Banca Sistema Group

DISCLOSURE BY THE ENTITIES PURSUANT TO EU REGULATION NO. 575/2013
THIRD PILLAR

31 December 2015

BANCA
SISTEMA
CONTEMPORARY BANK

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INTRODUCTION

This document complies with the prudential supervisory provisions which, in order to strengthen market discipline, call for public disclosure obligations (the so-called third pillar) regarding:

- capital adequacy;
- risk exposure;
- the general characteristics of the systems in place to identify, measure, and manage said risks.

The information subject to disclosure requirements are quantitative and qualitative in nature and are classified into general frameworks sections, each of which regards a particular disclosure area.

In particular, said public disclosure was written taking into account the following Regulations:

- EU Regulation no. 575/2013 of 26 June 2013 (CRR);
- Directive 2013/36/EU (CRD IV);
- "Supervisory provisions for banks" - Bank of Italy, Circular no. 285 of 17 December 2013;

Part eight (EU Regulation no. 575/2013 of the European Parliament and Council of 26 June 2013)		Qualitative information	Quantitative information
Section 1	Risk management objectives and policies (Art. 435)	X	N/A
Section 2	Scope of application (Art. 436)	X	N/A
Section 3	Own funds (Art. 437)	X	X
Section 4	Capital requirements (art. 438)	X	X
Section 5	Exposure to counterparty risk (Art. 439)	X	X
Section 6	Capital buffers (art. 440)	N/A	N/A
Section 7	Indicators of global systemic importance (Art. 441)	N/A	N/A
Section 8	Credit risk adjustments (Art. 442)	X	X
Section 9	Unencumbered assets (Art. 443)	X	X
Section 10	Use of ECAIs (Art. 444)	X	X
Section 11	Exposure to market risk (Art. 445)	N/A	N/A
Section 12	Operational risk (Art. 446)	X	N/A
Section 13	Exposures in equities not included in the trading book (Art. 447 CRR)	X	X
Section 14	Exposure to interest rate risk on positions not included in the trading book (Art. 448)	X	X
Section 15	Exposure to securitisation positions (Art. 449)	N/A	N/A
Section 16	Remuneration policy (Art. 450)	X	N/A
Section 17	Leverage (Art. 451)	X	X
Section 18	Use of the IRB Approach to credit risk (Art. 452)	N/A	N/A
Section 19	Use of credit risk mitigation techniques (Art. 453 CRR)	X	X
Section 20	Use of the Advanced Measurement Approaches to operational risk (Art. 454)	N/A	N/A
Section 21	Use of the IRB Approach to market risk (Art. 455)	N/A	N/A

Note that the information required by sections: 6 “Capital buffers”, 7 “Indicators of global systemic importance, 11 “Exposure to market risk”, 15 “Exposure to securitisation positions”.18 “Use of the IRB Approach to credit risk”, 20 “Use of the Advanced Measurement Approaches to operational risk and 21 “Use of Internal Market Risk Models, is not provided herein being that it does not regard the scope of operations, the risks taken on, and the methodologies used.

Banca Sistema publishes this public disclosure and any subsequent updates on its Internet site at the address www.bancasistema.it, in the Pillar III section of the Investor Relations area.

SECTION 1 – RISK MANAGEMENT OBJECTIVES AND POLICIES

(ART. 435 CRR)

QUALITATIVE INFORMATION

Organisational structure

Banca Sistema S.p.A. Group (hereafter the "Bank" or "Banca Sistema") ascribes great significance to risk management and control, as necessary conditions to guarantee the generation of sustainable value within a context of controlled risk.

The Risk Management strategy seeks to acquire a complete and coherent vision of the Bank's risks continuously stimulating the development of the risk culture in all of the Bank's functions.

Starting from 1 January 2014, the Bank has used a reference framework both to identify its own risk appetite and for the internal process of determining capital adequacy. This system is the Risk Appetite Framework (RAF) designed to make sure that the growth and development aims of the Bank are compatible with capital and financial solidity. The RAF comprises monitoring and alert mechanisms and related processes to take action in order to promptly intervene in the event of discrepancies with defined targets. The framework is subject to annual review in light of strategic guidelines and regulatory changes.

Consistent with the legal and regulatory provisions in force, the Bank adopts an internal control system based on three levels:

- **first level:** direct line controls to ensure the correct execution of the transactions, performed by the operational structures themselves (for example, hierarchical, systematic and test-checked controls), including by units dedicated exclusively to control duties that report to the managers of the operational structures, or also performed within the purview of the Back Office and - as far as possible - incorporated in IT procedures. These controls are carried out by the operational, business, and support functions (the so-called "first level functions"). The operational structures are the first one responsible for the risk management process.

- **second level:** controls on risks and on compliance having the objective, among other things, of ensuring:
  - the correct implementation of the risk management process;
  - the observance of the operating limits assigned to the various functions;
  - the compliance of business operations with the regulations, including those of self-regulation.

  Second level controls (risk management, compliance, and the prevention of money laundering) are assigned to the Risk and Compliance Division.

- **third level** controls of statutory audit, focused on identifying the breaches of procedures and regulations, as well as on evaluating the completeness, adequacy, functionality, in terms of efficiency and effectiveness, and reliability of the organisational structure of the other internal control system components and of the IT system (ICT audit), at regular intervals in relation to the nature and intensity of the risks. The third level controls are performed by the Internal Audit Division.

A summary of the main roles and responsibilities of the corporate bodies/functions concerned in the overall risk management and control activity, as defined in the "Regulations for the Coordination of the Control functions" approved by the Board of Directors of Banca Sistema S.p.A. in its meeting of 29 April 2016, is provided below.

The corporate bodies, the internal governance structures and the functions responsible for ensuring the completeness, adequacy, and reliability of the internal control system are:

- Governance bodies
  - The Board of Directors; avails itself of the following Internal Board Committees
    - Executive Committee
    - Internal Control and Risk Management Committee
    - Appointments Committee
    - Remuneration Committee
    - Ethics Committee
  - The CEO and General Manager also avail themselves of the following Company Committees:
    - CEO Committee (Management Committee)
    - Risk Management Committee
    - Technical Organisational Committee
    - Crisis Management Committee

- Company control functions
  - Risk and Compliance Division
    - Risk Management Function
    - Compliance and Anti-Money Laundering Function
  - Internal Audit Division
  - Designated manager

<u>Governance bodies: Board of Directors</u>

The Board of Directors (body with strategic supervisory functions) retains the powers prescribed by article 12 of the Articles of Association, by the Italian Civil Code, by the other applicable legal and regulatory provisions, by the Code of Conduct and by the supervisory provisions in force from time to time.

<u>Internal board committees</u>

Executive Committee

The Executive Committee is vested with specific powers in support of the Board of Directors for the current Bank management, exercised in accordance with the guidelines and policies formulated by the Board, without prejudice to matters reserved for the latter.

Internal Control and Risk Management Committee

The Internal Control and Risk Management Committee is made up predominantly of independent directors and has the duty to assist the Board of Directors with preliminary advisory and propositional functions in the assessments and decisions relative to the internal control system and risk management, including those relative to the periodic financial reports as well as those relative to risk management deriving from prejudicial facts of which the Board of Directors has become aware.

Specifically, the Committee expresses its opinion to the Board of Directors in relation to the definition of the policies and the assessment, at least annually, of the adequacy of the Control and Risk Management Systems, to the results presented by the Statutory Auditor with regard to company accounting reports, evaluating the proper use of the accounting standards and their level of standardisation for the purpose of drafting the consolidated financial statements.

Appointments Committee

The Appointments Committee consist of three non-executive directors (two of which independent) and plays an advisory and propositional role in identifying the best composition of the Board of Directors, indicating the professional figures whose presence may favour its proper and effective operation and if necessary helping to prepare the Bank's Executive Directors succession plan. The Committee also plays an active role in appointing the managers of the company internal control functions.

Remuneration Committee

The Remuneration Committee consists of three non-executive directors (two of which independent) and plays a proactive and preliminary role on behalf of the Board of Directors, thereupon to defining a policy for the remuneration of the directors and key management personnel, including the remuneration of all of the most significant personnel in conformity with Bank of Italy Circular no. 285/13. The Committee directly oversees the correct application of the rules relative to the remuneration of the managers of the company internal control functions, in accordance with the Board of Statutory Auditors.

Ethics Committee

The Ethics Committee supports the Board of Directors in identifying and assessing the ethical principles for defining the conduct policy, evaluating the degree to which said principles must be applied to the corporate environment; it supervises over the publication of the Code of Ethics and the guidelines for external corporate communications regarding this matter.

Governance bodies: CEO and General Manager

The CEO is charged with the current management of the Bank in line with the powers conferred thereupon by the Articles of Association and by the Corporate Bodies; for an effective assessment regarding the specific matters within his remit, he also avails himself of the specific internal management committees that support him, each for their specific remit.

The CEO participates, with propositional and decision-making functions, in the Board of Directors' and in the Executive Committee meetings (where he has the role of Chairman) implementing the policies resolved upon.

The CEO also plays the role of Director in charge of the internal control and risk management system in compliance with the Code of Conduct.

External board committees

Though guaranteeing the complete independence of the risk control function from the risk-assumption process, Banca Sistema established the following managerial Committees that see to the management of the various risk profiles.

CEO Committee (or Management Committee)

The CEO Committee has the duty to assist the CEO in all matters relative to the governance and to the Bank's activities, any critical issues, the dissemination of information and to define the agenda proposals of the Board of Directors and of the Executive Committee meetings.

The CEO convenes the CEO Committee meeting weekly, presiding over it and establishing the meeting agendas.

Risk Management Committee

The Risk Management Committee, within the purview of the internal control system, supports the CEO in defining the strategies, the risk policies, and the revenue objectives, proposing interventions and strategies for adapting thereto; it monitors capital adequacy with respect to the risk/profitability objectives taking into account the various types of risks and the correlations between them, and the compliance with the regulatory prescriptions on risk management and compliance; it analyses the organisational model underlying the measurement process and approaches for assessing and monitoring the various types of risk.

Technical Organisational Committee

The Technical Organisational Committee supports the CEO in monitoring the organisation's technical and operational requirements, formulating proposals for intervention and improvement, and supervises over the setting up and development of the organisational model. It collects and examines the organisational proposals of the various Functions, helping to define the corrective action and coordinating new projects, defining priorities and governing implementation.

Crisis Management Committee

The Crisis Management Committee is the structure responsible for crisis management and, from its formation to its termination, it is the highest decision-making and governance body of the Bank during a crisis.

Control bodies: Board of Statutory Auditors

The Board of Statutory Auditors supervises over the observance of legal, regulatory, and statutory provisions, on proper administration, on the adequacy of the organisational and accounting structure, and on the proper performance of the strategic and management control activities by the Bank.

The Board of Statutory Auditors (body with control function) is also responsible for supervising over the completeness, adequacy, functionality, and reliability of the internal control systems and of the RAF.

To perform its functions, said body avails of adequate information flows from the other corporate bodies and control functions.

Control bodies: Supervisory Body pursuant to Italian Legislative Decree no. 231/2001

The Supervisory Body (or "SB") is appointed by the Board of Directors with the duty to oversee the functioning, observance, and adequacy of the Organisational and Management Model (or "OMM") to prevent the offences anticipated by Italian Legislative Decree no. 231/2001 as well as to verify its consistency and validity over time.

The SB's duties, composition, and powers are described in the OMM and in the SB Regulation.

The SB is composed of the Chairman of the Board of Statutory Auditors (Chairman), an independent director, and the manager of the Internal Audit function.

Company control functions

The following organisational structures, which perform the activities prescribed for the company control functions, have been established in Banca Sistema:

I. Risk and Compliance Division
   - Risk Function
   - Compliance and Anti-Money Laundering Function

II. Internal Audit Division

III. Designated Manage

These Divisions are separated from each other with regard to organisation.

For each Division, the internal regulation describes roles and responsibilities, duties, operating procedures, information flows, and the scheduling of audit activities on a company level.

More specifically:

- Each year, the Compliance and Anti-Money Laundering Function and the Risk Function present the Corporate bodies, each based on their respective areas of competence, an activity schedule that identifies and assesses the main risks to which the Bank is exposed and the relevant management interventions. The intervention scheduling takes into account both any deficiencies observed in the inspections, and any new risks identified;
- Each year, the Internal Audit Function presents the corporate bodies an Audit Plan that indicates the scheduled auditing activities, taking into account the risks of the various activities and company structures; the plan contains a specific section relative to the auditing activity on the IT system (ICT auditing).

At the end of the management cycle, hence annually, said functions present the corporate bodies a report on the activities carried out, illustrating the audits performed, the results obtained, any weaknesses observed, and they propose interventions to be adopted to eliminate them; furthermore, each for the aspects relevant to their corresponding remit, they report on the completeness, adequacy, functionality, and reliability of the internal control system.

