a 'what if' type analysis, which evaluates the ability of the Bank to deal with possible worsening of its loan portfolio and the consequent increase of Internal Capital.

Counterparty risk is the risk that the "counterparty to a transaction regarding certain financial instruments will default before settling the transactions"[2]. This is different from credit risk in view of the type of transactions involved; they are normally related to transactions that generate exposure equal to their positive fair value, have a market value that changes over time in accordance with the underlying variables and that generate an exchange of payments, financial instruments or goods against payment. Counterparty risk creates a bilateral type of risk whereby both counterparties are exposed to the risk of incurring unexpected loss.

Banca Sistema has set up extremely prudent repurchase agreements and reverse repurchase agreements since the underlying assets are mainly Italian Government Securities and the counterparty is the Compensation and Guarantee Fund (CCG) or institutional counterparties.

The line by line method is used to measure counterparty risk.

The Risk Division produces specific reports to the Risk Division, the CEO and the Board of Directors on a monthly/quarterly basis.

The risk is reduced by careful management of operating independence, establishing limits both in terms of responsibilities and the extent and composition of the portfolios by type of securities.

Market risk involves the risk of loss that a financial intermediary is exposed to due to carrying out trading operations on financial instruments on the markets. More specifically, it involves the risk of recording losses due to unfavourable market trends that cause unexpected or unforeseeable reductions in the value of the instruments held.

These involve risks generated by operations on the markets regarding the financial instruments and currencies and the important components are:

- position risk: generic risk if caused by unfavourable price trends in the instruments traded, and specific risk due to factors related to the situation of the issuer;
- settlement risk, which includes transactions which have not yet been settled after expiry exposing the Bank to the risk of loss due to the failure to settle the transaction;
- concentration risk, which provides for specific regulatory capital for banks which - due to the risks positions relating to the trading portfolio for regulatory purposes - exceeds the limit identified by the credit line;

(2) Ref: "New Prudential Supervision provisions for Banks" - Bank of Italy Circular no. 263 of 27 December 2006 as amended - Title II, Chapter 3, Section I, Paragraph 1.

- exchange rate risk, which is the risk of suffering loss due to unfavourable changes in the exchange rates in foreign currencies.

The internal capital is calculated in accordance with the standardised method with respect to market risk[3].

This method calculates the requirement on the basis of the building-block approach, according to which the overall requirement is given by the sum of the capital requirements calculated against the individual market risks (position, settlement and concentration risk). This approach is prudential since the benefits provided by diversification are ignored by summing the individual requirements on a linear basis, therefore obtaining higher regulatory capital with respect to the risks taken on.

The Risk Division produces specific reports for the Risk Committee, the CEO and the Board of Directors.

As at 31 December 2013, the Bank did not have significant exposures to market risk.

Operational risk is the risk of suffering loss due to the inadequacy or inefficiency of procedures, human resources or internal systems, or by external events. They include, for example, losses ensuing from fraud, human error, interruptions of operations, the unavailability of systems, breaches of contract, or natural disasters.

Legal risk is also included in operational risk, while strategic risk and reputation risk are not included.

The Bank adopted the BIA method (Basic Indicator Approach) to calculate the capital requirement generated by operational risk.

This method provides that the capital requirements are calculated by applying a regulatory coefficient to an indicator of the volume of company operations identified in the operating income.

The Risk Division produces and sends the Risk Management Committee, the CEO and the Board of Directors a report which shows the capital absorption generated by the operational risk and how they changed since the previous report. The Bank manages the development of operational risk by defining specific policies and rules to deal with various issues and matters. The Bank also enters into specific insurance policies explicitly aimed at covering certain operational risks.

Pillar II

The applicable regulations regarding prudential supervision (circular 263/06 as amended) define **concentration risk** as risk resulting from exposure to counterparties, groups of related counterparties and counterparties in the same economic sector or who perform the same activity or belong to the same geographical area.

The Bank decided to measure the geo-sectorial concentration risk in accordance with the ABI method proposal. The ABI method allows the effects on internal capital to be assessed, caused by changes in the business sector

(3) Ref. "New Prudential Supervision provisions for Banks" - Bank of Italy Circular no. 263 of 27 December 2006 as amended - Title II, Chapter 4, Second Part.

concentration. These effects are calculated with reference to a benchmark, with respect to which any internal capital adjustment (add-on) is quantified by applying a reloading coefficient.

Reports on concentration risk are sent to the CEO, the Risk Management Committee and the Board of Directors.

Interest rate risk is the current or prospective risk of a reduction in the value of the asset or a reduction in the interest margin from the impact of adverse changes to interest rates.

The exposure to interest rate risk on the banking book is calculated in accordance with the provisions of prevailing law using the simplified Supervision approach (See Circular 263/2006, Title III, Attachment C). This is how the Bank can monitor the impact of unexpected changes in market conditions on the value of the shareholders' equity, thereby identifying the mitigation measures to adopt.

The company departments in charge of ensuring the correct management of interest rate risk include the Treasury Department, which is involved in identifying the most suitable risk indicators and monitoring the performance of funding assets and liabilities in relation to the pre-established limits, and top management, which is involved in making annual proposals to the Board of Directors regarding the loan and funding policies and management of interest rate risk, and suggesting, during the year, any necessary measures that should be taken to ensure that the work is carried out in accordance with the approved risk policies.

The CEO, Risk Division and Financial Manager receive a summarised daily report on the overall treasury position.

Hedging instruments were not being used as at 31 December 2013 since the risk was not significant.

Liquidity risk is defined as a risk of default on payment commitments, and may be caused by:

- Funding Liquidity Risk: inability to obtain funds or to meet payment commitments at market cost or incurring high funding costs.
- Market liquidity risk: when there are limits to the sale of assets or capital losses upon sale.

Liquidity risk in the sense of difficulties in obtaining funds to meet payment commitments, can be broken down as follows:

- Mismatch Liquidity Risk: the risk resulting from a mismatch between the amounts and/or the payment dates of the incoming and outgoing cash-flows relating to Bank operations, with reference both to contractual and behavioural expiry dates;
- Contingency Liquidity Risk: the risk resulting from unexpected future events that may require an unexpected amount of cash that is higher than the amount currently considered necessary; it is the risk of not being able to make unexpected and sudden short-term payments.

The methods used by the Risk Division to measure the Liquidity risk follows the liquidity gap approach set out in the Bank of Italy guidelines (Circular no. 263/06, Title III, Attachment D).

The instructions issued by the Basel Committee to ensure adequate monitoring of liquidity risk, entailing the following are also followed:

- formalisation of liquidity risk governance policies in line with operational characteristics and extent;
- assessment of the net financial position;
- periodic stress tests (class 3 sensitivity analyses for Banks) to evaluate the impact of negative events on the exposure to risk and the adequacy of the liquidity reserves;
- constant availability of adequate liquidity reserves;
- definition of the operating limits;
- definition of suitable liquidity risk mitigation instruments, firstly by drafting an adequate Contingency Funding Plan, which guarantees protection of the assets in liquidity drainage situations, through preparation of crisis management strategies and procedures to obtain funding sources in the case of emergencies.

The roles and responsibilities attached to the various company structures within the scope of the Liquidity risk management process have been identified to adequately monitor liquidity risk:

- Treasury Division (first level monitoring) represents the first level of liquidity risk management. It carries out daily monitoring and calculation of risk indicators;
- Risk Division (second level monitoring), carries out second level checks of liquidity risk on a monthly basis, and continuously assesses the adequacy and correct implementation of the liquidity policy and the Contingency Funding Plan.

The liquidity situation is subject to careful and continuous monitoring by the Treasury Division and the Risk Division, also within the scope of the Risk Management Committee meetings.

The Risk Division provides the CEO and the Board of Directors with periodic reports on the liquidity risk.

The Bank has structured its liquidity management on three interconnected levels through its Liquidity Policy and Contingency Funding Plan, which meet specific requirements:

- **Operating liquidity** (short term - up to 12 months), in order to guarantee the Bank's ability to meet its expected and unexpected cash payment commitments, for the upcoming 12 months;
- **Structural liquidity** (medium/long term - over 12 months) in order to maintain an adequate relationship between overall liabilities and medium/long term assets to avoid pressure on current and prospective sources, in the short term;
- **Contingency Funding Plan** (CFP), which governs the process, roles and responsibilities in the event of liquidity crisis situations.

The liquidity management policy and CFP provides for the following basic actions:

- identification of the duties and responsibilities to assign to the company departments involved in the liquidity management process;
- definition of the operating processes related to execution of the activities;

- calculation of the measurement instruments;
- definition of the operating limits, warning indicators and tolerance thresholds.

In order to monitor the Bank's liquidity position, the Risk Division monitors and analyses the indicators provided under Basel III, i.e.:

- the Liquidity Coverage Ratio (LCR) which measures the capacity to ensure an adequate level of unencumbered highly liquid assets in relation to the expected 30-day net cash flows;
- the Net Stable Funding Ratio (NSFR) that measures the capacity to ensure an adequate amount of capital and stable funding in relation to the level of liquidity of the asset over a year;
- the Leverage ratio, which monitors the risk that a particularly high level of debt over the availability of own funds would make the bank vulnerable, making it necessary to adopt corrective measures.