Risk and Compliance Division

The Risk and Compliance Division reports directly to the CEO.

The following functions operate within the Division:
- Risk
- Compliance and Anti-Money Laundering

The Compliance and Anti-Money Laundering Function therefore reports to the Risk and Compliance Division manager. The Compliance and Anti-Money Laundering Function includes the roles of the Compliance Officer and the Head of Anti-Money Laundering.

Risk Function
The Risk Management Function tasked with the identification, management and monitoring of all risks to which the Bank is or may be exposed. The Risk Management Function has the duty to cooperate in the formulation and implementation of the Risk Appetite Framework (RAF) and the related risk governance policies, and the various stages that make up the risk management process as well as in setting operational limits for the assumption of various types of risk.

Compliance and Anti-Money Laundering Function
The Compliance and Anti-Money Laundering Function is responsible for managing compliance risk with regard to all the business activities, verifying that the internal procedures are suitable to prevent said risk. The Function collaborates with other Bank's structures to define the methodologies for assessing the risk of non-compliance with the provisions.

The Compliance and Anti-Money Laundering Function is a control function, which includes the Anti-money laundering Function, and is established with the purposes of inspecting, with a risk-based approach.

Internal Audit Division

The Internal Audit Division reports directly to the Board of Directors and is functionally under the CEO.

The Internal Audit Division assesses, with a third level, the overall functioning of the internal control system, bringing possible improvements to the attention of the Corporate bodies. In particular, the Division assesses the completeness, the adequacy, the functioning, and the reliability of the components of the internal control system, of the risk management process, and of the company processes, also having regard to the capacity to identify errors and irregularities. In this context, among other things, it inspects the company risk control and compliance functions.

Designated manager responsible for drafting company accounting documents

In April 2015, the Board of Directors appointed Margherita Mapelli as Designated manager responsible for drafting company accounting documents, in accordance with the provisions pursuant to art. 154-bis of the Consolidated Law on Finance (TUF).

The new Designated manager - selected among the company managers - possesses the professional qualification – consisting in specific expertise in matters of accounting and financial information and of management and control of the respective Administrative Procedures - required by the Articles of Association. The Designated manager also possesses integrity requirements established by the standards in force for the members of the control bodies of listed companies.

For the purposes of fulfilling the obligations required by the cited regulatory provisions, the Designated manager plays a guiding and coordinating role in administrative matters involving the entire Group as well as an oversight role on the internal control system used for accounting and financial information and supervises over the implementation of formalities in accordance with common configurations at the Bank, approved by the Board of Directors.

The mapping of significant risks

Based on the analysis conducted, the Bank, considering its current and future operations, is exposed to the following risks at 31 December 2015:

I. Pillar 1 risks
   - credit and counterparty risk
   - market risk;
   - operational risk;

II. Pillar 2 risks
   - concentration risk;
   - liquidity risk;
   - excessive leverage risk;
   - interest rate risk on the banking book;
   - strategic risk;
   - reputational risk;
   - compliance risk.

The Bank instead is not exposed to residual risks, to participation risk, to basis risk, country risk, transfer risk, or to securitisation risk.

To determine the capital requirement on the first and second pillar risks, the Bank uses the standard approaches, that will be more clearly described in the following paragraphs.

All the analyses the Risk and Compliance Division conducts on the potential risk areas observed and on possible mitigation measures are formalised in the Tableau de Bord or on other specific income analysis documents submitted to the attention of the Risk Management Committee, of the Internal Control and Risk Management Committee, and of the Board of Directors, together with the Board of Statutory Auditors.

Risk management hedging policies

Pillar I

Credit risk consists in risk that the counterparty borrower is unable to honour its contractual commitments, thus resulting in an unexpected loss thereto so as to place its financial stability at risk in the immediate future.

The components of Banca Sistema 's operations that mainly generate credit risk are illustrated below:

a. Acquisition of receivables with and without recourse (factoring);
b. Loans to SME
c. Purchases of loans granted in the form of salary- and pension-backed loans/salary deductions from other intermediaries;
d. Financial instruments held on its own account;
e. Loans to supervised brokers.

For the purpose of determining the internal capital with respect to credit risk, the Bank uses the standardised approach, provided for the determination of the regulatory requirements with respect to credit risk[1].

The internal capital with respect to credit risk is, therefore, equal to the capital requirements defined in accordance with Pillar 1 regulations. The capital requirement is constantly measured and reported quarterly to the Bank of Italy.

In general, continuous analyses and measurements aimed at classifying exposures among the credit quality risk categories were conducted for all credit risk exposures, where deemed expedient.

The paragraphs below illustrate the credit risk management and mitigation controls specifically implemented based on the various transaction types.

<u>a. Acquisition of receivables with and without recourse (factoring):</u> Banca Sistema's policy predominantly consists in the purchase of receivables via without recourse factoring owed by central administrations, territorial bodies, and, in general, by Public Administration entities, and is characterised by the direct assumption of final debtor's credit risk. Credit risk is generated as a direct result of the definitive acquisition of credit from the customer company versus the insolvency of the assigned debtor.

Furthermore, the Bank accompanied its core business with the purchase of receivables with and without recourse/ maturity with exposures to private debtors.

Maintaining effective Credit Risk Management is a strategic objective for Banca Sistema and is pursued adopting integrated instruments and processes to ensure correct credit management in all phases (processing, disbursement, monitoring and management, intervening on loans with credit quality problems).

The credit risk management process provides for the involvement of Banca Sistema's various Central structures; this organisation of activities allows, via the specialisation of the resources and the separation of functions at each decision-making level, a high degree of efficiency and standardisation in overseeing credit risk and monitoring individual positions.

(1) Cf: "Supervisory provisions for banks" - Bank of Italy, Circular no. 285 of 17 December 2013 as amended, Part II, Chapter 3.

b. Loans subordinate to the issuing of guarantee by the National Guarantee Fund for SMEs: loans disbursed by Banca Sistema to undertakings classified as small to medium enterprises (SMEs). The granting of a loan is contingent upon the presence of the guarantee issued by the National Guarantee Fund (Fund) for SMEs (Italian Law no. 662/96 as amended) managed by the Mediocredito Centrale S.p.A. (MCC).

The presence of the Fund guarantee strictly limits the Bank's credit risk to the unsecured portion of the loan.

c. Salary/Pension backed loans: starting from June 2014, Banca Sistema (the so-called "Assignee") extended its business to the acquisition without recourse, from financial companies active in the sector (the so-called "Assigning company"), of the receivables deriving from:

- salary backed loans (hereafter also SBL) to public and private sector employees;
- pension-backed loans (hereafter also PBL);
- salary deductions to public-sector employees

The Credit Management Function conducts specific and constant monitoring of the factoring portfolio, Loans to SMEs and SBL/PBL/salary deductions. This Function conducts assessments and audits on the factoring portfolio based upon the guidelines defined within the "collection policy". The Credit Manager coordinates the monitoring activities and any out-of-court collection with the Servicing Function or other outside companies assigned.

The Bank performs second level controls following all phases of the credit process and continuously monitoring the credit risk in order to promptly detect any anomalies and/or discontinuities and to evaluate the persisting maintenance of a risk profile in line with the strategic indications provided.

d. Financial instruments held on its own account: Investments in italian government securities for which the Bank has set up a specific system of limits, structured so as to guarantee a careful and balanced management of operational autonomies within the scope, among other things, of the transactions regarding financial instruments recorded in the banking book and held on its own account, are classified in this portfolio.

Italian government security trading operations entail a credit risk exposure to Central administrations.

e. Exposures to supervised brokers: any excess liquidity is for the most part placed in the interbank market, resulting in a credit risk exposure to supervised brokers.

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

Counterparty risk is the risk that the "counterparty of a transaction having as its subject matter specific financial instruments may be in default prior to the settlement of the transaction itself"[2]. It differs from credit risk by virtue of the type of transactions to which it refers; typically, these can be attributed to transactions that generate an exposure equal to their positive fair value, that have a market value evolving over time based on underlying variables and generate an exchange of payments, financial instruments or commodities against payments. A distinctive feature of counterparty risk consists in determining a bilateral-type risk, for which both counterparties are exposed to the risk of incurring unforeseeable losses.

(2) Cf. Supervisory provisions for banks" - Bank of Italy, Circular no. 285 of 17 December 2013, Part II, Chapter 7 as amended.

In relation to Banca Sistema's operations, the risk is generated mainly by repos having as the counterparty the Compensation and Guarantee Fund or others institutional counterparties. The Comprehensive Method is used to measure counterparty risk[3].

Risk mitigation is pursued by a careful management of the operational autonomy, establishing limits both in terms of responsibility and the consistency and composition of the portfolio by type of security.

Market risk: As at 31 December 2015 the Bank was not exposed to said risk.

Market risk consists in the downside risk to which a financial intermediary is exposed from conducting financial instrument trading transactions in markets. In particular, the risk of posting losses due to adverse trends in the reference market, that could cause an unexpected and unforeseeable reduction in the value of the instruments held.

These are risks generated by market trading transactions regarding financial instruments and currencies; the important components are:

- position risk, divided into generic risk, caused by an favourable price trend of the bulk of the instruments traded, and specific risk, due to factors related to the issuer's status;
- settlement risk, including the transactions not yet settled after the due date that expose the Bank to the downside risk deriving from non-settlement of the transaction;
- concentration risk, which calls for a capital requirement specific for the banks that, as an effect of the risk positions relative to the regulatory trading portfolio, exceed the individual credit line limits;
- foreign exchange risk, which is the risk of incurring losses as a result of adverse changes in the prices of foreign currencies.

The internal capital with respect to market risk is determined in accordance with the standardised approach. This approach anticipates the calculation of the requirement based on the so-called building block approach according to which the overall requirement is given by the sum of the capital requirements determined for the individual market risks (position, regulation and concentration risk). This approach is prudential, being that linearly summing the individual requirements, the benefits provided by diversification are ignored, thus obtaining a capital requirement greater than the risk assumed.

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

Operational risk: Operational risk is the risk of loss arising from inadequate or dysfunctioning internal processes, human resources or systems, or from external events.

In this context, the Bank implemented an operational risk management process (Operational Risk Framework) to identify, measure, and monitor the operational risk (Cf: Table 12 - Operational Risk)

The Information and Communication Technology (ICT) risk is the risk of incurring economic, reputational and market losses in relation to the use of information and communication technology. In the supplemented representation of the business risks, this type of risk is considered, in accordance with the specific aspects, among operational, reputational and strategic risks.

(3) Cf. EU Regulation 575/2013 Title II, Chapter 4.

The Bank monitors the ICT risks based on the continuous information flows regarding IT risks between the functions concerned. The Bank ensures the consistency between the results deriving from the ICT risk assessment and what has emerged in the operational risk assessment.

As an additional oversight of operational risk, the Bank has opened an insurance policy on operational risks deriving from actions of third parties or caused to third parties, as well as suitable riders to cover the damages caused by suppliers of infrastructures and services, and it approved a Business Continuity Plan.

Pillar II

The Bank is exposed to the following Pillar 2 risks.

Concentration risk: the relevant legislation with regard to Prudential supervision (circular 285/13 as amended) defines this as the risk deriving from exposures to counterparties, groups of associated counterparties and with the counterparties of the same economic sector or that carry out the same activities or are in the same geographical area.

The Bank measures geo-sectorial concentration risk following the proposed ABI approach. The ABI approach allows the effects on the internal capital caused by changes of sectorial concentration to be assessed. Said effects are calculated using a benchmark with respect to which, by applying a markup coefficient, any adjustment of internal capital (Add-on) is quantified.

Furthermore the bank measures the single-name concentration risk using the standard approach indicated by the supervisory authority[4]. This approach results in an add-on of capital, based on the Herfindahl index, calculated with respect to the exposures, and to a proportionality constant, calibrated as a function of the portfolio risk.

Interest rate risk represents the risk, current or prospective, of a decrease of value of the capital or a decrease of the net interest income deriving from the impacts of the adverse changes in the interest rate.

The exposure to interest rate risk on the banking book is calculated as provided for by current regulations, via the simplified regulatory approach[5].

In this way, the Bank is able to monitor the impact of unexpected changes in market conditions on shareholders' equity, thus identifying the relative mitigation measures to be implemented.

The company functions responsible for guaranteeing the correct management of the interest-rate risk are the Treasury Division, the Risk Function, which is responsible for determining the most appropriate risk indicators and for monitoring their performance of the assets and liabilities, and Top Management which has the specific duty, of annually presenting the Board of Directors with the lending, deposits and savings, and interest-rate risk management policies, as well as suggesting during the year any expedient interventions to ensure the performance of the activity consistent with the approved risk policies.