Reputation risk (or risk to image) is the risk of loss that may incur following events that could harm its image before various types of stakeholders (shareholders, customers, counterparties, investors, the Supervisory Authorities). This negative perception may result from the direct experience of the parties, such as sensations, not necessarily caused by actually observable events. This risk is closely related to operational risk in this case. There are three different situations that can be distinguished in accordance with the Bank's level of responsibility when negative events occur that could harm the company's image:

- the Bank is considered to be a passive "victim" of the harmful event and therefore this is attributed to external factors that cannot be controlled or forecast (natural disasters, sabotage, acts of terrorism, unlawful actions by outside parties);
- management is considered to be unintentionally involved and therefore only partially responsible for the failure to prevent the harmful event (technical errors, public accusations which cannot be legally proven);
- management is considered to be fully responsible for the harmful event that occurs and it is therefore understood that not even minimal effort went into preventing the event (breach of prevailing law, human error).

The awareness of the difficulties related to quantifying reputation risk encouraged the Bank to concentrate on finding out more with respect to the quality of the organisational and control structures in order to implement adequate protection to reduce this.

To this end, maximum significance was given to the positions that must ensure substantive compliance with the requirements of honesty and professional competence, especially with regard to:

- the level of awareness of the top bodies with respect to the significance of these matters;
- promotion of a code of ethics and honest behaviour at all company levels;
- adequate management of relations with all stakeholders;
- suitability of the risk mitigation and management systems;
- the effectiveness of the Supervisory Body controls.

Strategic risk is the current or prospective risk of a reduction in earnings or capital, generally due to four well-defined cases:

- changes in the operating context;
- erroneous company decisions;
- inadequate implementation of decisions made;
- poor or erroneous reaction to changes in the operating context (structural breaks).

Strategic risk therefore emerges when there is a break in the normal running of the business activities, due either to internal or external changes to the company's structure, it being otherwise assumed that this type of risk would not exist since it would be assumed that the business should normally run on a stable basis.

Special emphasis is placed on the fact that this risk could be especially critical as currently configured due to the high levels of dynamism required by the decision-making bodies to establish adequate and timely corrections in response to the continuous changes in the macroeconomic/economic context that characterises the market in which the Bank operates.

Some typical situations that could give rise to strategic risk are described below:

- acquisitions/partnership operations;
- changes in the corporate structure;
- consolidation/growth operations in order to achieve greater economies of scale for example;
- diversification of products and distribution channels;
- technological innovation and operational optimisation in order to increase the quality of the services offered.

The assessment of strategic risk, carried out by the Risk Division as part of the Risk Management Committee, aims to identify and explain the individual aspects that could determine the emergence of strategic risk. This has the double function of identifying the operating stages that have critical elements and any mitigation actions to be undertaken. Analysis of the Bank's position on the market is of particular importance, especially with respect to the main competitors. To that end, the specific area of activity of Banca Sistema gives it an advantage since it operates in a market segment that has not yet been well explored.

In addition, special attention has also been given to managing strategic risk in the definition of the new Business Plan, in which the key performance indicators and key risk indicators have been defined which will allow the Bank to monitor actual compliance with the guidelines defined by the strategic supervision body.

Compliance risk is the risk of non compliance with the regulations and involves the risk of incurring legal or administrative sanctions, significant financial loss or damage to reputation due to breach of the law (laws, regulations) or self-regulation rules (for example articles of association, codes of conduct or the corporate governance code).

This risk is common at all levels of company organisation, especially within the scope of the operating guidelines; prevention activities should be concentrated where the risk is generated: therefore all staff must be made properly aware of their responsibilities.

In general, the most significant regulations regarding the risk of non-compliance are those that regard the exercise of intermediation, anti-money laundering regulations, management of conflicts of interest, transparency with respect to customers, and more generally, the rules established to protect the consumer.

Since there is a Department that constantly monitors the risk of non-compliance, and in view of the range of products on offer, we believe that the Bank is not particularly exposed to that risk.

A Compliance Department was set up to ensure that the risk of non compliance was managed on an active, mindful basis. The Department will ensure that internal procedures are consistent with the aim of preventing the breach of external rules (laws and regulations) and internal rules (codes of conduct, codes of ethics) applicable to the Bank.

The Bank adopted an organisational architecture based on an internal network model (“widespread compliance”) whereby the Compliance Officer is in charge of the Department, who:

- governs, addresses and controls the compliance process, and more generally, management of the risk of non compliance within the Bank;
- co-ordinates and checks the assistance given by other Bank Departments involved (authorised) in execution of activities that help manage the risk of non-compliance.

TABLE 2 - RANGE OF APPLICATION

QUALITATIVE DISCLOSURE

The public disclosure obligations referred to in this document apply to the Banca Sistema S.p.A. Group.

On 31 December 2013, the Banca Sistema Group comprised the Parent Company, Banca Sistema S.p.A., and the following companies:

- Specialty Finance Trust Holding Limited, a company governed by English law, with registered offices at Dukes House 32-38 Dukes Place, London EC3A 7LP UK, 100% controlled by Banca Sistema. The company provides administrative services to Banca Sistema for the receivables acquired.
- Specialty Finance Trust Servicing Ltd., directly 100% owned by Specialty Finance Trust Holding Limited SFTH, with registered office in London (UK), in liquidation since 1 July 2013.

The investee company SF Trust Italia ("SFTI") previously held by SFT Holding, a company 100% owned by Banca Sistema, was transferred on 26 November 2013.

The company Solvi S.r.l was also incorporated by the parent company Banca Sistema during the year. The merger by incorporation reproduced the same effects registered in the consolidated financial statements drafted for statutory purposes.

TABLE 3 - REGULATORY CAPITAL BREAKDOWN

QUALITATIVE DISCLOSURE

The regulatory capital is the first protection against the risks taken on, and is the main reference parameter for the Bank of Italy assessments regarding the Bank's solidity.

Capital management involves all the policies needed to define the size of the capital in current and future terms, and the best combination between various alternative capitalization instruments, in order to ensure adequate cover of the risks taken on and compliance with the ratios required by the regulatory provisions. When a company grows in size, there are changes to the company assets, therefore representing a decisive element in the development stages.

As provided by those provisions, bank groups are subject, on a consolidated basis, to rules with respect to regulatory capital, comprehensive capital requirements, the assessment of full capital adequacy and risk concentration.

As provided in the applicable regulations, consolidated regulatory capital comprises the sum, net of deductions and within the calculation limits provided by law, of the following elements:

Common Equity

Common equity comprises the most solid resources available such as the share capital and all items similar in nature to this. These components have a high absorption capacity for losses and can be easily liquidated. Components such as goodwill, intangible assets and treasury shares are therefore not included under these components as it is difficult to liquidate them in the short term.

Tier 1

Total Tier 1 capital includes non-capital, innovative instruments. These instruments have a high capacity of absorbing loss since they have clauses preventing payment of interest or par value reduction mechanisms in relation to the financial and solvency situation of the Bank.

Tier 2

The components included in the Tier 2 capital are capable of guaranteeing sufficiently rapid payment times even though they do not fulfil the requirement of being completely similar to share capital. They include but are not limited to items such as hybrid capitalisation instruments and Tier 2 underlying liabilities[4].

Tier 3

The resources included under Tier 3 capital are the ones that are the most dissimilar to equity by their very nature if compared to those included under Tier 1 or Tier 2. Tier 3 liabilities fall under the definition of Tier 3 capital and generally the liabilities excluded from Tier 2 liabilities.

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(4) Ref: Bank of Italy Circular no. 263 of 27 December 2006 as amended - Title I, Chapter 2, Section II, Paragraph 4 "innovate and non-innovative capital instruments" Paragraph 5 "hybrid capitalisation and underlying liability instruments.

QUANTITATIVE DISCLOSURE

The consolidated regulatory capital was calculated on the basis of the Supervisory Measures.

REGULATORY CAPITAL

Amounts in thousands of Euros

	2013
A. Tier 1 capital before application of prudential filters	**27,705**
B. Tier I capital prudential filters:	-
B1 - positive prudential Ias/Ifrs filters (+)	-
B2 - negative prudential Ias/Ifrs filters (-)	-
C. Tier 1 capital gross of deductible elements (A+B)	27,705
D. **Elements deductible from Tier I capital**	-
E. Total tier 1 capital (C-D)	**27,705**
F. Tier 2 capital before application of prudential filters	**12,000**
G. Tier II capital prudential filters:	-
G1 - positive prudential Ias/Ifrs filters (+)	-
G2 - negative prudential Ias/Ifrs filters (-)	-
H. Tier 2 capital gross of deductible elements (F+G)	**12,000**
I. **Elements deductible from Tier II capital**	-
L. Total Tier 2 capital (H-I)	**12,000**
M. Elements deductible from total Tier 1 and Tier 2 capital	-
N. Regulatory capital (E + L - M)	**39,705**
O. Tier 3 capital	-
P. Regulatory capital including TIER 3 (N + O)	**39,705**

TABLE 4 - CAPITAL ADEQUACY

QUALITATIVE DISCLOSURE

In accordance with the Second Pillar provisions, banks must periodically assess their current and prospective capital adequacy, with an expanded range of risks to calculate compared to the First Pillar. In its meeting of 25 March 2014, the Board of Directors approved the ICAAP report, considering the capitalisation to be adequate both for current and for future purposes.

Banca Sistema constantly monitors its capital adequacy on a monthly basis and also includes the second pillar risks in its analysis.