As at 31 December 2015, no interest rate risk hedging instruments were used.

(4) Cf: "Supervisory provisions for banks" - Bank of Italy, Circular no. 285 of 17 December 2013 as amended, Title III, Chapter 1, Schedule D.
(5) Cf. Circular no. 285/2013, Part One, Title III, Chapter 1, Schedule C

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

- *Funding Liquidity Risk*: the inability to acquire funds or to honour ones respective payment commitments at market cost, i.e. incurring high funding costs.
- *Market liquidity risk*: presence of limits to the freeing-up of assets or of losses in capital account based on the freeing-up thereof.

In particular, with reference to the liquidity risk understood as the difficulty of acquiring the funds to honour ones payment commitments, a distinction is made between:

- *Mismatch liquidity risk*: the risk deriving from the asymmetry between the amounts and/or the maturities of the incoming and outgoing flows relative to the Bank's operations, with reference both to the contractual maturities and conduct.
- *Contingent Liquidity Risk*: the risk deriving from unexpected future events that may require an amount of liquidity greater than that currently considered to be necessary; it is the risk of not honouring sudden and unexpected short-term payments.

The methodology used by the Bank to measure liquidity risk, follows the liquidity gap approach identified by the Bank of Italy guidelines.

In that regard, it should be noted that the Bank has second level Key Risk Indicators (KRI) that verify the continuous alignment with Basel regulatory targets. In detail, the Bank monitors the short term Liquid Coverage Ratio (LCR) defined by the ratio between the stock of high quality liquid assets (HQLA) and the net outflows over a time horizon of 30 days. The monitoring of the Liquidity Coverage Ratio makes it possible to verify whether the Bank maintains a level of high-quality liquid non-term restricted assets, readily convertible into liquidity to satisfy the needs relative to a time interval of 30 days, during any particularly significant liquidity stress scenario. The stock of liquid assets should at least allow the Bank to honour their financial commitments over a time horizon of thirty days, a period within which it is supposed appropriate remedial actions on the part of the corporate bodies and/or by the Regulatory Authorities may be taken in order to rectify any deficit observed.

With regard thereto, Banca Sistema, prudentially, during 2015 constantly maintained a large quantity of securities and readily liquid assets hedging potential outflows of liquidity.

With reference instead to the structural liquidity indicators, the Bank uses the Net Stable Funding Ratio (NSFR) defined as the available amount of stable funding and the required amount of stable funding. The NSFR establishes a minimum acceptable amount of stable funding based on the liquidity characteristic of the assets and on the transactions of an institution over a time horizon of one year. The use of said indicator should prevent an excessive recourse to short-term wholesale loans on the part of the Bank.

Furthermore to guarantee an adequate level of protection against liquidity risk, the provisions enacted by Basel Committee in terms of the matters below were applied:

- the formalisation of Liquidity Risk Governance policies, consistent with the characteristics and the size of the transactions;
- the assessment of net financial position;
- the performance of periodic stress tests (sensitivity analysis for class 3 Banks) to evaluate the impact of negative events on risk exposure and on the adequacy of the liquidity reserves;

- the constant retention of adequate liquidity reserves;
- the definition of operational limits;
- the definition of appropriate liquidity risk mitigation instruments, first by drafting an adequate Contingency Funding Plan, that guarantees the protection of capital in situations of liquidity drainage, via the preparation of crisis management strategies and procedures for acquiring funding sources in case of emergency.

In order to determine an adequate protection against liquidity risk, roles and responsibilities were identified, in particular:

- Treasury Division (first level protection) represents the first protection in liquidity risk management. The function calculates and monitors the risk indicators;
- Every month, the Risk Division (second level protection), conducts the second level controls in liquidity risk management and continuously assess the adequacy and proper implementation of the Liquidity Policy and of the Contingency Funding Plan.

The liquidity status is subject to a careful and continuous monitoring by the Treasury and Risk Divisions, also in connection with the Risk Management Committee meetings.

The Risk Division periodically provides the CEO and the Board of Directors with adequate reporting concerning the Liquidity risk.

Through the Liquidity Policy and the Contingency Funding Plan, the Bank structured the liquidity risk management on three interconnected levels, which correspond to specific purposes:

- **Operational liquidity** (short term – up to 12 months), with the purposes of guaranteeing the Bank's capacity to honour its anticipated and unforeseen cash payment commitments for the next 12 months;
- **Structural Liquidity** (medium-/long-term - beyond 12 months), meant to maintain an adequate ratio between overall liabilities and medium/long term assets aimed at avoiding pressure on current and prospective sources in the short-term;
- **Contingency Funding Plan** (CFP) regulates the process, the roles and the responsibilities in case of liquidity crisis situations.

The liquidity management policy and CFP policy provided for the following fundamentals:

- identifying tasks and responsibilities to be assigned to the company functions involved in the liquidity management process;
- defining the operating processes associated with performing the activities;
- determining the measuring tools;
- defining the Operating Limits, Warning Indicators, and Tolerance Thresholds.

Risk of excessive leverage risk of excessive leverage means the risk that a level of debt particularly high with respect to the bank's own funds renders the bank vulnerable, making the adoption of corrective measures necessary in its business plan, including distressed selling of assets which might result in losses or in value adjustments to its remaining assets;

The indicator is reported quarterly to the Bank of Italy for monitoring purposes. Throughout 2015, Banca Sistema always maintained an indicator level above the regulatory limit proposed by the Basel Committee.

Reputational risk is the risk of incurring losses subsequent to events so as to result in a worsening image in the eyes of the various types of stakeholders (shareholders, customers, counterparties, investors, Regulatory Authorities). Said negative perception may be due as much to direct experiences on the part of the parties considered as it can to sensations thereof, not necessarily caused by concretely observable events.

The reputation is associated with the sum of factors whose value expresses the company's capacity to create "wealth" not only for its shareholders but, in a more extensive sense, for all the stakeholders.

Knowledge of the difficulties associated with quantifying reputational risks have driven the Bank to implement suitable measures to mitigate them, focusing its inquiries on the quality of the organisational and control structures.

Within this framework, the utmost consideration was given to profiles capable of guaranteeing substantial compliance with the correctness and professional competence requirements, with particular regard to:

- the level of awareness of the top management bodies regarding the relevance of subject;
- the promotion of a culture of ethics and correct conduct at all levels of the company;
- the suitable management of relations with all stakeholders;
- the suitability of the risk management and mitigation systems;
- the effectiveness of controlling action by the Supervisory Body.

Strategic risk is the risk, current or prospective, of a decrease in earnings or capital, which can generally be attributed to four very specific cases:

- changes of the business environment;
- erroneous company decisions;
- inadequate implementation of decisions made;
- poor or erroneous reactivity to changes in the business environment (structural break).

The onset of strategic risk, therefore, can be attributed to a situation of discontinuity in the normal performance of business activities, whether due to internal or external changes to the company scope or any substantial non-existence of the risk in question due to the presumable stability of the normal course of business management.

It would be advisable to place special emphasis on the fact that, as it is configured, this risk takes on a connotation of peculiar criticality, due to the elevated dynamism required by the decision-making bodies in defining adequate and prompt corrections consistent with the continuous changes in the macroeconomic context/business cycle characterising the market in which the Bank operates.

A few cases that may typically lead to strategic risk are listed below:

- acquisition transactions/partnerships;
- changes in the company structure;
- consolidation operations/growth in size meant to attain economies of scale;
- diversification of products and distribution channels;
- technological innovation and operational optimisation oriented towards increasing the quality of the services offered.

Compliance risk is the risk of non-compliance with the regulations and in incurring judicial or administrative penalties, significant financial losses or damages to reputation as a consequence of violations of imperative provisions (as prescribed by law or regulations) or also of self-regulation (for example articles of association, codes of conduct, corporate governance codes).

Said risk is distributed at all levels of the corporate structure, especially in connection with the operating lines; the prevention must first of all be performed where the risk is generated: it is therefore necessary that all personnel appropriately assume their responsibilities.

Generally, the most significant regulations for the purpose of compliance risk are those regarding the performance of intermediation activity, the regulations to prevent money laundering, the management of conflicts of interest, the transparency with respect to customers and, more generally, the regulations in place to protect consumers.

With respect to monitoring compliance risk, following the joining of the Compliance and Anti-Money Laundering Function with the Risk and Compliance Department, a new methodological approach was established governing the activities of that Function from the second half of 2014. This approach is based on a risk-based perspective, taking advantage of the synergies with the activities already carried out by the Department on the subject of risk management. In this context, a centralised compliance model has been adopted which provides for regulations with a direct scope or supervised directly by the Department and with an indirect scope, for which a specialist function is in place with primary responsibility for the management and monitoring of the compliance risk.

SECTION 2 - SCOPE OF APPLICATION

(ART. 436 CRR)

QUALITATIVE INFORMATION

The public disclosure obligations, reported in this document apply to Banca Sistema S.p.A., consistent with article 19 of EU Regulation 575/2013, which provides for the option of exemption from inclusion of the companies in prudential consolidation, where the total amount of assets and off-balance sheet items of the undertaking concerned is lower than the smaller of EUR 10 million or 1 % of the total amount of assets and off-balance sheet items of the undertaking that holds the investment.

On 31 December 2015, the Banca Sistema Group comprised the Parent Company, Banca Sistema S.p.A., and Speciality Finance Trust Holding Limited, a company incorporated under UK law and fully controlled by the Bank.

SECTION 3 - OWN FUNDS

(ART. 437 CRR)

QUALITATIVE INFORMATION

Own Funds, risk weighted assets and solvency ratios as at 31 December 2015 were determined based on the new regulation, harmonised for Banks, contained in the Directive 2013/36/EU (CRD IV) and in the Regulation (EU) 575/2013 (CRR) of 26 June 2013, that transpose in the European Union the standards defined by the Basel Committee on Banking Supervision (the so-called Basel 3 framework), and based upon the Circular of the Bank of Italy no. 285 and no. 286 (enacted in 2013), and the update of Circular no. 154.

The above regulatory framework provides for that Own funds (or regulatory capital) be characterised by structure based on two tiers:

- Tier 1 Capital in turn composed of:
  - Common Equity Tier 1 Capital, CET 1;
  - Additional Tier 1 Capital – AT1;
- Tier 2 Capital (T2)

The legislative provisions relative to own funds require the gradual introduction of the new regulatory framework, through a transitory period, in general until 2017, during which certain elements that under normal circumstances will be computable or fully deductible in Common Equity, impact Common Equity Tier 1 capital only by percentage.

The conditions provided for by art. 26(2) of the EU Regulations no. 575 of 26 June 2013 (CRR) having been met due to its computability, the profit for the year net of the portion intended for dividends was considered in the Common Equity Tier 1 capital, in accordance with board resolutions.