This is carried out within the scope of the ICAAP (Internal Capital Adequacy Assessment Process), where the responsibility lies entirely with "the body in charge of strategic supervision, which designs and organises it on a fully independent basis in accordance with the respective duties and privileges". The following First and Second Pillar risks are included in the applicable scope for ICAAP purposes, with the methods indicated in the table below:

CATEGORY	RISK TYPE	METHODS
First pillar	Credit risk	Standardised method
	Counterparty risk	Standardised method (CRM - line-by-line method with regulatory volatility adjustments)
	Market risk	Standardised method
	Operational risk	Basic method (BIA)
Second pillar	Concentration risk	Granularity Adjustment ABI method to estimate the Geo-Sectorial Concentration Risk (Attachment B, Title III, Circular 263/06)
	Interest rate risk	Simplified method (Attachment C, Title III, Circular 263/06)
	Liquidity risk	Qualitative assessment
	Reputation risk	Qualitative assessment
	Strategic risk	Qualitative assessment
	Compliance risk	Qualitative assessment

The ICAAP is organised into 5 sub-activities, set out in detail below:

Identification of the material risks and their management: the identification of the risks that the Bank could be exposed to is activated by the applicable organisational structures, taking various elements into account:

- recognition of the asset aggregates;
- company strategic plan in which the top management illustrates the investment policies and targets, both in the short and medium term;

- changed market context, new opportunities or significant size changes (absolute or relative) of the business components to the extent of influencing the positioning on the market and the consequent assessments of the initial risk;
- introduction of new products or services;
- economic situation.

The Risk Division will carry out a detailed analysis and assessment of the business dealings in order to identify the material risks.

Measurement/assessment of material risks and calculation of the related internal capital: the Risk Division defines the measurement, assessment and risk management methods.

With reference to the First Pillar risks, the measurement methods adopted are those used for the purposes of Prudential Supervision.

With reference to the Second Pillar risks, which are difficult to quantify, a judgemental type analysis is made in order to define the assessment and risk mitigation techniques, in association with the various departments involved (for example: The Financial Manager, the Organisational Manager, the Legal Manager, the Compliance and corporate affairs divisions, etc.).

In order to properly apply the principle of proportionality, the Bank of Italy divided the banks into three different classes, in accordance with their sizes and the operational complexity. Banca Sistema is currently placed in class 3 regarding "banking groups and banks that use standardised methods, with consolidated or individual assets equal to or less than Euro 3.5 billion respectively".

Calculation of total internal capital and reconciliation with the regulatory capital: in accordance with the provisions of the applicable regulations, the Bank calculates its total internal capital using the building block approach, which sums any internal capital relating to the other material risks revealed by the First Pillar risk regulatory requirements.

The Risk Division then reconciles the total internal capital with regulatory requirements.

Calculation of total capital and reconciliation with the Regulatory Capital: the financial statements and supervisory areas of the administrative department analyses all the capital components available in order to quantify the total capital available.

The Risk Division is then responsible for reconciling the Regulatory Capital and the Total Internal Capital.

Management and maintenance of the ICAAP: the Risk Division will check whether the total capital is enough to cover the Total Internal Capital requirements that had previously been calculated. If it should not be enough, this will be promptly reported to the CEO and a Risk Management Committee meeting will be called so the necessary corrective measures can be put in place.

Upon conclusion of the Process, the Risk Division will be in charge of producing the disclosure report to submit to the Internal Auditing office and the Board of Directors for approval.

Once the ICAAP has been concluded, the Internal Audit Department will have to produce its assessment of the solidity of the entire process and identify any problematic issues in the activities carried out or areas for improvement.

The review of the ICAAP will end with the formalisation of the internal audit report that will be submitted to the Board of Directors for approval. The capital impact findings of the Second Pillar regulations confirm the good capital base which will be able to deal with all risks, both in normal day to day operations and in conditions of stress.

QUANTITATIVE DISCLOSURE

CAPITAL ADEQUACY

Amounts in thousands of Euros

Categories/Values	Unweighted amounts 2013	Weighted amounts / requirements 2013
A. RISK ASSETS		
A.1 CREDIT RISK AND COUNTERPARTY RISK	**1,781,153**	**249,500**
1. Standardised method	1,781,153	249,500
2. Method based on internal ratings	-	-
2.1 Base	-	-
2.2 Advanced	-	-
3. Securitisation	-	-
B. REGULATORY CAPITAL REQUIREMENTS	-	-
B.1 CREDIT RISK AND COUNTERPARTY RISK	-	**19,960**
B.2 MARKET RISK	-	**105**
1. Standard method	-	105
2. Internal models	-	-
3. Concentration Risk	-	-
B.3 OPERATIONAL RISK	-	**3,370**
1. Basic method	-	3,370
2. Standardised method	-	-
3. Advanced method	-	-
B.4 OTHER PRUDENTIAL REQUIREMENTS	-	-
B.5 OTHER CALCULATION ELEMENTS	-	-
B.6. TOTAL PRUDENTIAL REQUIREMENTS	-	**23,435**
C. RISK ASSETS AND REGULATORY RATIOS	-	**292,939**
C.1 Weighted risk assets	-	292,939
C.2 Tier 1 capital / Risk-weighted assets (Tier 1 capital ratio)	-	9.5%
C.3 Regulatory capital including TIER 3 / Risk-weighted assets (Total capital ratio)	-	13.6%

TABLE 5 - CREDIT RISK
GENERAL INFORMATION FOR ALL BANKS

QUALITATIVE DISCLOSURE

Initial recognition of a receivable is at the date of settlement on the basis of its fair value including the costs/income of the transaction directly attributable to the acquisition of the receivable.

Costs/income having the aforesaid characteristics that will be repaid by the debtor or that can be considered as standard internal administrative costs are excluded.

The initial fair value of a financial instrument is usually equivalent to the amount granted or the cost incurred by the acquisition.

Following initial recognition, the receivables from customers are measured at amortised cost which, using the actual interest rate method, allows the economic effect of costs/income relating to the single transaction to be distributed over the remaining expected life of the receivable.

Generally, the Bank continuously performs analyses and assessments for all credit risk exposure, aimed at classifying exposures where considered necessary among the impaired credit risk categories. On the basis of the Regulatory provisions issued by the Bank of Italy and internal provisions, impaired exposures can be divided among the following categories:

- **non-performing loans**: loans with debtors in serious long-term difficulties or irremediably insolvent, even if this has not yet been legally decided;
- **watch list loans**: loans with parties who are undergoing temporary difficulties but where the difficulties are objective and are expected to be resolved in a reasonable length of time;
- **restructured loans**: loans for which restructuring agreements have been reached where changes from the original contractual terms are permitted that will result in a loss for the Bank;
- **loans past due and/or impaired**: debtors with past due and/or impaired loans of more than 90 days at the applicable date; with respect to the factoring business, past due exposures are considered to be those positions relating to a single debtor where no payment has been made 90 days from the actual date the invoice became due for payment.

The receivables that do not fall within the aforesaid classifications are considered to be performing.

Loans classified as impaired loans are analysed in order to quantify the potential impairment of the individual loan. With regard to past due exposures relating to the Public Administration, referring to receivables acquired on a definitive basis as part of the factoring, it was decided that the conditions for making value adjustments were not present considering the quality of the receivable and the debtor counterparties. The only non-performing loans concern loans to local authorities that were already in financial difficulties when acquired[5]. These loans were booked at their fair value, taking into account expected future cash flows.

A prudential write-down was applied to the performing loans. This method separates out the receivables portfolio, identifying the clusters for which the Bank makes in-depth assessments when pricing them. The national economic system deterioration rates registered by the Bank of Italy were applied to these “non ordinary” receivables and

(5) The financial difficulties statement is adopted by the Municipal Council by making the applicable decision.
Article 244 of the TUEL establishes that “an entity will be in financial difficulties if it cannot guarantee payment of its indispensable functions and services or if third parties are owed cash receivables by the local entity that it cannot pay”

exposures with respect to the Central Authorities (average over the past 6 years) and a fixed Loss Given Default of 45%.

On the other hand, a fixed percentage of the expected loss of 0.3% was applied to the exposures classified under the "ordinary" cluster[6]. The amount of value adjustments net of previous provisions and the partial or full recovery of amounts previously written-down are recorded in the income statement under "net value adjustments/write-backs due to loan impairment".

Loans are derecognised from the financial statements when they are deemed totally unrecoverable or if transferred, when this entails the substantial transfer of all loan-related risks and benefits.

(6) The fixed percentage of 0.3% is the generic write-down rate applied to the exposures that have fallen under the ordinary cluster since the Bank was established.

QUANTITATIVE DISCLOSURE

The tables below were taken from the Financial statements as at 31 December 2013, part E of the Notes to the financial statements. The amounts at year-end are considered to represent the exposures to risk of the Bank during the applicable period.

CREDIT EXPOSURE DISTRIBUTION
BY RELATED PORTFOLIO AND BY CREDIT QUALITY (BOOK VALUES)

Amounts in thousands of Euros

Portfolios / Quality	Banking group						Other companies		
	Non-performing loans	Watch list loans	Restructured loans	Impaired past due exposures	Non-impaired past due exposures	Other assets	Impaired	Other	**Total**
1. Held-for-trading financial assets	-	-	-	-	-	-	-	-	**-**
2. Available-for-sale financial assets	-	-	-	-	-	847,045	-	-	**847,045**
3. Held-to-maturity financial assets	-	-	-	-	-	-	-	-	-
4. Loans to banks	-	-	-	-	-	58,814	-	-	**58,814**
5. Loans to customers	4,504	-	-	9,194	33,575	1,040,812	-	-	**1,088,085**
6. Financial assets carried at fair value	-	-	-	-	-	-	-	-	-
7. Financial assets held for disposal	-	-	-	-	-	-	-	-	-
8. Hedging derivatives	-	-	-	-	-	-	-	-	-
Total 2013	**4,504**	-	-	**9,194**	**33,575**	**1,946,671**	**-**	**-**	**1,993,944**

CREDIT EXPOSURE DISTRIBUTION
BY RELATED PORTFOLIO AND BY CREDIT QUALITY (GROSS AND NET VALUES)

Amounts in thousands of Euros

Portfolios / Quality	Impaired assets			*Performing*			
	Gross exposure	Specific adjustments	Net exposure	Gross exposure	Portfolio adjustments	Net exposure	**Total Exposure (net)**
1. Held-for-trading financial assets	-	-	-	-	-	-	**-**
2. Available-for-sale financial assets	-	-	-	847,045	-	847,045	**847,045**
3. Held-to-maturity financial assets	-	-	-	-	-	-	-
4. Loans to banks	-	-	-	58,814	-	58,814	**58,814**
5. Loans to customers	13,716	18	13,698	1,075,686	1,300	1,047,387	**1,088,085**
6. Financial assets carried at fair value	-	-	-	-	-	-	-
7. Financial assets held for disposal	-	-	-	-	-	-	-
8. Hedging derivatives	-	-	-	-	-	-	-
Total 2013	**13,716**	**18**	**13,698**	**1,981,545**	**1,300**	**1,980,246**	**1,993,944**

There were no receivables subject to renegotiation as part of any collective agreements under the "credit exposures to performing customers" as at 31 December 2013.

CASH AND OFF-BALANCE SHEET CREDIT EXPOSURES TO BANKS: GROSS AND NET VALUES

Amounts in thousands of Euros

Type of exposure / Values	Gross exposure	Specific value adjustments	Portfolio value adjustments	Net exposure
A. **CASH EXPOSURES**				
a. Non-performing loans	-	-	-	-
b. Watch list loans	-	-	-	-
c. Restructured loans	-	-	-	-
d. Past due loans	-	-	-	-
e. Other assets	58,814	-	-	58,814
TOTAL A	**58,814**	-	-	**58,814**
B. **OFF-BALANCE SHEET EXPOSURES**				
a. Impaired	-	-	-	-
b. Other	2,224	-	-	2,224
TOTAL B	**2,224**	-	-	**2,224**
TOTAL A+B	**61,038**	-	-	**61,038**

Cash credit exposures to banks - movements of gross impaired exposures and "country risk" parties: The cash exposures to Banks are all performing.

Cash credit exposures to banks - movements of total value adjustments: The cash exposures to Banks are all performing.

CASH AND OFF-BALANCE SHEET CREDIT EXPOSURES TO CUSTOMERS: GROSS AND NET VALUES

Amounts in thousands of Euros

Type of exposure / Values	Gross exposure	Specific value adjustments	Portfolio value adjustments	Net exposure
A. **CASH EXPOSURES**				
a. Non-performing loans	4,505	1	-	4,504
b. Watch list loans	-	-	-	-
c. Restructured loans	-	-	-	-
d. Impaired past due exposures	9,211	17	-	9,194
e. Other assets	1,922,733	-	1,300	1,921,433
TOTAL A	**1,936,448**	**18**	**1,300**	**1,935,130**
B. **OFF-BALANCE SHEET EXPOSURES**				
a. Impaired	-	-	-	-
b. Other	22	-	-	22
TOTAL B	**22**	-	-	**22**

CASH CREDIT EXPOSURES TO CUSTOMERS: MOVEMENTS OF GROSS IMPAIRED EXPOSURES

Amounts in thousands of Euros

Reasons / Categories	Non-performing loans	Watch list loans	Restructured loans	Past due loans
A. **Gross opening exposure**	-	-	-	**542**
▪ of which: exposures disposed of and not derecognised	-	-	-	-
B. **Increases**	**4,505**	-	-	**13,156**
B.1 income from performing credit exposures	4,505	-	-	13,156
B.2 transfers from other categories of impaired exposures	- -	-	-	-
B.3 other increases	-	-	-	-
C. **Decreases**	-	-	-	**4,418**
C.1 transferred to performing credit exposures	-	-	-	219
C.2 write-offs		-	-	-
C.3 collections	-			4,199
C.4 gains on disposals	-	-	-	-
C.4 bis gains on disposals	-	-	-	-
C.5 transfers to other categories of impaired exposures	-	-	-	-
C.6 other decreases	-	-	-	-
D. **Gross closing exposure**	**4,505**	-	-	**9,280**
▪ of which: exposures disposed of and not derecognised	-	-	-	-

CASH CREDIT EXPOSURES TO CUSTOMERS: MOVEMENTS OF TOTAL VALUE ADJUSTMENTS

Amounts in thousands of Euros

Reasons / Categories	Non-performing loans	Watch list loans	Restructured loans	Past due loans
A. **Overall opening adjustments**	-	-	-	**2**
▪ of which: exposures disposed of and not derecognised	-	-	-	-
B. **Increases**	**1**	-	-	**17**
B.1 value adjustments	1	-	-	10
B.1 bis losses from disposal	-	-	-	-
B.2 transfers from other categories of impaired exposures	-	-	-	-
B.3 other increases	-	-	-	7
C. **Decreases**	-	-	-	**2**
C.1 value write-backs from revaluation	-	-	-	-
C.2 value write-backs from collections	-	-	-	-
C.2 bis profit from disposal	-	-	-	-
C.3 write-offs	-	-	-	-
C.4 transfers to other categories of impaired exposures	-	-	-	-
C.5 other decreases	-	-	-	2
D. **Closing total adjustments**	**1**	-	-	**17**
▪ of which: exposures disposed of and not derecognised	-	-	-	-

SEGMENT DISTRIBUTION OF CASH AND "OFF-BALANCE SHEET" CREDIT EXPOSURES TO CUSTOMERS (BOOK VALUE)

Exposures / Counterparties	Governments			Other public entities			Financial companies			Insurance companies			Non-financial companies			Other entities		
	Net exposure	Specific value adjustments	Portfolio value adjustments	Net exposure	Specific value adjustments	Portfolio value adjustments	Net exposure	Specific value adjustments	Portfolio value adjustments	Net exposure	Specific value adjustments	Portfolio value adjustments	Net exposure	Specific value adjustments	Portfolio value adjustments	Net exposure	Specific value adjustments	Portfolio value adjustments
A. Cash exposures																		
A1. Non-performing loans	-	-	-	4,504	1	-	-	-	-	-	-	-	-	-	-	-	-	-
A2. Watch list loans	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
A3. Restructured loans	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
A4. Past due loans	304	-	-	2,620	8	-	-	-	-	-	-	-	4,506	6	-	1,764	3	-
A5. Other exposures	1,000,630	-	62	485,960	-	1,172	344,525	-	-	-	-	-	88,736	-	66	1,581	-	-
TOTAL A	**1,000,934**		**62**	**493,084**	**9**	**1,172**	**344,525**	-	-	-	-	-	**93,242**	**6**	**66**	**3,345**	**3**	-
B. "Off-balance sheet" exposures																		
B1. Non-performing loans	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
B2. Watch list loans	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
B3. Other impaired assets	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
B4. Other exposures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	22	-	-
TOTAL B	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**22**	-	-
TOTAL (A+B) 2013	**1,000,934**		**62**	**493,084**	**9**	**1,172**	**344,525**	-	-	-	-	-	**93,242**	**6**	**66**	**3,367**	**3**	-

GEOGRAPHIC DISTRIBUTION OF CASH AND "OFF-BALANCE SHEET" CREDIT EXPOSURES TO CUSTOMERS
(BOOK VALUE)

Amounts in thousands of Euros

Exposures / Geographic areas	ITALY		OTHER EUROPEAN COUNTRIES		AMERICA		ASIA		REST OF THE WORLD	
	Net exposure	Total value adjustments	Net exposure	Total value adjustments	Net exposure	Total value adjustments	Net exposure	Total value adjustments	Net exposure	Total value adjustments
A. Cash exposures										
A1. Non-performing loans	4,504	1	-	-	-	-	-	-	-	-
A2. Watch list loans	-	-	-	-	-	-	-	-	-	-
A3. Restructured loans	-	-	-	-	-	-	-	-	-	-
A4. Past due loans	9,194	17	-	-	-	-	-	-	-	-
A5. Other exposures	**1,921,184**	1,300	248	-	-	-	-	-	-	-
TOTAL	**1,934,882**	**1,318**	**248**	-	-	-	-	-	-	-
B. "Off-balance sheet" exposures										
B1. Non-performing loans	-	-	-	-	-	-	-	-	-	-
B2. Watch list loans	-	-	-	-	-	-	-	-	-	-
B3. Other impaired assets	-	-	-	-	-	-	-	-	-	-
B4. Other exposures	22	-	-	-	-	-	-	-	-	-
TOTAL	**22**	-	-	-	-	-	-	-	-	-
TOTAL 2013	**1,934,904**	**1,318**	**248**	-	-	-	-	-	-	-