On the following page is a summary chart of the terms and conditions of the Common Equity Tier 1, Additional Tier 1 Capital, and Tier 2 capital

Main characteristics of capital instruments				
		Ordinary shares	Subordinated Tier 1 bonds	Subordinated Lower Tier 2 bond
1	Issuer	Banca Sistema S.p.A.	Banca Sistema S.p.A.	Banca Sistema S.p.A.
2	International Securities Identification number (ISIN)	IT0003173629	IT0004881444	IT0004869712
3	Legislation applicable to the instrument	Italian law	Italian law	Italian law
Regulatory treatment				
4	Transitory measures of the CRR	Common Equity Tier 1	Additional Tier 1	Tier 2
5	Post transitory measures of the CRR	Common Equity Tier 1	Additional Tier 1	Tier 2
6	Allowable at the level of individual institutions; consolidated; individual institution and consolidated	Individual institution(1)	Individual institution(1)	Individual institution(1)

(1) The public disclosure obligations apply to Banca Sistema, consistent with article 19 of the CRR which provides for the option of exemption from prudential consolidation for the companies which lie within specific exemption

Main characteristics of capital instruments				
		Ordinary shares	Subordinated Tier 1 bonds	Subordinated Lower Tier 2 bond
7	Type of instrument	Ordinary shares art. 28 CRR	Debt securities art. 52 CRR	Debt securities art. 62 CRR
8	Amount calculated in own funds (€/million)	9,65	8.0	12.0
9	Nominal amount of the instrument (€/million)	N/A	8.0	12.0
9a	Issue price	N/A	At par	At par
9b	Redemption Price	N/A	At par	At par
10	Accounting classification	Shareholders' equity	Liabilities - amortised cost	Liabilities - amortised cost
11	Original date issued	N/A	- 5 million on 18/12/2012 - 3 million on 18/12/2013	- 10 million on 15/11/2012 - 2 million on 18/12/2013
12	Unredeemable or on maturity	N/A	On maturity	On maturity
13	Original maturity date	N/A	Date of dissolution or winding-up of Banca Sistema or due to the lapse of the term provided for by the articles of association (currently the articles of association of Banca Sistema envisage the date of 31 December 2100)	15/11/2022
14	Prepayment at the discretion of the issuer subject to prior approval of the Supervisory Authority	No	Yes	No
15	Dated and amount of the prepayment	N/A	The Issuer reserves the right to proceed, starting from 18/12/2017, with the full or partial early amortisation of the residual par value of the securities. Early amortisation clauses associated with taxation and/ or regulatory events also exist. Early amortisation is subject to prior authorisation on the part of the Bank of Italy.	N/A
16	Dates subsequent to early amortisation	N/A	Subsequent to the first date of early amortisation, the Issuer reserves the right to evaluate whether to proceed with the early amortisation on an annual basis	N/A
Coupons/dividends				
17	Fixed or floating dividends/ coupons	N/A	Fixed then floating	Floating
18	Coupon rate and any correlated indices	N/A	Fixed rate: 7% Floating rate: 6-month Euribor + 5%	6-month Euribor + 5,50%
19	Presence of a "dividend stopper" mechanism	no	YES	No

Main characteristics of capital instruments				
		Ordinary shares	Subordinated Tier 1 bonds	Subordinated Lower Tier 2 bond
20a	Fully discretionary, partially discretionary or obligatory (in terms of time)	N/A	Partially discretionary. Loss absorption mechanisms that result in the cancellation of any accrued interest and unpaid interest and, if insufficient, a reduction of the residual par value of the securities, are provided for. Said mechanisms are generated in case of a “capital event” or a significant reduction of the retained profits or of other reserves so as to result in the issuer or supervisory authority’s judgement of a “capital event”. It is also envisaged that the securities be subject to loss absorption measures whenever the Bank of Italy, to the intents and purposes of the regulations in force at the time, deems said measure to be necessary.	N/A
20b	Fully discretionary, partially discretionary or obligatory (in terms of amount)	N/A	Partially discretionary	N/A
21	Presence of "step up" or of other repayment incentive	N/A	No	No
22	Not cumulative or cumulative	N/A	Not-cumulative	N/A
23	Convertible or not convertible	N/A	Not convertible	Not convertible
24	If convertible, event(s) that results(result) in conversion	N/A	N/A	N/A
25	If convertible, fully or in part	N/A	N/A	N/A
26	If convertible, conversion rate	N/A	N/A	N/A
27	If convertible, obligatory or optional conversion	N/A	N/A	N/A
28	If convertible, specify the type of instrument into which conversion is possible	N/A	N/A	N/A
29	If convertible, specify the Issuer of the instrument into which it is converted	N/A	N/A	N/A
30	Write-down mechanisms	N/A	Yes	No
31	In case of a write-down mechanism, event(s) that causes(cause) it	N/A	See item 20.	N/A
32	In case of a write-down, full or partial write-down	N/A	Fully or partially	N/A
33	In case of a write-down, permanent or temporary write-down	N/A	Permanent	N/A
34	In case of a temporary write-down, description of the revaluation mechanism	N/A	N/A	N/A

Main characteristics of capital instruments				
		Ordinary shares	Subordinated Tier 1 bonds	Subordinated Lower Tier 2 bond
35	Position in the subordination hierarchy in case of liquidation (specify the type of instrument of immediately senior rank)	N/A	In case of liquidation or the undergoing of insolvency proceedings on the part of Banca Sistema, the Securities and the relevant rights for principal and interest are, (i) subordinate to all of Banca Sistema's non-subordinate creditors (including the depositors) or with a degree of subordination less than that of the Securities such as Tier 2 instruments, (ii) pari passu among themselves and with respect additional Tier 1 instruments and to other debtor positions of Banca Sistema which do not have a degree of subordination above or below the Securities, and (iii) superior with respect to ordinary shares and shares of every class (including any preference shares and savings shares) of Banca Sistema.	The bond loan was issued with a subordination clause to the intents and purposes of the provisions contained in the supervisory regulations for Banks enacted by the Bank of Italy. Therefore, in case of voluntary or compulsory liquidation of the issuer, the bondholders will be reimbursed only after all of the issuer's other not equally subordinate creditors have been satisfied.
36	Non-complying characteristics of the instruments that benefit from transitory measures	N/A	No	No
37	If affirmative, specify the non-compliant characteristics	N/A	N/A	N/A

QUANTITATIVE INFORMATION

The following tables show:

- the amount of Own funds according to the publication layout cited in the implementing Regulations (EU) no. 143/2013
- the reconciliation among the components of Own funds and the Balance Sheet of Banca Sistema's separate financial statements and the association of the components of own funds with the relevant items of the publication layout cited above.

In reference to Own Funds, it is noted that shares in Banca Sistema have been traded on the Mercato Telematico Azionario - Italian Equities Market (MTA) of the Italian Stock Exchange, STAR segment since 2 July 2015.

OWN FUNDS

(Amounts in thousands of Euro)

	Equity components	(A) Amount	(B) Regulation reference article (EU) no. 575/2013	(C) Amount when law is fully in effect
Common Equity Tier 1: instruments and reserves				
1	Capital instruments and the relevant Share premium reserves	50,269,248	26, paragraph 1, 27, 28, 29, ABE list pursuant to art. 26, paragraph 3	50,269,248
2	Retained earnings	25,746,667	26, paragraph 1, letter c)	25,746,667
3	Other comprehensive accumulated income (and other reserves, include the profits and losses not realised pursuant to the applicable accounting regulation)	350,413	26, paragraph 1	350,413
5a	Profit for the period verified by independent personnel net of all foreseeable expenses or dividends	12,774,791	26, paragraph 2	12,774,791
6	Common Equity Tier 1 (CET1) before regulatory adjustments	**89,141,119**		**89,141,119**
Common Equity Tier 1 (CET1)				
8	Intangible assets (net of the relevant tax liabilities) (negative amount)	-1,871,896	36, paragraph 1, letter b), 37, 472, paragraph 4	-1,871,896
26	Regulatory adjustments applied to Common Equity Tier 1 in relation to the amounts subject to pre-CRR treatment	-377,078		350,413
26a	Regulatory adjustments relative to the unrealised gains and losses pursuant to articles 467 and 468	-377,078		350,413
	of which unrealised profits relative to exposures with Central Authorities classified in the category "Available-for-sale financial assets" of IAS 39 approved by the EU	-417,075	467	417,075
	of which a filter for unrealised losses	39,997	467	-66,662
28	**Total regulatory adjustments to Common Equity Tier 1 (CET1)**	**-2,248,973**		**-1,871,896**
29	**COMMON EQUITY TIER 1 (CET1)**	**86,892,146**		**87,269,224**
Additional Tier 1 (AT1): instruments				
30	Capital instruments and the relevant Share premium reserves	8,000,000	51.52	8,000,000
32	of which classified as liabilities pursuant to the applicable accounting regulation	8,000,000		8,000,000
36	**Total regulatory adjustments to Common Equity Tier 1 (CET1)**	**8,000,000**		**8,000,000**
44	**Total regulatory adjustments to Common Equity Tier 1 (CET1)**	**8,000,000**		**8,000,000**
45	**Tier 1 (T1=CET1+AT1)**	**94,892,146**		**95,269,224**

	Equity components	(A) Amount	(B) Regulation reference article (EU) no. 575/2013	(C) Amount when law is fully in effect
Additional Tier 2 (T2): instruments and provisions				
46	Capital instruments and the relevant Share premium reserves	12,000,000	62.63	12,000,000
51	**Tier 2 (T2) before regulatory adjustments**	**12,000,000**		12,000,000
58	**Tier 2 (T2)**	**12,000,000**		12,000,000
59	**Total Capital (TC = T1 + T2)**	**106,892,146**		**107,269,224**
60	**Total risk weighted assets**	**635,657,859**		**635,657,859**
Capital ratios and Reserves				
61	Common Equity Tier 1 (as a percentage of risk exposure)	13.7%	92, paragraph 2, letter a), 465	13.7%
62	Tier 1 capital (as a percentage of risk exposure)	14.9%	92, paragraph 2, letter b), 465	15.0%
63	Total capital (as a percentage of risk exposure)	16.8%	92, paragraph 2, letter c)	16.9%
64	The institution-specific capital buffer requirement (requirement relative to the Common Equity Tier 1 in compliance with article 92, paragraph 1, letter a), the capital conservation buffer, the countercyclical capital buffer, the systemic risk buffer, institute systemic risk buffer in percentage of the risk exposure requirement	2.50%	CRD 128, 129, 130	2.50%
65	of which: the capital conservation buffer requirement	2.50%		2.50%

RECONCILIATION OWN FUNDS - BALANCE SHEET

(Amounts in thousands of Euro)

Asset items	Accounting Data	Amount Material for the purposes of Own funds	Ref. Transitory model table for the publication of information regarding equity funds
120. Intangible assets	1,871,896	-1,871,896	8
of which: goodwill	1,785,760	-1,785,760	8
of which: Other intangible assets	86,136	-86,136	8

Liability items	Accounting Data	Amount Material for the purposes of Own funds	Ref. Transitory model table for the publication of information regarding equity funds
30. Securities issued	20,102,319	20,000,000	30.32.46
of which: subordinate instruments subject to transitional provisions	20,102,319	20,000,000	30.32.46
130. Valuation reserves	350,413	-26,665	3,26,26a
of which: valuation reserves on securities available for sale	417,075	-417,075	26.26a
of which: other valuation reserves	-66,662	39,997	26.26a
160. Reserves	26,929,739	26,929,739	1.2
170. Share premiums	39,435,649	39,435,649	1
180. Capital	9,650,526	9,650,526	1
220. Profit (loss) for the year	19,394,357	12,774,791	5a
of which: profit for the period net of dividend distributed for the year		12,774,791	5a

Total Own Funds at 31 December 2015		**106,892,146**	

SECTION 4 - CAPITAL REQUIREMENTS

(ART. 438 CRR)

QUALITATIVE INFORMATION

According to the provisions of the Second Pillar, banks must periodically assess their capital adequacy, current and prospective, expanding the variety of the risks to be calculated with respect to the First Pillar.

The foregoing activity is conducted within the purview of the ICAAP (Internal Capital Adequacy Assessment Process), for which the "body with strategic supervisory functions" is fully responsible; said body defines, in full autonomy, the design and the organisation in accordance with its respective expertise and prerogatives.

The results of the ICAAP are subject to analysis on the part of the Supervisory Authorities within the scope of the SREP (Supervisory Review and Evaluation Process). In compliance with the EBA and Guidelines on common SREP, by letter dated 16 December 2015 the Bank of Italy requested that the following minimum requirements be maintained:

- CET1 ratio of 7.2% + additional 0.2% above the minimum regulatory requirement;
- TIER1 ratio of 9.6% + additional +1.1% above the minimum regulatory requirement;
- Total capital ratio of 12.9% + additional +2.4% above the minimum regulatory requirement;

For the sake of completeness, note how Directive 2013/36/EU (CRD IV) establishes the obligation for the designated national authorities to activate an operational framework for the definition of the countercyclical capital buffer ratio (CCyB) starting from 1 January 2016. The ratio is subject to quarterly review. The European law was implemented in Italy with Bank of Italy circular no. 285 that contains special provisions in matters of CCyB.

The reference indicator materially reflects the credit cycle and the risks deriving from excessive growth of credit in Italy, also taking into account the specific nature of the domestic economy. It is based on the deviation from the long-term trend in the ratio between credit and Gross Domestic Product.

The ratio is expressed as percentage of the overall exposure of the banks that have material credit exposures within the national territory. It is between 0% and 2.5% and is fixed in intervals of 0.25 percentage points or multiples of 0.25. The Bank of Italy, based on the reference index, the general benchmark indexes formulated by CERS as well as any other indicator that signals the onset of systemic risk, may set an anticyclical internal coefficient greater than 2.5%.

The Supervisory Authority - giving the state of the economy and of credit in Italy- for the first and second quarters 2016, deemed it expedient to keep the foregoing coefficient equal to zero.

For the purposes of a concrete application of the principle of proportionality, the Bank of Italy subdivided the banks into three different classes based on operational size and complexity. At present, Banca Sistema falls within class 3, relative to "banking groups and banks that utilise standardised approaches, with assets, respectively, consolidated or individual, equal to or less than EUR 3.5 billion".