TIME DISTRIBUTION BY RESIDUAL CONTRACT DURATION OF FINANCIAL ASSETS AND LIABILITIES

Items / Timescales	on demand	From 1 to 7 days	From 7 to 15 days	From 15 days to 1 month	From 1 month to 3 months	From 3 months to 6 months	From 6 months to 1 year	From 1 year to 5 years	Over 5 years	Duration not defined
Cash assets	**106,752**	**236,043**	**706**	**47,121**	**202,571**	**532,010**	**384,807**	**421,330**	**8,745**	**48,468**
A.1 Government securities	-	-	-	-	129,897	494,266	223,816	-	-	-
A.2 Other debt securities	-	-	-	-	-	-	16	-	230	-
A.3 UCITS units	-	-	-	-	-	-	-	-	-	-
A.4 Loans	106,752	236,043	706	47,121	72,674	37,744	160,975	421,330	8,515	48,468
▪ Banks	199	-	-	-	10,000	-	-	-	-	48,468
▪ Customers	106,553	236,043	706	47,121	62,674	37,744	160,975	421,330	8,515	-
Cash liabilities	**298,189**	**198,904**	**263,838**	**67,677**	**715,247**	**130,205**	**111,973**	**184,511**	**20,279**	-
B.1 Deposit and current accounts	268,229	8,549	13,838	17,677-	74,812	130,205	96,973	184,511	279	-
▪ Banks	76,416	-	5,000	-	-	-	-	-	-	-
▪ Customers	191,813	8,549	8,838	17,677	74,812	130,205	96,973	184,511	279	-
B.2 Debt securities	-	-	-	-	-	-	15,000	-	20,000	-
B.3 Other liabilities	29,960	190,355	250,000	50,000	640,435	-	-	-	-	-

Items / Timescales	on demand	From 1 to 7 days	From 7 to 15 days	From 15 days to 1 month	From 1 month to 3 months	From 3 months to 6 months	From 6 months to 1 year	From 1 year to 5 years	Over 5 years	Duration not defined
"Off-balance sheet" transactions	-	**-**	-	-	-	-	**10,000**	**-**	-	-
C.1 Financial derivatives with exchange of capital	-	-	-	-	-	-	-	-	-	-
▪ Long positions	-	-	-	-	-	-	-	-	-	-
▪ Short positions	-	-	-	-	-	-	-	-	-	-
C.2 Financial derivatives without exchange of capital	-	-	-	-	-	-	-	-	-	-
▪ Long positions	-	-	-	-	-	-	-	-	-	-
▪ Short positions	-	-	-	-	-	-	-	-	-	-
C.3 Deposits and loans receivable	-	-	-	-	-	-	-	-	-	-
▪ Long positions	-	-	-	-	-	-	-	-	-	-
▪ Short positions	-	-	-	-	-	-	-	-	-	-
C.4 Irrevocable commitments to grant finance	-	-	-	-	-	-	-	-	-	-
▪ Long positions	-	-	-	-	-	-	-	-	-	-
▪ Short positions	-	-	-	-	-	-	-	-	-	-
C.5 Financial guarantees issued	-	-	-	-	-	-	-	-	-	-
C.6 Financial guarantees received	-	-	-	-	-	-	-	-	-	-
C.7 Credit derivatives with exchange of capital	-	-	-	-	-	-	10,000	-	-	-
▪ Long positions	-	-	-	-	-	-	-	-	-	-
▪ Short positions	-	-	-	-	-	-	10,000	-	-	-
C.7 Credit derivatives without exchange of capital	-	-	-	-	-	-	-	-	-	-
▪ Long positions	-	-	-	-	-	-	-	-	-	-
▪ Short positions	-	-	-	-	-	-	-	-	-	-

GEOGRAPHIC DISTRIBUTION OF CASH AND "OFF-BALANCE SHEET" CREDIT EXPOSURES TO BANKS (BOOK VALUE)

Amounts in thousands of Euros

Exposures / Geographic areas	ITALY		OTHER EUROPEAN COUNTRIES		AMERICA		ASIA		REST OF THE WORLD	
	Net exposure	Total value adjustments	Net exposure	Total value adjustments	Net exposure	Total value adjustments	Net exposure	Total value adjustments	Net exposure	Total value adjustments
A. Cash exposures										
A1. Non-performing loans	-	-	-	-	-	-	-	-	-	-
A2. Watch list loans	-	-	-	-	-	-	-	-	-	-
A3. Restructured loans	-	-	-	-	-	-	-	-	-	-
A4. Past due loans	-	-	-	-	-	-	-	-	-	-
A5. Other exposures	58,740	-	74	-	-	-	-	-	-	-
TOTAL	**58,740**	**-**	**74**	-	-	-	-	-	-	-
B. "Off-balance sheet" exposures										
B1. Non-performing loans	-	-	-	-	-	-	-	-	-	-
B2. Watch list loans	-	-	-	-	-	-	-	-	-	-
B3. Other impaired assets	-	-	-	-	-	-	-	-	-	-
B4. Other exposures	2,224	-	-	-	-	-	-	-	-	-
TOTAL	**2,224**	-	-	-	-	-	-	-	-	-
TOTAL 2013	**60,964**	**-**	**74**	-	-	-	-	-	-	-

As at 31 December 2013, the significant risks (exposures for amounts equal to or greater than 10% of the Regulatory Capital) comprise 17 positions for an amount of:

a. Book value Euro 160,936 (in thousands);
b. Weighted value: Euro 134,882 (in thousands).

TABLE 6 - CREDIT RISK

INFORMATION ON THE PORTFOLIOS SUBJECT TO THE STANDARDISED METHOD

AND THE SPECIALISED CREDIT EXPOSURES AND THE CAPITAL INSTRUMENT EXPOSURES WITHIN THE SCOPE OF THE IRB METHODS

QUALITATIVE DISCLOSURE

Banca Sistema currently calculates the capital requirements for credit risk on the basis of the standardised method.

The Bank mainly acquires corporate receivables owed by central authorities, territorial entities and in general by the Public Administration, directly taking on the credit risk with respect to the end debtor.

The Bank used the rating issued by the ECAI as at 31 December 2013:

- "Dominion Bond Rating Service" (DBRS), for exposures towards: Central authorities and central banks; supervised intermediaries; public sector entities and territorial entities;
- "Fitch Ratings", for exposures to companies and other entities.

The identification of a reference ECAI does not represent - with respect to the objective or the purpose - an evaluation of merit of the ratings attributed by the ECAIs or support for the methods used, for which the external creditworthiness ratings agencies are the only ones in charge.

QUANTITATIVE DISCLOSURE

The table below shows the distribution of the exposures subject to credit risk on the basis of the weighting factors (creditworthiness classes).

Amounts in thousands of Euros

Regulatory class	Weighting						Total
	0%	20%	50%	75%	100%	150%	
Central Authorities and Central Banks	1,053,038	-	-	-	-	-	**1,053,038**
Territorial entities, public sector entities, non-profit entities	-	295,149	180,811	-	82	-	**476,042**
Supervised intermediaries	-	10,356	23	-	-	-	**10,379**
Multilateral development banks	-	-	-	-	-	-	**-**
International Organisations	-	-	-	-	-	-	**-**
Companies and other entities	-	-	45,089	-	47,802	-	**92,891**
Retail	-	-	-	319	-	-	**319**
UCITS	-	-	-	-	-	-	**-**
Securitisations	-	-	-	-	-	-	**-**
Guaranteed bank bonds	-	-	-	-	-	-	**-**
Property-backed loans	-	-	-	-	-	-	**-**
Impaired exposures	-	-	-	-	-	13,698	**13,698**
High risk loans	-	-	-	-	-	-	**-**
Other exposures	71	-	-	-	2,488	-	**2,559**

TABLE 8 - RISK MITIGATION TECHNIQUES

QUALITATIVE DISCLOSURE

With reference to the credit risk mitigation techniques, in order to reduce exposure of the factoring portfolio, and more specifically its exposure with regard to the Local Health Authorities (ASL), the Bank has drawn up specific standard hedging credit linked notes (CLN) compliant with international ISDA derivative regulations (International Swaps and Derivatives Association).

The issue of these types of instruments allows the Bank to transfer the credit risk of the underlying loans and therefore improve its capital ratios by the hedging generated by the hedging contract and the amounts collected from the subscription of the notes.

There is a CLN registered at the applicable date, subscribed to by a regulatory intermediary, at a nominal value of Euro 10 million, with maturity in July 2014 and with the underlying asset being the healthcare receivables of the ASL/AO.

In addition, the Bank began to diversify its product portfolio in 2013, including “credit from current accounts secured by pledge”. The Bank thereby makes credit available to customers, giving them the option of debiting their current accounts up to a certain agreed amount against a guarantee given by a pledge on securities with the Bank.

QUANTITATIVE DISCLOSURE

Amounts in thousands of Euros

Segment	Exposures	Guarantee	Post CRM exposure	RWA
Public sector entities	192,239	10,000	182,239	90,691

As at 31 December 2013, there was about Euro 33 million in “Credit from current accounts secured by pledge” granted. The value of the exposure is completely backed by eligible secured guarantees for the purposes of credit risk mitigation.

TABLE 9 - COUNTERPARTY RISK

QUALITATIVE DISCLOSURE

The Bank pays adequate attention to counterparty risk, understood as the risk of default by the counterparty to a transaction with respect to certain financial instruments such as over the counter instruments, repurchase agreements and reverse repurchase agreements on securities or goods, assignments or borrowing of loaned securities or goods and security financing transactions, transactions with long-term settlement in which one of the counterparties undertakes to sell or acquire a security, goods or foreign currency against the collection or payment of cash at a contractually established settlement date that falls later than the standard market date for similar types of transactions.