The following First and Second Pillar risks are included in the reference scope for the purposes of Internal Capital Allocation Assessment Process with the relative approaches indicated in the table below:

CATEGORY	TYPE OF RISK	APPROACH
First pillar	Credit risk	Standardised approach
	Counterparty Risk	Standardised approach (exposure: CRM comprehensive method with supervisory volatility adjustments)
	Market Risk	Standardised approach
	Operational risk	Basic Indicator Approach Qualitative assessment (self-assessment)
Second pillar	Concentration Risk	Granularity Adjustment
	Interest Rate Risk	Standard Approach
	Liquidity Risk	Net financial position and Basel 3 indicators
	Reputational Risk	Qualitative Assessment
	Risk of excessive leverage	Leverage Ratio
	Strategic risk	Qualitative Assessment
	Compliance risk	Qualitative Assessment

The ICAAP is divided into 5 sub-activities described in detail on the following pages:

1) **Identification and management of material risks:** the competent organisational structures implement the identification process for the risks to which the Bank could be exposed taking into consideration various elements:

   - measuring the balance sheet aggregates;
   - the Strategic Business Plan, within which the company's top management illustrate both the short- and medium-term investment policies and objectives;
   - the changed market environment, new opportunities or significant dimensional variations (absolute or relative) of the business components so as to influence positioning in the market and the resulting initial risk assessments;
   - the introduction of new products or services;
   - economic context.

2) **Measurement/assessment of the risk observed and calculation of the relative internal capital:** the Bank defines the risk measurement, assessment and management approaches.

With reference to Pillar 1 risks, the measurement approaches adopted are those used for Prudential supervision purposes.

With reference to the hard-to-quantify Pillar 2 risks, a judgemental type analysis is performed aimed at defining the valuation and mitigation techniques for the risk considered, in concert with the Bank's other functions.

3) **Calculation of overall internal capital and reconciliation with the regulatory capital:** adhering to the provisions of relevant legislation, the Bank calculates the overall internal capital in accordance with the building block approach, which consists in summing any internal capital relative to other material risks noted in Pillar 2 to the regulatory requirements in relation to Pillar 1 risks.

   The Bank then conducts the reconciliation operations between overall internal capital and regulatory requirements.

4) **Determination of total capital and reconciliation with Own funds:** the Bank analyses all the balance-sheet items available in order to quantify the total capital available.

   The next activity consists in the reconciliation between Own funds and Total Capital.

5) **Management and maintenance of the ICAAP:** the Bank verifies that the total capital is sufficient to cover the previously determined Total Internal Capital requirements. If a situation of insufficiency emerges, the company's top management is promptly informed.

   Upon concluding the process, the analysis relative to the capital adequacy is submitted to the attention of the Internal Audit office and, for approval, to the attention of the Board of Directors.

   The ICAAP having been completed, the Internal Auditing Office is asked to produce an assessment on the solidity of the entire process and to identify any anomalies in the activities performed or areas for improvement.

   The ICAAP auditing procedure terminates with the formalisation of the internal auditing report that is submitted to the Board of Directors for approval.

   In conformity with the provisions on capital adequacy, the Bank completed the activities intended to fulfil the requirements anticipated by the Second pillar, preparing and sending the Supervisory Authorities - subject to approval by the Board of Directors - the ICAAP report regarding the data of 31 December 2015 within 30 April 2016. The results of the ICAAP confirm the Bank's capital strength: the financial resources available guarantee, with sufficient margins, the hedging of all current and prospective risks, even under conditions of stress.

QUANTITATIVE INFORMATION

(Amounts in thousands of Euro)

Categories/Values	Unweighted amounts		Weighted amounts/requirements	
	31/12/2015	31/12/2014	31/12/2015	31/12/2014
A. RISK ASSETS	2,234,170	1,799,310	535,194	298,803
A.1 Credit and counterparty risk	**2,234,170**	**1,799,310**	**535,194**	**298,803**
1. Standardised approach	-	-	-	-
2. Internal ratings based approach	-	-	-	-
2.1 Basic	-	-	-	-
2.2 Advanced	-	-	-	-
3. Securitisations	-	-	-	-
B. MINIMUM REGULATORY REQUIREMENTS			**42,815**	**23,904**
B.1 Credit and counterparty risk			**-**	**1**
B.2 Credit assessment adjustment risk			**-**	-
B.3 Settlement risk			-	-
B.4 Market risk			-	-
1. Standard approach			-	-
2. Internal models			-	-
3. Concentration risk			8,037	8,037
B.5 Operational risk			**8,037**	**8,037**
1. Basic indicator approach			-	-
2. Standardised approach			-	-
3. Advanced measurement approach			-	-
B.6 Other calculation elements			50,853	**29,102**
B.7 Total capital requirements			**635,658**	**363,771**
C. RISK ASSETS AND CAPITAL RATIOS			**635,658**	**363,771**
C.1 Risk-weighted assets			635,658	363,771
C.2 CET1 capital/risk-weighted assets (CET1 capital ratio)			13.67%	10.40%
C.3 Tier1 capital/risk-weighted assets (Tier 1 capital ratio)			14.93%	12.60%
C.4 Total own funds/risk-weighted assets (Total Capital Ratio)			16.82%	15.90%

SECTION 5 - EXPOSURE TO COUNTERPARTY RISK

(ART. 439 CRR)

QUALITATIVE INFORMATION

The Bank pays adequate attention to counterparty risk understood as the risk that the counterparty of a transaction, regarding specific financial instruments – such as over the counter derivatives, repo and reverse repos on securities or commodities, security or commodity borrowing or lending transactions, and Security Financing Transactions, transactions with long-term settlement in which one of the counterparties pledges to sell or purchase a security, a commodity, a foreign currency against the collection or payment of cash on a contractually established settlement date after that defined by market practice for transactions of same type – may default.

This particular type of credit risk generates a bilateral-type exposure, due to which both counterparties are exposed to the risk of incurring unforeseeable losses.

The Bank conducts a careful and balanced counterparty risk management, establishing an adequate system of limits in terms of consistency and composition of its securities portfolio. With reference to the repurchase agreement positions, the Bank operates having as its counterparty the Compensation and Guarantee Fund (being an indirect participant, Banca Sistema avails itself of the clearing system provided by the depositary bank) or institutional counterparties.

As at 31 December 2015, only repurchase agreements are outstanding with the Compensation and Guarantee Fund.

QUANTITATIVE INFORMATION

OUTSTANDING REPURCHASE AGREEMENTS

(Amounts in thousands of Euro)

Type of instrument	A. Regulatory trading portfolio	B. Banking book
Reverse repurchase agreements	-	177,868
Repurchase agreements	-	909,089

SECTION 8 - CREDIT RISK ADJUSTMENTS

(ART. 442 CRR)

QUALITATIVE INFORMATION

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.

Subsequent to the initial recognition, loans to customers are valued at amortised cost, which, using the effective interest rate approach, allows the economic effect of cost/income relative to the individual transaction to be distributed during the entire expected residual life of the loan.

In general, for all credit risk exposures, the Bank conducts continuous analysis and measurements aimed at classifying the exposures, where deemed expedient, among the non-performing loan risk categories. Based on the supervisory regulations existing on this document's reporting date and the internal regulations, the non-performing exposures are subdivided into the following categories:

Doubtful

On- and off-balance sheet exposures (loans, securities, derivatives, etc.) owed by a party in state of insolvency (even if not judicially ascertained) or in broadly similar situations, regardless of any loss forecast formulated by the Group (cf. Art. 5 bankruptcy law). The definition therefore applies regardless of the existence of any collateral (real or private) provided as protection against the exposures. These exposures are subject to an analytical assessment and the amount of the adjustment is equal to the difference between the book value of the receivable in the financial statements at the time of the assessment and its expected realisable value.

Unlikely to pay

Classification into this category is first of all the result of the Banks opinion regarding the improbability that, without recourse to actions such as the enforcement of the guarantee, the debtor will fulfil all of his credit obligations (principal and/or interest). This assessment is made independently of whether any sums (or instalments) are past due and not paid. It is therefore unnecessary to wait for explicit symptoms of irregularity (non-repayment) if there are elements that entail a situation of default risk on the part of the debtor (e.g. a crisis in the industrial sector in which the debtor operates). The set of on- and off-balance sheet exposures to the same debtor in above conditions is named "unlikely to pay", save that the conditions for classifying the debtor under doubtful do not exist. The exposures to retail parties may be classified in unlikely to pay category at the level of the individual transaction, provided that the Bank evaluate has assessed that the conditions for classifying the set of exposures to the same debtor in that category do not exist.

Past due and/or overdrawn exposures

These are understood to be the on-balance sheet exposures at book value and "off-balance sheet" exposures (loans, securities, derivatives, etc.), other than those classified as doubtful, watch-list or among the restructured exposures, that, on the reference date of the report, are past due or have been overdrawn by more than 90 days.

In order to verify the continuity of the overdue exposure in connection with the factoring operation, the following is specified:

- for "with recourse transactions", the overdue exposure, other than that associated with the assignment of future credits, is determined only if both of the following conditions exist:
  - the advance is of an amount equal to or greater than amount of the credit coming due;
  - at least one invoice has not been honoured (past due) by more than 90 days and the set of the past due invoices (including those by less than 90 days) exceeds 5% of the total receivables.
- for "without recourse transactions", for each assigned debtor, individual invoice that with the greatest delay must be referred.

In the calculation of the capital requirement for the credit and counterparty risk, Banca Sistema uses the standardised approach. This envisages that the exposures that lie within the portfolios relative to "Central Authorities and Central Banks", "Territorial entities", and "Public sector institutions" and "Businesses", must apply the notion of overdue and/or overdrawn exposures at the level of the debtor party.

The methods used to calculate the analytical and generic write-downs applied to the credit portfolio are described below.

The Bank conducts a satisfactory valuation of the credits that demonstrate objective evidence of a possible impairment and that no objective evidence exists suggesting that the book value of said credits is not fully recoverable, taking into account the default rate and of the magnitude of recovery of non-performing positions historically experienced by the Bank.

The Bank classifies their credits as a function of their credit rating; this classification is subject to review whenever the Bank becomes aware of significant events that could modify the prospects for the recovery thereof. In order to promptly recognise said events, the Bank, via the Credit Management Department, constantly monitors the wealth of information relative to the debtors and constantly checks agreements the existing out-of-court agreements and the various phases of the on-going legal procedures.

Below are the guidelines used by the Bank to conduct both the general and collective write-downs on the credit portfolio.

The Bank makes the write-downs on an analytical basis for the credits that show specific evidence of impairment losses i.e. for the credits assigned the status of "**Unlikely to pay**" or "**Doubtful**" in virtue of subjective assessments that result in elements that suggest the credit as not fully collectable or not collectible within the estimated time limits.

With reference to the credits from the factoring portfolio with the Public Administration, the Bank makes an analytical write-down for the Municipalities registered as being in a state of "financial difficulty" in accordance with legislative decree 267/00.

If appropriate write-downs were not made at the pricing stage, the Bank makes an analytical write-down on the outstanding value of the loan net of the rediscount which has not yet fallen due. This percentage write-down is defined as a function of the recovery rate historically recorded by the bank and is subject to revision during the year in case of changes in the collection activities the result in a change in the relative recovery rates. As regards instead the credit positions from the factoring portfolio where the debtor counterparty is a private company, the Bank evaluates, on a case-by-case basis, the amount of the allocation to be applied as a function of the presumable credit recovery value.

With reference to the non-performing ("unlikely to pay" and "doubtful") credits lying in the SME loan portfolio, in case of termination of the contract, the Bank proceeds to write down, as a function of the expected recovery rate, the portion of the loan not collateralised by the Guarantee Fund issued through Mediocredito Centrale.

The specific write-down relative to the individual case of salary-/pension-backed loans / salary deduction is assessed on a case-by-case basis.

The return of exposures classified among "unlikely to pay" and "doubtful" to performing is carried out upon proposal by the Credit Management and subsequent to a favourable opinion of the Risk and Compliance Division which proposes, upon resolution by the Risk Management Committee, of the change of status with the release of the allocations previously resolved upon, subject to verification of the absence of criticality and of the state of insolvency.

The credits for which objective evidence of impairment have not been identified individually are subject to assessment of a collective impairment loss. The collective write-down is based on the probability of being classified under doubtful and on the amount of potential future losses in case of default.

QUANTITATIVE INFORMATION

The tables indicated in the following Table were taken from the Financial Statements as at 31 December 2015, Part E of Notes to the financial statements It is deemed that the end of period values are representative of the Bank's risk exposures during the relevant period.