This is a specific type of credit risk that generates a bilateral type risk, whereby both counterparties are exposed to the risk of incurring unexpected loss.

The Bank manages counterparty risk in a careful, balanced manner, establishing an adequate limit system in terms of portfolio consistency and composition. With reference to the repurchase agreement positions, the Bank counterparty is Cassa Compensazione Garanzia (which does not generate requirements against counterparty risk) or institutional counterparties.

QUANTITATIVE DISCLOSURE

COUNTERPARTY RISK

Type of instruments	Positive gross fair value	Reduction due to offsetting (gross offset)	Positive net fair value (net of the offsetting agreements)	Collateral securities	Net fair value (net of offsetting and guarantees)	EAD	Distribution of fair value by underlying asset type
Repurchase agreements							
Held-for-trading financial assets	-	-	-	-	-	-	-
Loans to banks	-	-	-	-	-	-	-
Loans to customers (performing)	132,228	-	132,228	127,948	-	4,280	4,280
Reverse repurchase agreements							-
Due to banks	-	-	-	-	-	-	-
Due to customers	-	-	-		-	-	

Type of instruments	Regulatory trading portfolio	Banking portfolio
Repurchase agreements	-	288,048
Reverse repurchase agreements	-	240,125

TABLE 12 - OPERATIONAL RISK

QUALITATIVE DISCLOSURE

Operational risk is the risk of suffering losses due to the inadequacy or inefficiency of procedures, human resources or internal systems, or by external events. The following cases fall under the operational risk classification for example:

- fraud;
- human error;
- interruption of operations;
- system unavailability;
- inadequate execution of the processes;
- contractual breach;
- natural disasters.

Operational risk includes legal risk, while strategic risk or reputational risk are not included. Therefore operational risk refers to the various types of events that are not individually significant alone but only if analysed together and quantified by the entire risk category.

The Supervisory Authorities acknowledge that the specific approach adopted by individual banks for managing operational risk may depend on a series of factors including the size, organisational set-up and the nature and complexity of the transactions.

In this context, there is more awareness about operational risk and controls, which, along with the implementation of a functional internal reporting system and the availability of emergency plans, form the essential elements of an effective and efficient operational risk management system.

In order to calculate the capital requirements to cover operational risk, Banca Sistema uses the Basic Indicator Approach - BIA - where the capital requirements are calculated by applying a regulatory coefficient to an indicator of the volume of company operations as set out by Title II, chapter 5 of the Supervisory regulations.

The regulatory ratio provided for the Base method - BIA, is 15% of the volume of company business dealings identified in the operating income. In order to measure the regulatory requirement with respect to the operational risk, the average operating income amounts over the past 3 years are weighted (with respect to the situation at year end as at 31/12) with the above-mentioned ratio.

If one of those figures is negative or invalid, this figure will not be used to calculate the total capital requirement. The requirement will therefore be calculated as the average of the amounts with positive values only.

For newly formed bank groups, the relevant indicator for the amounts relating to the three-year period prior to the establishment of the Group is generally determined as the sum of the relevant indicators of the individual companies that form the group.

A project to assess operational risks related to company operations was begun in 2014 and a subsequent analysis of the controls in place that can reduce the theoretical risk emerged with a consequential evaluation of the so-called “residual risk” levels, i.e. after the existing controls have been made, allowing the necessary actions to take to be identified. The Bank also started a project to assess operational risks called Operational risk Management (ORM).

The initial phase concluded at the end of 2013 in which all the internal rules were reviewed, identifying all the main processes and relative sub-processes.

The subsequent phase implies an initial evaluation of the possible operational risks related to the actual operations in the company in question and a subsequent analysis of the controls in place that can reduce the theoretical risk which has emerged and a consequential evaluation of the so-called “residual” risk levels, i.e. after the existing controls have been made, allowing the necessary actions to take to be identified.

The objective of the RSA is to provide management with an instrument to manage operational risk, i.e. the possibility of evaluating the existing control system in terms of ability to efficiently deal with the risks and reduce the risks identified to an “acceptable” level.

TABLE 13 - CAPITAL INSTRUMENT EXPOSURES
INFORMATION ON THE POSITIONS INCLUDED ON THE BANK PORTFOLIO

QUALITATIVE DISCLOSURE

Investments in capital instruments forming part of the bank portfolio pursue a number of different objectives such as: strategic, institutional, financial investments and supporting operational activities.

Accounting techniques

The capital instrument exposures included in the banking portfolio are classified under Equity investments and Assets available for sale in the financial statements.

<u>Available-for-sale financial assets</u>

<u>Accounting standards</u>

- **Classification criteria.** This category includes the non-derivative financial assets not classified otherwise as "Held-for-trading financial assets" or "Held-to-maturity financial assets" or "Financial assets measured at fair value" or "Receivables". The investments "available for sale" are financial assets that are intended to be retained for an indefinite period of time and that may be sold for reasons of liquidity, changes in interest rates, exchange rates or market prices.

- **Recognition criteria**. Initial recognition of available-for-sale financial assets is at the date of settlement, based on their fair value including the costs/income of the transaction directly attributable to the acquisition of the financial instrument. Costs/income having the aforesaid characteristics that will be repaid by the debtor or that can be considered as standard internal administrative costs are excluded.

The initial fair value of a financial instrument is usually the cost incurred for its acquisition.

- **Measurement and recognition criteria for income components**. Following initial recognition, available-for-sale financial assets are measured at their fair value with any gains or losses resulting from a change in the fair value compared to the amortised cost, recorded in a specific equity reserve recorded in the statement of comprehensive income up until said financial asset is derecognised or an impairment loss is recorded.

Impairment testing is performed in accordance with paragraphs 58 et seq. of IAS 39 at every year end. As regards equity securities listed on an active market, a significant or prolonged reduction of the fair value below the purchase cost is also evidence of impairment.

The amount of any impairment is recorded under the income statement item "net value adjustments/write-backs due to impairment of available-for-sale financial assets". This amount also includes the reversal to the income statement of any profits/losses from the measurement previously recorded in the specific shareholders' equity reserve.

If the reasons behind the impairment are no longer valid following an event which occurred after recognition, a write-back will be made on the income statement if it refers to debt securities and to shareholders' equity if it refers to equity securities measured at fair value.

- **Derecognition criteria.** Available-for-sale financial assets are derecognised when the contractual rights on the cash flows deriving from the assets expire, or in the case of a transfer, when the same entails the substantial transfer of all risks and benefits related to the financial assets.

Equity investments

Accounting standards

- **Classification criteria.** This category includes investments in subsidiaries, associates and joint ventures by Banca Sistema.
- **Recognition criteria.** Equity investments are recorded in the financial statements at purchase cost.
- **Measurement criteria.** If there is evidence that the value of an equity investment may be impaired, the recoverable value of said equity investment is estimated by considering the present value of future cash flows that the investment could generate, including the final disposal value of the investment and/or other measurement elements.

  The amount of any impairment, calculated on the basis of the difference between the book value of the investment and its recoverable value is recorded in the income statement under "profits (losses) from equity investments".

  If the reasons for impairment are removed following an event occurring after recognition of the impairment, write-backs are made to the income statement under the same item as above to the extent of the previous adjustment.
- **Derecognition criteria.** Equity investments are derecognised from the financial statements when the contractual rights to cash flows deriving from the investment are lost or when the investment is transferred, with the substantial transfer of all related risks and benefits.
- **Recognition criteria of income components.** In accordance with IAS 18, dividends are recorded when the right of the shareholder to receive payment has been established and, therefore, after the date of resolution of the Shareholders' Meeting of the investee company.

QUANTITATIVE DISCLOSURE

Type of exposures / values	Book value			Fair Value			Market value	Gains/losses and impairment		Unrealised capital gains/ losses and recorded on the Balance Sheet	
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	Level 1	Profits	Losses	Plus (+)	Minus (-)
Available-for-sale financial assets	-	-	-	-	-	-	-	-	-	-	-
Financial assets carried at fair value	-	-	-	-	-	-	-	-	-	-	-
Goodwill	-	-	1,786	-	-	1,786	-	-	-	-	-

The goodwill is related to the purchase of the Solvi investment by SF Trust Italia.

Goodwill, previously recorded in the separate financial statements of Solvi S.r.l., as a result of the merger by incorporation of said entity into the Bank, was recorded directly in the Bank's separate financial statements.

The impairment test for goodwill in accordance with IAS 36 requires testing that the recoverable value of the goodwill is higher than its book value in the financial statements.

At the reference date, given the absence of trigger events, the limited value of goodwill with respect to the liquidity expressed by the Bank and the profits forecast in the 2014-2016 Business Plan, there was no need to effect any reduction in value.

TABLE 14 - INTEREST RATE RISK ON THE POSITIONS INCLUDED ON THE BANK PORTFOLIO

QUALITATIVE DISCLOSURE

The banking portfolio is made up of all the financial instruments either due or payable and that are not included in the trading portfolio. As already noted in this document, the risk on the positions in the banking portfolio refers to the possibility of negative changes in the cash flows or market values of the assets and liabilities of the Bank due to adverse and unexpected changes in the market rates.