DISTRIBUTION OF THE FINANCIAL ASSETS BY PORTFOLIOS AND BY CREDIT QUALITY (BOOK VALUES)

(Amounts in thousands of Euro)

Portfolios/quality	Banking group					**Total**
	Doubtful	Unlikely to pay	Non-performing past due exposures	Performing past due exposures	Performing financial assets	
1. Available-for-sale financial assets	-	-	-	-	920,402	920,402
2. Held-to-maturity financial assets	-	-	-	-	-	-
3. Due from banks	-	-	-	-	1,996	1,996
4. Loans to customers	13,899	5,093	65,225	258,961	1,116,077	1,459,255
5. Financial assets measured at fair value	-	-	-	-	-	-
6. Financial assets held for disposal	-	-	-	-	-	-
Total 2015	**13,899**	**5,093**	**65,225**	**258,961**	**2,038,475**	**2,381,653**
Total 2014	**9,158**	**9,955**	**20,610**	**63,330**	**1,966,365**	**2,069,418**

DISTRIBUTION OF CREDIT EXPOSURES BY PORTFOLIO AND BY CREDIT QUALITY (GROSS AND NET VALUES)

(Amounts in thousands of Euro)

Portfolios/quality	Non-performing assets			Performing financial assets			**Total (net exposure)**
	Gross exposure	Specific adjustments	Net exposure	Gross exposure	Portfolio adjustments	Net exposure	
1. Available-for-sale financial assets	-	-	-	920,402	-	920,402	920,402
2. Held-to-maturity financial assets	-	-	-	-	-	-	-
3. Due from banks	-	-	-	1,996	-	1,996	1,996
4. Loans to customers	91.353	7,137	84,216	1,378,272	3,233	1,375,039	1,459,255
5. Financial assets measured at fair value	-	-	-	-	-	-	-
6. Financial assets held for disposal	-	-	-	-	-	-	-
Total 2015	**91.353**	**7,137**	**84,216**	**2,300,670**	**3,233**	**2,297,437**	**2,381,653**
Total 2014	**42.197**	**2,473**	**39,724**	**2,031,029**	**2,457**	**2,029,694**	**2,069,418**

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

(Amounts in thousands of Euro)

Type of exposures/Values	Gross exposure					Individual adjustments	Collective adjustments	Net exposure
	Non-performing assets				Performing financial assets			
	Up to 3 months	from more than 3 months up to 6 months	from more than 6 months up to 1 year	More than one year				
A. **ON-BALANCE SHEET EXPOSURES**								
a. doubtful	-	-	-	-		-		-
of which: forborne exposures	-	-	-	-		-		-
b. Unlikely to pay	-	-	-	-		-		-
of which: forborne exposures	-	-	-	-		-		-
c. Non-performing past due exposures	-	-	-	-		-		-
of which: forborne exposures	-	-	-	-		-		-
d. Performing past due exposures	-	-	-	-	-	-	-	-
of which: forborne exposures	-	-	-	-	-	-	-	-
e. Other performing exposures	-	-	-	-	1,996	-	-	1,996
of which: forborne exposures	-	-	-	-	-	-	-	-
TOTAL A	**-**	**-**	**-**	**-**	**1,996**	**-**	**-**	**1,996**
B. **OFF-BALANCE-SHEET EXPOSURES**								
a. Non-performing	-	-	-	-	-	-	-	-
b. Performing	-	-	-	-	45	-	-	45
TOTAL B	-	-	-	-	45	-	-	45
TOTALE (A+B)	**-**	**-**	**-**	**-**	**2,041**	**-**	**-**	**2,041**

On-balance sheet credit exposures to banks: ***dynamics of gross non-performing exposures and those subject to "country risk"***: The on-balance sheet exposures to Banks are all performing.

On-balance sheet credit exposures to banks: ***dynamics of overall adjustments*****:** The on-balance sheet exposures to Banks are all performing.

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

(Amounts in thousands of Euro)

Type of exposures/Values	Gross exposure					Individual adjustments	Collective adjustments	Net exposure
	Non-performing assets				Performing financial assets			
	Up to 3 months	from more than 3 months up to 6 months	from more than 6 months up to 1 year	More than one year				
A. **ON-BALANCE SHEET EXPOSURES**								
a. doubtful	474	499	848	18,200		6,122		13,899
of which: forborne exposures	-	-	-	-		-		-
b. Unlikely to pay	5,913	-	-	-		820		5,093
of which: forborne exposures	-	-	-	-		-		-
c. Non-performing past due exposures	33,621	11,275	12,926	7,598		195		65,225
of which: forborne exposures	-	-	-	-		-		-
d. Performing past due exposures					259,724		763	258,961
of which: forborne exposures					-		-	-
e. Other performing exposures					2,038,950		2,470	2,036,480
of which: forborne exposures					-		-	-
TOTAL A	**40,008**	**11,774**	**13,774**	**25,798**	**2,298,674**	**7,137**	**3,233**	**2,379,658**
B. **OFF-BALANCE-SHEET EXPOSURES**								
a. Non-performing	-	-	-	-	-	-	-	-
b. Performing	-	-	-	-	671	-	-	671
TOTAL B	**-**	**-**	**-**	**-**	**671**	**-**	**-**	**671**
TOTAL (A+B)	**40,008**	**11,774**	**13,774**	**25,798**	**2,300,016**	**7,137**	**3,233**	**2,289,646**

ON-BALANCE SHEET CREDIT EXPOSURES TO CUSTOMERS: DYNAMICS OF GROSS NON-PERFORMING EXPOSURES

(Amounts in thousands of Euro)

Reasons/Categories	Doubtful	Unlikely to pay	Non-performing past due exposures	Performing past due exposures	Performing
A. **Starting gross exposure**	**11,439**	**10,078**	**20,680**	**63,568**	**1,951,919**
- of which: non-derecognised assigned exposures					
B. **Increases**	**14,448**	**6,349**	**66,516**	**251,271**	**689,880**
B.1 incoming performing exposures	11,930	6,015	59,558	185,105	3,025
B.2 transfers from others categories of non-performing exposures	1,222	-	4,328	1,423	8,901
B.3 other increases	1,296	334	2,630	64,743	677,954
C. **Decreases**	**5,866**	**10,513**	**21,776**	**55,115**	**602,849**
C.1 outgoing performing exposures	973	2,395	6,955	3,025	185,105
C.2 derecognitions	-	-	-	-	-
C.3 collections	4,893	2,630	14,760	32,122	360,209
C.4 gains on sales	-	-	-	-	-
C.5 losses on sales	-	-	-	-	-
C.6 transfers to others categories of non-performing exposures	-	5,488	61	19,968	57,535
C.7 Other decreases	-	-	-	-	-
D. **Final gross exposure**	**20,021**	**5,913**	**65,420**	**259,724**	**2,038,950**
- of which: non-derecognised assigned exposures					

ON-BALANCE SHEET CREDIT EXPOSURES TO CUSTOMERS: DYNAMICS OF OVERALL ADJUSTMENTS

(Amounts in thousands of Euro)

Reasons/Categories	Doubtful					Non-performing past due exposures		Performing past due exposures		Performing	
	Total	Of which: forborne exposures	Unlikely to pay	Total	Of which: forborne exposures	Total	Of which: forborne exposures	Total	Of which: forborne exposures	Total	Of which: forborne exposures
A. **Initials total adjustments**	**2,281**	**-**	**122**	**-**	**-**	**70**	**-**	**249**	**-**	**-**	**-**
- of which: non-derecognised assigned exposures	-	-	-	-	-	-	-	-	-	-	-
B. **Increases**	**4,126**	**-**	**885**	**-**	**-**	**192**	**-**	**675**	**-**	**-**	**-**
B.1 value adjustments	3,540	-	813	-	-	101	-	550	-	-	-
B.2 losses from disposal	-	-	-	-	-	-	-	-	-	-	-
B.3 transfers from others categories of non-performing exposures	102	-	12	-	-	17	-	11	-	-	-
B.4 other increases	484	-	127	-	-	72	-	114	-	-	-
C. **Decreases**	**286**	**-**	**286**	**-**	**-**	**67**	**-**	**161**	**-**	**-**	**-**
C.1 valuation write-backs	5	-	-	-	-	10	-	31	-	-	-
C.2 collection write-backs	271	-	6	-	-	1	-	4	-	-	-
C.3 profits from disposals	-	-	-	-	-	-	-	-	-	-	-
C.4 derecognitions	-	-	-	-	-	-	-	-	-	-	-
C.5 transfers to others categories of non-performing exposures	-	-	119	-	-	-	-	113	-	-	-
C.6 Other decreases	10	-	2	-	-	56	-	12	-	-	-
D. **Final total adjustments**	**6,122**	**-**	**820**	**-**	**-**	**195**	**-**	**763**	**-**	**-**	**-**
- of which: non-derecognised assigned exposures	-	-	-	-	-	-	-	-	-	-	-

DISTRIBUTION BY SECTOR OF ON- AND OFF-BALANCE SHEET CREDIT WITH CUSTOMERS (BOOK VALUE)

(Amounts in thousands of Euro)

Exposures/Counterparties	Governments			Other public institutions			Financial companies			Insurance companies			Non-financial companies			Other subjects		
	Net Exposure	Individual adjustments	Collective adjustments	Net Exposure	Individual adjustments	Collective adjustments	Net Exposure	Individual adjustments	Collective adjustments	Net exposure	Individual adjustments	Collective adjustments	Net Exposure	Individual adjustments	Collective adjustments	Net Exposure	Individual adjustments	Collective adjustments
A. **On-balance sheet exposures**																		
A.1 Doubtful	-	-	-	10,877	4,851	-	-	-	-	-	-	-	2,866	712	-	156	559	-
- of which: forborne exposures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
A.2 Unlikely to pay	-	-	-	-	-	-	-	-	-	-	-	-	5,093	820	-	-	-	-
- of which: forborne exposures	-	-		-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
A.3 Non-performing past due exposures	1,631	20	-	31,995	83	-	-	-	-	-	-	-	30,238	88	-	1,361	4	-
- of which: forborne exposures	-	-		-	-		-	-			-		-	-		-	-	
A.4 Performing exposures	1,194,364	-	105	521,021	-	1,436	199,872	-	-	-	-	-	252,569	-	1,146	127,615	-	546
- of which: forborne exposures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total A	**1,195,995**	**20**	**105**	**563,893**	**4,934**	**1,436**	**199,872**	**-**	**-**	**-**	**-**	**-**	**290,766**	**1,620**	**1,146**	**129,132**	**563**	**546**
B. **Off-balance-sheet exposures**																		
B.1 Doubtful	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
B.2 Unlikely to pay	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
B.3 Other non-performing assets	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
B.4 Performing exposures	-	-	-	-	-	-	-	-	-	-	-	-	671	-	-	-	-	-
Total B													**671**					
Totale (A+B) 2015	**1,195,995**	**20**	**105**	**563,893**	**4,934**	**1,436**	**199,872**						**291,437**	**1,620**	**1,146**	**129,132**	**563**	**546**
Totale (A+B) 2014	**1,037,189**		**70**	**551,918**	**2,199**	**1,885**	**304,358**						**139,346**	**268**	**439**	**19,968**	**6**	**58**

DISTRIBUTION BY SECTOR OF ON- AND OFF-BALANCE SHEET CREDIT EXPOSURES TO CUSTOMERS (BOOK VALUE)

(Amounts in thousands of Euro)

Exposures/Geographical 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. **On-balance sheet exposures**										
A.1 Doubtful	13,899	6,122	-	-	-	-	-	-	-	-
A.2 Unlikely to pay	5,093	820	-	-	-	-	-	-	-	-
A.3 Non-performing past due exposures	65,225	195	-	-	-	-	-	-	-	-
A.4 Other performing exposures	2,274,229	3,174	21,211	59	-	-	-	-	-	-
Total A	**2,358,446**	**10,311**	**21,211**	**59**	**-**	**-**	**-**	**-**	**-**	**-**
B. **Off-balance-sheet exposures**										
B.1 Doubtful	-	-	-	-	-	-	-	-	-	-
B.2 Unlikely to pay	-	-	-	-	-	-	-	-	-	-
B.3 Other non-performing assets	-	-	-	-	-	-	-	-	-	-
B.4 Other performing exposures	671	-	-	-	-	-	-	-	-	-
Total B	**671**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total (A+B) 2015	**2,359,117**	**10,311**	**21,211**	**59**	**-**	**-**	**-**	**-**	**-**	**-**
Total (A+B) 2014	**2.051.522**	**4.930**	**1.266**	**-**	**-**	**-**	**-**	**-**	**-**	**-**

TIME DISTRIBUTION OF FINANCIAL ASSETS AND LIABILITIES BY REMAINING CONTRACTUAL TERM

(Amounts in thousands of Euro)