Banca Sistema does not take on significant interest rate risk as a rule, as it mainly uses repurchase agreements, own bonds and interbank deposits in addition to the funding from the deposit account (SI conto!).

The interbank loans are mainly very short-term loans at fixed rates. Customer deposits with the SI conto! accounts are at fixed rates, with standard maturity dates.

Loans to customers are mainly at fixed rates, while in other cases the interest rates can be fixed at the sole discretion of the Bank within the scope of applicable law.

Taking on of interest rate risk related to the funding activities by the Treasury Division is carried out in accordance with the policies and limits established by the Board of Directors.

The company departments in charge of ensuring the correct management of interest rate risk include the Treasury Division, which is involved in the direct management of funding, the Risk Division which identifies the most suitable risk indicators and monitors the performance of funding assets and liabilities in relation to the pre-established limits, and top management, which is involved in making annual proposals to the Board of Directors of the Bank regarding the loan and funding policies and management of interest rate risk, and suggesting, during the year, any necessary measures that should be taken to ensure that the work is carried out in accordance with the risk policies.

On the basis of the funding information provided by the Treasury department, the expected interest rates and assessments on developments in investments, top management provides the Treasury department with instructions on use of the available lines of credit.

The top management receives a summarised daily report on the overall treasury position in order to monitor interest rate risk.

Hedging instruments are not used since the risk taken on is not significant.

QUANTITATIVE DISCLOSURE

The capital requirement necessary for interest rate risk is calculated, in accordance with indications by Bank of Italy Circular 263/2006, using a simplified model that divides the assets and liabilities of the Group banks banking portfolio into 14 time ranges on the basis of their residual lives; the assets and liabilities at variable rates are slotted into the various time ranges on the basis of the interest rate re-pricing date.

The model provides for the assets and liabilities to be entered onto the timetables in accordance with the instructions of Bank of Italy Circular 272 "Manual to fill out the accounts table" and Circular 115 "Instructions to fill out the consolidated regulatory reports of the credit institutions" apart from:

- current account assets classified as "on demand";
- current account liabilities and demand deposits to be divided in accordance with the following instructions:
    - if "on demand", with a standard fixed rate of 25% ("non-core component");
    - for the remaining amount ("core component") in the next eight time ranges (from "up to 1 month" to "4-5 years") in proportion to the number of months contained.

The asset positions are offset by the liability positions within each time range, thereby obtaining a net position. The net position of each range is multiplied by certain weighted factors obtained as the product between a hypothetical change in the rates for all the maturities and an approximation of the duration amended with respect to the individual ranges as provided by the simplified Bank of Italy method.

In order to calculate the interest rate risk of the banking book, the Bank of Italy provides that under the "normal state of affairs" reference can be made to the annual changes in interest rates recorded over a 6-year observation period, considering the 99th percentile (raised)".

A summary of the results relating to measurement of the interest rate risk is shown below.

The risk ratio calculated as the ratio between the above-described internal capital and the regulatory capital is also shown.

EXPOSURE TO INTEREST RATE RISK	Values at 31/12/2013
1. Internal capital compared to the interest rate risk	482
2. Regulatory capital	39,705
3. Risk index	1.2%
4. Threshold limit defined by law	20%

TABLE 15 - REMUNERATION AND BONUS SYSTEMS AND PROCEDURES

QUALITATIVE DISCLOSURE

The remuneration policies were formulated in accordance with the procedure described below, in compliance with the instructions contained in the Regulation and the provisions, in accordance with the Regulation, of article 9.1 of the Banca Sistema Articles of Association.

More specifically, article 9.1 of the articles of association of Banca Sistema state that "the remuneration policies in favour of employees or outside staff who are not employees" and "any remuneration plans based on financial instruments" will be approved by the Shareholders' Meeting, with approval by at least 60% of the share capital with voting rights, it being understood that this increased decision-making quorum will not apply to resolutions that will be passed by the company due to the regulatory rules on the basis of requests recorded by the Supervisory Authorities.

The formation of the Banca Sistema and Group remuneration policies (including this Document on the Remuneration Policies) provides for the involvement of the following company bodies and departments in accordance with the duties and responsibilities indicated below:

The Executive Committee of Banca Sistema, using the company departments specified herein, will draft and define the proposals relating to the Banca Sistema and Group remuneration policies (including this Document on the Remuneration Policies), which will then be submitted to the Board of Directors and if it gives its approval, to approval of the Shareholders' Meeting of Banca Sistema. The Executive Committee will also manage and implement the bonus plan for Group employees and executive managers, approved by the Shareholders' Meeting and in general will implement the Group remuneration policies. The Executive Committee will be assisted by the following company departments in performing its duties:

- The HR (Human Resources) Division, which coordinates the remuneration policy definition process.
- The Risk Division, which is involved in identifying potential events that could influence company activities, analysing the impact of said events within the scope of the risk limits considered to be acceptable by the company, and periodically monitoring the impact of implementing the remuneration policies on the Group risk profiles. This Division has worked on defining the risk indicators in the new Group remuneration system.
- The Compliance Department, which will make a prior check of compliance of the remuneration policies, and will carry out an assessment of compliance of the remuneration policies with the applicable regulatory framework and internal regulations every year, including the Code of Ethics of the Group in order to reduce the legal and reputation risks.
- The Internal Auditing Department, which checks and controls implementation of the staff remuneration and bonus policies, in compliance with the Regulation and in general with the regulatory provisions, and informs the competent bodies of any critical issues encountered.

In its capacity as the body in charge of strategic supervision pursuant to article 4.2 of the Regulation, the Board of Directors of Banca Sistema will adopt and review the remuneration policies to submit for approval to the Board of Directors on an annual basis at least, and will be responsible for correctly implementing them. It will also ensure that the remuneration policies are adequately recorded and can be accessed within the company structure.

When the Board of Directors examines the proposals to submit to the shareholders' meeting, they will be assisted by the Appointments and Remuneration Committee, comprising three directors who will carry out the following, also with the assistance with the above-mentioned company departments:

- it will provide consultation and proposals on payments for the corporate representatives pursuant to article 26 of the Consolidated Law on Banking ("TUB"), and heads of the internal control departments, and consultation on determination of the remuneration criteria used for the remaining "key staff" (as defined herein);
- will directly supervise correct application of the rules relating to remunerating the heads of internal control, in close agreement with the control body;
- will prepare the documentation to submit to the body with strategic supervision powers for the relative decisions;
- will assist the other committees in the body with strategic supervision powers;
- will ensure that the right corporate departments get involved in the process of processing and controlling the remuneration policies and procedures.

Self-assessment process and identification of key staff

The Regulation requires all banks to develop an accurate self-assessment system to identify "key staff", i.e. those people whose professional activities have or could have a significant impact on the risk profile of the bank.

This process must be based on the recognition and evaluation of the individual positions (responsibility, hierarchical levels, work carried out and operational authority). This is required of all banks or parent companies, regardless of whether the more detailed rules apply to the key staff (that do not apply in Banca Sistema or the Group since it involves "minor" intermediaries) since it allows to application of the entire subject matter to be adjusted in accordance with the actual capacity of the individual company figures to affect the risk profile of the bank. The self-assessment process and results must be based on adequate grounds and formally drawn up.

In accordance with the Regulation, the "key staff" are presumed to be the following subject to proof to the contrary by the bank:

i) managers with executive powers;

ii) the general manager and managers in the main lines of business, corporate departments or geographical areas, and those who report directly to bodies with strategic supervision, management and control powers;

iii) managers and staff at the highest levels of the internal control bodies (in particular the managers and staff at the highest levels of the internal auditing, compliance, risk management and human resource departments, and those who have direct responsibility for the truthfulness and correctness of the accounting and financial information of the bank);

iv) other parties who individually or collectively (for example loan granting committees, operating portfolio management tables) take significant risks (known as the "risk takers"); In order to identify these parties, the banks establish relevant criteria such as the total amount of remuneration in absolute terms, the option of taking on risk positions, generating profits or affecting other items on the financial statements for significant amounts; in any case, staff whose total gross remuneration, including discretionary retirement benefits, does not exceed Euro 200,000 per year, and whose variable portion does not exceed 20%, may not be considered significant.

v) any employee receiving total remuneration, including discretionary retirement benefits, that puts them into the same remuneration bracket as categories ii) and iv) above, if the work has or could have a material impact on the risk profile of the Bank.

On the basis of those premises, the CEO of Banca Sistema, with the support of the human resource department and the risk management department, and external consultants, and in accordance with the standard of proportionality governed by article 3.3 of the Regulation, made an in-depth assessment of the parties to place in the various "key staff" categories.

The results of that process, with a total of 22 positions, covered by 16 resources (two resources cover the position of Director in all the Subsidiaries) are summarised below:

1) Managers with executive powers
- Managers with executive powers in the Parent Company (1 position);
- Managers with executive powers in the subsidiary SF Trust Italia S.r.l. (hereinafter "SFTI" - 2 positions)
- Managers with executive powers in the subsidiary Specialty Finance Trust Holdings Ltd (hereinafter "SFTH") (2 positions).
- Managers with executive powers in the subsidiary SF Trust Servicing Ltd. (hereinafter "SFTS" - 2 positions)
- Managers with executive powers in the subsidiary Solvi S.r.l. (hereinafter "Solvi" - 1 position)

2) Managers of the main company departments
- Central Factoring Division (1 position);
- Central Banking Division (1 position);
- Central Finance and Administration Division (2 positions);
- Legal, Compliance and Company Affairs Division (1 position);
- Central Operations Division (1 position);
- Marketing and Communication Division (1 position);
- General Manager Solvi (1 Position)

3) Managers and staff at the highest levels of the internal control bodies
- Compliance Department (1 position);
- Internal audit Department (1 position)
- HR Division (1 position)
- Risk Division (1 position)

4) Other “Risk Takers”

- Treasury Department (1 position);
- Commercial Factoring Division (1 position)

More stringent rules will apply to structuring “key staff” remuneration until there is full correspondence between the remuneration and the economic-financial performance - both current and prospective - in accordance with factors that take account of the risks taken on and sustainability of the corporate results over time.

Detailed ex-post disclosure on the structure of the remuneration received by the key staff is provided to the Shareholders’ Meeting every year.

<u>The group remuneration system - general principles</u>

Subject to the more detailed provisions below, remuneration is formed of the following components, especially with respect to the “key staff”:

A) Fixed component:

- is provided for at all levels of responsibility;
- is based on the technical, professional and managerial skills of the staff members and the responsibility assigned to each; it is constantly monitored to check both internal and external fairness with respect to the market, including with the assistance of assessments drawn up by independent consultants chosen by the Parent Company;
- it is also calculated in relation to the specific jobs carried out by the members of the Board of Directors, and their involvement in any internal committees;
- it is aimed at ensuring the sound and prudent management of the Bank and the Group;
- it has always been based on the criteria of sustainability.

B) Variable component:

- is also calculated in accordance with the remuneration levels offered by the market for similar functions in comparable structures;
- is determined on the basis of parameters that are as objective as possible;
- it is calculated on the basis of a quantitative and qualitative assessment system;
- with respect to the quantitative criteria, it has been structured on both short and medium-long term goals assigned to key staff who have the most responsibility for running the company;
- calculated in accordance with exclusively qualitative goals and not related in any way to the financial results for those who have control functions and parties who have to draw up the accounting and corporate documents;
- adequately referenced to the risk profile involved;
- characterised by the sustainability criteria over time;
- assigned on an annual basis and given, providing for the following deferral mechanisms and return rules for the cases described below, in order to align the variable component to the actual results and risks taken on.

C) Benefit:

- additional company benefits are added to the remuneration for all employees or for some of them, in accordance with the roles covered.

<u>The remuneration structure of employees who fall under the "key staff" category</u>

A) FIXED COMPONENT

The fixed remuneration component for all Group employees is in line with the applicable Collective Labour Agreement (CCNL) rules, and for employees of the foreign companies, the rules that apply in the jurisdiction where the work is carried out. This principle also applies to employees who fall under the "key staff" category. The fixed component, is the greater element, and applies to the skills and responsibilities related to the role covered, rewarding the professional capacity and experience and the commitment involved.

B) VARIABLE COMPONENT

The variable component of employee remuneration for the "key staff" and all employees who obtain bonuses is represented by a total annual bonus, comprising a cash bonus given 6 months after the year in which the service was provided, and starting from 2013, in compliance with the provisions of the Bank of Italy, a deferred bonus (in cash) paid in the 3 years after the year following the year in which the service was rendered.

The total annual bonus is given at the discretion of the Executive Committee on the basis of individual and company qualitative and quantitative goals, differentiated by job (the bonus is related to qualitative targets only for those who have control functions and parties who draw up the accounting and corporate documents and are not related in any way to the individual or company financial results).

In order to guarantee financial sustainability, the total maximum amount of the bonus paid by the Group may not, in any case, exceed the amount of the "bonus pool" set aside at the end of every year by the Bank's Board of Directors, upon proposal of the CEO in association with the Financial Manager, with the amount equal to a percentage of the total gross remuneration (company cost) paid by all the Group companies in the applicable year (for 2012, the percentage was about 20% with a "bonus pool" of about Euro 1,200,000).

The total annual bonus for each worker is calculated on the basis of both a corporate and individual performance evaluation.

The targets will be established at the beginning of the year in accordance with the objective financial parameters in order to calculate the corporate performance.

The total annual bonuses for both the key staff and all Group employees may not exceed 100% of the gross annual remuneration. In any case, the cash bonus given during the year will represent 60% of the total annual bonus. The individual bonuses of less than 20% (or in any case less than Euro 10,000 gross) of the base pay form the exception, since there is no deferred component; the entire bonus will be paid in the 6 months following assessment of the performance.

Starting from 2013, deferred bonuses will no longer be given that have SGBS S.r.l. shares as a component, as decided in the Bonus Policies document approved by the Shareholders' Meeting in April 2012 since these shares were completely distributed in 2012.

If an assignee leaves his or her position with the Group, the other SGMS shareholders will have the right to acquire the shares of the outgoing shareholder at the price of the most recent sworn valuation, unless the Bank sends SGBS a written statement to the effect that the outgoing shareholder can keep his or her investment. The issue of this discretionary statement by the Bank will clearly be related to the behaviour of the employee or manager during their working relationship with the Group, along with the long-term stability of the results obtained.

In addition, the Executive Committee gave the right to each investor to acquire the shares as part of the 2012 Bonus Plan (an "Investor"), establishing, at its own discretion, in accordance with the Banca Sistema Group payment policies, the amount and relative Purchase Price, both in the case of a semi-free assignment, and in the case of assignment at the market value of the Shares at the time of acquisition.

The remuneration structure of employees who do not fall under the "key staff" category

The remuneration of the Group employees who do not fall under the "key staff" category comprises a fixed component, the largest amount, calculated in accordance with the applicable CCNL (for employees of foreign companies, the law that applies in the jurisdiction in which they work), possible in addition to a lower annual bonus, given by the CEO on a discretionary basis, with authorisation from the Executive Committee on the basis of a qualitative analysis of the individual performance. The bonuses given to staff who do not fall under the "key staff" category, in accordance with the Regulation, are subject to the limits of the "bonus pool" and also given in the manner and with the timeframes described above under point B).

Calculation of the variable component of the remuneration

Corporate performance

The Executive Committee, having been advised by the Appointments Committee, will evaluate the 2013 corporate performance, determining the corporate performance index in accordance with the budget and any other economic parameters.

This is how a variable remuneration system is created, relating the individual performance parameters to the overall group financial performance, to ensure that the bonus system is consistent with the long-term corporate and bonus objectives, while also encouraging staff loyalty.

The Bank will also be able to maintain or reach a sound capital base by using this instrument.

Individual Performance

The Executive Committee, in accordance with the Appointment Committee, will authorise the CEO to determine the individual performance of each employee in accordance with the hierarchical line and using the criteria described below. As set out under paragraph 8, the bonus plan will require the approval of the Board of Directors for key staff.

Amounts paid in breach of the provisions of the Bank of Italy Regulation of 30 March 2011 (paragraph 5.2.5) will be subject to a claw back clause.

The discretionary cash bonus - part paid in the year of assessment

In the first quarter following each year, all employees will be assessed with respect to their achievement of the individual goals for the year in question. On the basis of that assessment and whether or not they reached the quantitative and qualitative goals established by the business plan of the Bank, the discretionary bonuses for the previous year will be assigned and given in the first half of each year, and which may vary from 0% to other percentages on the basis of the individual performance.

The individual qualitative criteria that forms the basis of the assessment includes:

- compliance and respect for the values (Integrity, Independence, Excellence, Transparency, Social and Environmental Responsibility) on which Banca Sistema bases its business, applicable law and the Group Code of Ethics;
- honesty in relations with customers and enhancing customer loyalty;
- professional capacity and skills;
- constant dedication to work, availability with respect to colleagues and the ability to work as a team;
- the capacity to find concrete and possibly innovative solutions, with the objective always being the sound and prudent management of the Bank and its values over the long term;
- the ability to take responsibility for decisions; the ability to promptly to pursue the goals identified;
- the capacity to optimise the use of resources; the capacity to involve and motivate co-workers, encouraging growth including through the attentive use of authorisation;
- the reduction of legal and reputation risk.

The individual quantitative criteria listed can include profitability, volumes, cost control, reduction of risk, funding and loans in the medium-long term.

10.2.2) The discretionary cash bonus -deferred portion

The CEO and all the staff may receive deferred bonuses within the scope of the long-term bonus plan as described above.

The deferred bonus will be given three years after the year following the one in which the service was provided.

The amount of the deferred bonus will be corrected by a correction factor equal to the ROE for the year in the first year of payment. This figure may obviously be positive or negative in accordance with the group's performance for the year.

The bonus amount thereby calculated will form the basis for the calculation of the bonus for the following year.

QUANTITATIVE DISCLOSURE

The table below shows the remuneration amounts for the year, divided into the fixed and variable components, and the number of "Managers with executive powers", "Managers of the main company departments", and "Managers and staff at the highest levels of the internal control bodies" beneficiaries of the Banca Sistema Group. The total figures include the beneficiaries of Banca Sistema and the other Group companies and the breakdown includes persons who hold more than one different position.

Beneficiary Category	Number of beneficiaries	Fixed remuneration	2013 bonus available	Deferred 2013 bonus
Managers with executive powers	6	623,833	212,350	139,066
Managers of the main company departments	9	941,236	114,950	72,133
Managers and staff at the highest levels of the internal control bodies	4	418,807	31,000	//
Other risk takers	2	261,896	39,000	26,000