Item/Time brackets	on demand	from more than 1 day to 7 days	from more than 7 day to 15 days	from more than 15 days to 1 month	from more than 1 month to 3 months	from more than 3 months to 6 months	from more than 6 months up to 1 year	from more than 1 year to 5 years	Over 5 years	indeterminate
Non-derivative financial assets	**253,693**	**184,750**	**24,653**	**34,886**	**424,032**	**273,382**	**567,835**	**529,237**	**71,997**	**1,909**
A.1 Government securities	-	-	-	-	267,978	98,972	372,019	180,870	-	-
A.2 Other debt securities	-	-	-	-	-	-	-	-	-	-
A.3 UCI units	-	-	-	-	-	-	-	-	-	-
A.4 Loans	253,693	184,750	24,653	34,886	156,054	174,410	195,816	348,367	71,997	1,909
- banks	87	-	-	-	-	-	-	-	-	1,909
- customers	253,606	184,750	24,653	34,886	156,054	174,410	195,816	348,367	71,997	-
Cash liabilities	**385,291**	**944,012**	**16,647**	**148,574**	**362,870**	**90,727**	**88,677**	**193,781**	**26,682**	**-**
B.1 Deposits and current accounts	354,431	112,967	16,624	43,248	307,242	88,025	82,353	178,945	1,719	-
- banks	10,574	105,000	5,000	20,000	141,500	-	-	-	-	-
- customers	343,857	7,967	11,624	23,248	165,742	88,025	82,353	178,945	1,719	-
B.2 Debt securities	-	-	-	-	-	632	632	-	20,000	-
B.3 Other liabilities	30,860	831,045	23	105,326	55,628	2,070	5,692	14,836	4,963	-
Off-balance-sheet transactions	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
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 disburse funds	-	-	-	-	-	-	-	-	-	-
- long positions	-	-	-	-	-	-	-	-	-	-
- short positions	-	-	-	-	-	-	-	-	-	-
C.5 Financial guarantees issued	-	-	-	-	-	-	-	-	-	-
C.6 Financial Guarantees received	-	-	-	-	-	-	-	-	-	-
C.7 Credit derivatives with exchange of capital	-	-	-	-	-	-	-	-	-	-
- long positions	-	-	-	-	-	-	-	-	-	-
- short positions	-	-	-	-	-	-	-	-	-	-
C.8 Credit derivatives without exchange of capital	-	-	-	-	-	-	-	-	-	-
- long positions	-	-	-	-	-	-	-	-	-	-
- short positions	-	-	-	-	-	-	-	-	-	-

DISTRIBUTION BY SECTOR OF ON- AND OFF-BALANCE SHEET CREDIT EXPOSURES TO BANKS (BOOK VALUE)

(Amounts in thousands of Euro)

Exposures/Geographical Areas	Italy		Other European Countries		America		Asia		Rest of the world	
	Net Exposure	Adjustments overall value	Net Exposure	Adjustments overall value	Net Exposure	Adjustments overall value	Net Exposure	Adjustments overall value	Net Exposure	Adjustments overall value
A. **On-balance sheet exposures**										
A.1 Doubtful	-	-	-	-	-	-	-	-	-	-
A.2 Unlikely to pay	-	-	-	-	-	-	-	-	-	-
A.3 Non-performing past due exposures	-	-	-	-	-	-	-	-	-	-
A.4 Other performing exposures	1,996	-	-	-	-	-	-	-	-	-
Total A	**1,996**	-	-	-	**-**	**-**	**-**	**-**	**-**	**-**
B. **Off-balance-sheet exposures**										
B.1 Doubtful	-	-	-	-	-	-	-	-	-	-
B.2 Unlikely to pay	-	-	-	-	-	-	-	-	-	-
B.3 Other non-performing assets	-	-	-	-	-	-	-	-	-	-
B.4 Other performing exposures	45	-	-	-	-	-	-	-	-	-
Total B	**45**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total (A+B) 2015	**2,041**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Totale (A+B) 2014	**18,557**	**-**	**63**	**-**	**-**	**-**	**-**	**-**	**-**	**-**

At 31 December 2015, Significant exposures (exposures equal to or greater than 10% of the regulatory capital) consist of 19 positions for a sum of:

a. Book value € 2,559,004 (in thousands)

b. Weighted value € 101,146 (in thousands)

SECTION 9 - UNENCUMBERED ASSETS

(ART. 443 CRR)

QUALITATIVE INFORMATION

The Bank's encumbered assets include Debt securities as guarantees for refinancing transactions c/o the ECB and debt securities used as collateral in repurchase agreements. The encumbered assets also include trade receivables as security c/o the Central Bank via ABACO.

In order to avoid excessive recourse to *over collateralisation* of the securities available, the Bank, starting from 2016, consistent with the prudential supervisory provisions, anticipated, within the purview of the *Risk Appetite Framework*, that an adequate level of readily monetisable assets be available in line with the foreseeable evolution of operations, as forecast by the 2016 budget.

As at 31 December 2015, the encumbered debt securities amounted to approximately EUR 949 million while the book value of the credits in ABACO and the security deposit with Cassa Depositi e Prestiti fell mainly among the other encumbered assets (101 million).

The securities acquired by the bank during reverse repo agreements are noted in particular among the "collateral received".

Finally, the last table provides evidence of the sum of the liabilities associated with the encumbered assets and with the guarantees received relative to the reverse repos.

QUANTITATIVE INFORMATION

MODEL A – ENCUMBERED ASSETS

(Amounts in thousands of Euro)

	Book value of the encumbered assets	Fair value of the encumbered assets	Book value of the unencumbered assets	Fair value of the unencumbered assets
Assets of the reporting institution	1,050,278		1,539,511	
Equity instruments	-	-	5,000	5,000
Debt securities	949,363	949,363	147,569	147,569
Other assets	100,915		1,386,942	

MODEL B – COLLATERAL RECEIVED

(Amounts in thousands of Euro)

	Fair Value of the encumbered collateral received or of own debt securities issued	Fair Value of the collateral received or of own debt securities issued that may be potentially encumbered
Real collateral received by the reporting institute	176,530	3,939
Equity instruments	-	-
Debt securities	176,530	3,939
Other collateral received	-	-
Own debt securities issued other than own- or ABS- issued secured bonds	-	-

MODEL C – ENCUMBERED ASSETS/COLLATERAL RECEIVED AND ASSOCIATED LIABILITIES

(Amounts in thousands of Euro)

	Liabilities corresponding to contingent liabilities or securities loaned	Assets, collateral received and own debt securities issued other than the secured bonds encumbered by ABS
Book value of selected financial liabilities	909,089	1,226,808

SECTION 10 - USE OF ECAIs (Art. 444 CRR)

QUALITATIVE INFORMATION

Banca Sistema calculates the capital requirement with respect to credit risk based on the standardised approach.

The Bank's loan activities predominantly consist:

- in the purchase with and without recourse of the accounts receivables due from Central Authorities, territorial bodies and in general from Public Authorities;
- Loans to SME
- Purchases of loans granted in the form of salary- and pension-backed loans/salary deductions from other intermediaries.

As at 31 December 2015, the Bank availed itself of the rating issued by the ECAI:

- "*Dominion Bond Rating Service*" (DBRS), for exposures to: central authorities and central banks; supervised brokers; public sector institutions; territorial entities;
- "*Fitch Ratings*", with regard to exposures to companies and other parties.

The identification of a reference ECAI in no way represents, in subject matter or in purposes, an assessment on the merit of the opinions made by the ECAI or a support of the methodologies used, for which the External Credit Assessment Institutions remain solely responsible.

QUANTITATIVE INFORMATION

The following table shows the distribution of exposures subject to credit risk on the basis of the weighting factors (credit rating classes) not considering the *SME supporting factor*.

(Amounts in thousands of Euro)

Regulatory class	Ponderazione							Total
	0%	20%	50%	75%	100%	150%	250%	
Central authorities and central banks	1,272,313	-	-	-	3,816	-	-	**1,276,129**
Territorial Entities, public sector institutions;, non-profit institutions	-	521,088	-	-	-	-	-	**521,088**
Supervised brokers	-	18,554	-	-	-	-	-	**18,554**
Multilateral development banks	-	-	-	-	-	-	-	**-**
International organisations	-	-	-	-	-	-	-	**-**
Companies and other parties	-	-	-	-	191,221	-	-	**191,221**
Detail	-	-	-	134,552	-	-	-	**134,552**
UCI	-	-	-	-	-	-	-	**-**
Securitisations	-	-	-	-	-	-	-	**-**
Covered Bonds	-	-	-	-	-	-	-	**-**
Property-secured loan	-	-	-	-	-	-	-	**-**
Exposures in equity instruments	-	-	-	-	5,000	-	2,378	**7,378**
Non-performing exposures	-	-	-	-	6,078	76,821	-	**82,899**
Other exposure	104	-	-	-	2,245	-	-	**2,349**

SECTION 12 - OPERATIONAL RISK

(ART. 446 CRR)

QUALITATIVE INFORMATION

Operational risk is the risk of loss arising from inadequate or dysfunctioning internal processes, human resources, internal systems, or from external events. The following cases are of this type:

- fraud;
- human errors;
- interruptions of operations;
- unavailability of systems;
- inadequate execution of processes;
- breaches of contract;
- natural catastrophes etc.

Operational risk includes legal risk, whereas it does not include strategic risks and reputational risks. Operational risk, therefore, refers to other types of events that, under present conditions, would not be individually relevant if not analysed jointly and quantified for the entire risk category.

In order to determine the capital requirement to hedge operational risk, the Bank adopted the Basic Indicator Approach – BIA, which envisages that the capital requirement be calculated applying a regulatory coefficient equal to 15% of the three-year average of the relevant indicator established in article 316 of EU Regulation no. 575/2013.

The Supervisory authority acknowledges that the specific approach adopted by the individual bank to deal with operational risk may depend on a series of factors, including the size, the organisational set up as well as the nature and complexity of its transactions. In this context, the Bank implemented an operational risk management process (Operational Risk Framework) to identify, measure, and monitor the operational risk. "This method implies a first assessment of the possible associated risks in terms of probability and impact (so-called "Gross risk level") and a subsequent analysis of the existing controls (qualitative assessment on the effectiveness and efficiency of controls) capable of reducing the gross risk level and a consequential assessment of the risk levels (the so-called "Net risk").

The objective of the Operational Risk Framework is to provide management with managerial tools in case of operational risk, i.e. the possibility to evaluate the existing control systems within the Bank, in terms of the ability to efficiently deal with the risks and to minimise the material risks identified to an "acceptable" level. This instrument produces performance measures (IROR), by means of aggregation of the scores associated with individual Operating Procedures/Processes, used for the analysis of the risk level associated with each individual Procedure or for the type of risk.

The Bank continuously assessed the synthetic operational risk indicator relative to the company operations (Total IROR), the capital requirement generated by operational risk, and their evolution with respect to the previous observation.

As an additional oversight of operational risk, the Bank has opened an insurance policy on operational risks deriving from actions of third parties or caused to third parties, as well as suitable riders to cover the damages caused by suppliers of infrastructures and services, and it approved a Business Continuity Plan.

SECTION 13 - EXPOSURES IN EQUITIES NOT INCLUDED IN THE TRADING BOOK

(ART. 447 CRR)

QUALITATIVE INFORMATION

Investments in equities, included in the banking book, pursue a plurality of objectives such as: strategic, institutional, of financial investment and of support for operations.

Accounting techniques

The exposures in equity instruments included in banking book are classified in the financial statement items "Equity Investments" and "Available-for-sale assets".

Financial assets available for sale - accounting criteria

- **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.

  A financial instrument is designated to the category in question when it is initially recorded or following any reclassifications in accordance with paragraphs 50 to 54 of IAS 39, as amended by Regulation (EC) no. 1004/2008 of the European Commission of 15 October 2008.

- **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.

If the fair value is reduced in cost by more than 50% or in duration by more than 18 months, the impairment is considered to be permanent. If, however, the decrease in the fair value of the cost of the instrument is lower than or equal to 50% but above 20%, or in duration by not more than 18 months but not less than 9, the Bank will analyse other income and market indicators. If the results of said analysis are such as to shed doubt on the possibility of recovering the amount originally invested, permanent impairment will be recognised. The amount transferred to the income statement is therefore equal to the difference between the book value (acquisition cost net of any losses due to impairment already reported in the income statement) and the current fair value.

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, in a subsequent period, the fair value of the financial instrument increases and this increase may be objectively related to an event that occurred after the impairment was reported in the income statement, the impairment must be eliminated by reporting the write-back under the same income statement item where monetary elements (for example, debt securities) and shareholders’ equity if they relate to non-monetary items are reported (for example, equity securities). The write-back in the income statement may not, in any event, exceed the amortised cost that the instrument would have had in the absence of the previous adjustments.

Interest income on the aforesaid financial assets is calculated by applying effective interest rate criteria with recognition of the result under the income statement item “interest income and similar income”.

The profits and losses deriving from the disposal or reimbursement of the aforementioned financial assets are reported in the income statement item “Profits (losses) from disposal or repurchase of: available- for-sale financial assets” and include the possible reversal to the income statement of the profits/losses previously recorded in the specific shareholders’ equity reserve.

- **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 criteria

- **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**

  The equity method provides for the initial recognition of the investment at cost and subsequent value adjustment based on the relevant share of the shareholders’ equity of the subsidiary.

  The differences between the value of the equity investment and the shareholders’ equity of the relevant subsidiary are included in the accounting value of the subsidiary.

  In the valuation of the relevant share, any potential voting rights are not taken into consideration.

  The relevant share of the annual results of the subsidiary is shown in a specific item of the consolidated income statement.

  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. Should the recovery value prove lower than the book value, the difference is recognised in the income statement and/ or other measurement elements.

The most recent approved (annual or interim) financial statements are used for the consolidation of the investments in associates. In the cases in which the companies do not apply the IAS/IFRS standards and therefore, for said companies, it has been verified that the possible application of the IAS/IFRS would not have produced significant effects on the Banca Sistema Group’s consolidated financial statements.

- **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 INFORMATION

(Amounts in thousands of Euro)

Type of exposures /Values	Book value			Fair value			Market value	Realised Gains /losses and impairment		Unrealised/capital gains/losses recorded in the Balance Sheet	
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	Level 1	Profits	Losses	Cap. Gains(+)	Cap. Losses(-)
Available-for-sale financial assets	-	-	5,000	-	-	5,000	-	-	-	-	-
Financial assets measured at fair value	-	-	-	-	-	-	-	-	-	-	-
Equity investments			2,378			2,378					
Goodwill	-	-	1,786	-	-	1,786	-	-	-	-	-

The value reported in financial assets available for sale represents the purchase for 200 stakes with a total value of € 5 million, accounting for 0.066% of the share capital of Bank of Italy.

Equity investments includes a 25.80% stake held by the Bank in CS Union S.p.A. (a company resulting from the merger of Candia S.p.A. and St. Ing. S.p.A.), purchasing and managing non-performing financial and trade receivables, as well as recovering debt from and for private companies.

The goodwill originates from the consolidation of the former SF Trust Group of Solvi Srl, subsequent to the merger by incorporation in the Parent Company.

SECTION 14 - EXPOSURE TO INTEREST RATE RISK ON POSITIONS NOT INCLUDED IN THE TRADING BOOK (ART. 448 CRR)

QUALITATIVE INFORMATION

The banking book consists of all the asset and liability-based financial instruments not included in the trading book. As already shown in this document, said risk, on the positions included in the banking book, consists in the possibility of negative changes in the cash flows or of the market value of Bank assets and liabilities due to adverse movements and unexpected market rates.

As a rule the primary loan products to customers, with the exception of the Loans to SMEs, are fixed rate.

Customer deposits and savings on the savings account and on the current account are fixed rate, just as for the interbank deposits are predominantly fixed rate with very short duration.

The assumption of the interest rate risk associated with funding activity carried out by the Treasury Division takes place in observance of the policies and limits established by the Board of Directors.

The defence against interest-rate risk is achieved through the identification of indicators more appropriate for monitoring the performance of total assets and liabilities in relation to the limits of lending, savings and deposit, and interest-rate risk management policies, as well as of any expedient measures to ensure the performance of the activity consistent with the risk policies.

As at 31 December 2015, no interest rate risk hedging instruments were used.

QUANTITATIVE INFORMATION

The Internal Capital for interest-rate risk is calculated, in accordance with the indications of the Bank of Italy circular 285/2013, by a simplified model which subdivides assets and liabilities of the banking book in 14 time brackets based on their residual maturity; floating-rate assets and liabilities are matched with their various time brackets based on interest rate repricing date.

The model provides for that the assets and liabilities be entered in the payment schedule book in accordance with the criteria provided for in the Bank of Italy circular letter 272 "Manual for filling out the Accounts Matrix" and in Circular 115 "Instructions for filling out the supervisory reports of credit institutions on a consolidated basis", with the exception of the:

- current accounts with positive balances, classified in the "On demand" bracket;
- overdraft accounts and demand deposits to be classified in accordance with the following instructions:
    - in the "On demand bracket", by convention, a fixed quota of 25% (the so-called "non-core component");
    - for the remaining amount (the so-called "core component") in the subsequent eight time brackets (from "up to 1 month" to "4-5 years") in proportion to the number of the months contained therein.

Furthermore the Bank models its savings product "Si conto! Deposito" option considering the implicit option of early withdrawal. In particular, the historical percentage of recorded early redemptions is calculated for that item; said value is applied to the entire savings and deposits recovered from the product and the quota is entered in the bucket at 1 day. The remaining sums are "bucketised " as a function of the contractual maturity chosen by the customer.

Within each time period, the asset positions are offset against the liability positions, so as to obtain a net position. The net position by bracket is multiplied by the corresponding weighting factor obtained as the product between a hypothetical change of the rates and an approximation of the modified duration for the individual bracket as provided for by the Bank of Italy's simplified approach.

For the purpose of calculating the banking book's interest-rate risk, Bank of Italy anticipates under conditions of the "normal course of business" one may refer to the annual change of the interest rate recorded in an observation period of 6 years, considering the 99th percentile (rally)".

Reported below is the internal capital determined with respect to interest rate risk.

Also reported is the risk indicator calculated as the ratio between the above-described internal capital and own funds.

(Amounts in thousands of Euro)

EXPOSURE TO INTEREST RATE RISK	Values as at 31/12/2015
1. Internal capital for interest rate risk	4,457
2. Regulatory capital	106,892
3. Risk indicator	4.2%
4. Threshold limit defined by code	20%

SECTION 16 - REMUNERATION POLICY (Art. 450 CRR)

QUALITATIVE INFORMATION

Information regarding the existing remuneration policies is provided in the "Report on Remuneration". The "Report" may be consulted in the "Governance" section of the Bank's internet website at the address: www.bancasistema.it.

The Report on Remuneration includes all the information required by art. 450 of the CRR with regard to the policy and to the normal remuneration practice, regarding the staff categories whose professional activities have a material impact on the bank's risk profile.

SECTION 17 - LEVERAGE

(ART. 451 CRR)

QUALITATIVE INFORMATION

Starting from 1 January 2015, the Leverage Ratio was introduced with the objective of containing the degree of Banks' debt entering a minimum level to hedge overall exposures by means of own capital. The Basel Committee set the indicator's minimum level was set at 3%.

The leverage ratio is calculated as the ratio between the Tier 1 capital and the overall exposure. In particular, the denominator of the indicator is composed of the total exposures corrected eliminating, among other things, the assets deducted from the Tier 1 capital, the Securities Financing Transactions, and including the off-balance-sheet exposures.

With reference to the numerator, instead, during the period from 1 January 2015 to 31 December 2021, the leverage ratio is calculated using:

- the transitory Tier 1 capital, i.e. the sum of the bank's Common Equity Tier 1 capital (CET1) and the Additional Tier 1 capital(AT1) calculated according to the rules in force;
- the Tier 1 capital "when the law is fully in effect ", i.e. cleansed of the exemptions pursuant to the Transitory measures.

As at 31 December 2015, a leverage indicator equal to 4.2% above the minimum regulatory level proposed by the Basel Committee was recorded. The indicator is currently reported quarterly to the Bank of Italy for monitoring purposes.

The bank deems the leverage risk to be contained, also considering that about 38% of the total assets used in ratio calculation consists of the own securities portfolio composed entirely of government securities with duration less than 1 year. The short duration of the portfolio guarantee both limited fair-value variation of the securities, and, in the event of significant negative fair value variations, the possibility of assessing whether to keep the security until maturity, de facto annulling the losses potentially recorded.

QUANTITATIVE INFORMATION

Leverage		31.12.2015
Total (book value)		**2,411,994**
Adjustments of asset postings		
	repos receivable	-177,868
	others excluded posting	-2,348
TOTAL ASSETS adjusted		**2,231,777**
Posting deducted from Own Funds - when the law is fully in effect		-1,872
Posting deducted from Own Funds - During the transition period		-2,249
repurchase agreement add-ons		5,128
derivative add-ons		0
Off-balance-sheet items		21,228

Overall exposure of leverage ratio - when the law is fully in effect		2,256,262
Overall exposure of leverage ratio - during the transition period		2,255,885

Tier 1 - When the law is fully in effect	95,269
Tier 1 - During the transition period	94,892

Leverage - When the law is fully in effect	4.222%
Leverage - During the transition period	4.206%

SECTION 19 - USE OF CREDIT RISK MITIGATION TECHNIQUES

(ART. 453 CRR)

QUALITATIVE INFORMATION

Starting from 2014, Banca Sistema expanded its credit products offering introducing the “Loans to SME”, i.e. loans provided by Banca Sistema to undertakings classified as micro, small and medium enterprises (SME). The granting of the loan is contingent upon the presence of the guarantee issued by the National Guarantee Fund (the average guarantee for the existing cases as at 31/12 is equal to approximately 80%) for SMEs (Italian Law no. 662/96 as amended) managed by the Mediocredito Centrale S.p.A.).

Said exposures fall in the regulatory segments “Retail Exposures” and “Exposures to corporates”.

Lastly, the category of personal financing which allows an advance to be obtained from the sums deposited on the term deposit (Si Account! Deposito) converges in particular in the “Retail exposures” segment. The loan granted is guaranteed by the term-encumbered sums.

Moreover, as at 31 December 2015, “current account overdraft facility guaranteed by pledge” transactions were granted for a drawdown equal to approximately EUR 2.4 million. The value of the exposure is backed by eligible collateral for the purpose of *credit risk mitigation*[7].

QUANTITATIVE INFORMATION

(Amounts in thousands of Euro)

Segment	Exposures	Guarantee	Exposures post CRM	RWA
Exposures retail	185,086	50,534	134,552	98,520
Exposures to corporates	201,722	10,501	191,221	190,442

(7) EU Regulation 575/2013 Title II, Chapter 4.

CERTIFICATION OF THE DESIGNATED MANAGER RESPONSIBLE FOR DRAFTING COMPANY ACCOUNTING DOCUMENTS

The Manager responsible for drafting the company accounting documents, Margherita Mapelli, hereby declares that, pursuant to art. 154-bis, paragraph 2 of the Consolidated Law on Finance, the accounting information contained in this “Disclosure by the Entities pursuant to EU Regulation no. 575/2013 – 31 December 2015” corresponds to the company’s documents, books and accounting records.

Margherita Mapelli
Designated manager responsible
for drafting company accounting documents

GLOSSARY

The definitions of the main technical terms used in the document are provided below.

Categories of financial instruments provided for by IAS 39
Trading activities, which include
the assets acquired to be sold in the short term, or also belonging to instrument portfolios managed on a single basis in order to realise profits in the short term; assets carried at fair value, the IAS accounting standards allow the assets which the institute nevertheless decides to recognise at fair value to be classified in that category with the change of value recorded in the income statement in compliance with certain case studies provided for by IAS 39; assets held to maturity, non-derivative assets with established maturity date and fixed or determinable payment schedule for which the actual intention and capacity to hold them until maturity exists; receivables and loans, non-derivative assets derivatives with fixed or determinable payments, not listed in an active market; available-for-sale assets

CET1
Common Equity Tier 1 capital.

Common equity tier 1 ratio (CET1 Ratio)
The ratio between Common Equity Tier 1 capital (CET1) and total risk-weighted assets.

CRM
Credit Risk Mitigation.

Default
The identifies the condition of stated impossibility to honour ones debts and/or to pay the relevant interest.

IAS/IFRS
The IAS (International Accounting Standards) are issued by the International Accounting Standards Board (IASB). The standards issued after July 2002 are named IFRS (International Financial Reporting Standards).

IASB (International Accounting Standard Board)
The IASB (in the past, named the IASC) is responsible for issuing the IAS/IFRS standards.

ICAAP
The regulation of the "Second Pillar" requires that the banks adopt the Internal Capital Adequacy Assessment Process (ICAAP) processes and instruments to determine the internal capital levels sufficient to cope with any type of risk, even those not protected by the overall minimum capital requirement ("First Pillar"), within the scope of an assessment of the current and foreseeable exposure which takes into account the strategies and the evolution of the reference setting.

Impairment
With reference to a financial asset, a state of impairment occurs when the carrying value of said asset is greater than the estimate of its recoverable value.

Leverage Ratio
In the banking sector, Leverage ratio is also generally defined as the ratio between the shareholders equity of the institution and total assets

Non-performing
A term generally referring to irregular loans.

Probability of Default (PD)
This is the probability that the debtor will default over a time horizon of one year.

Rating
Valuation of a company's quality or of its debt-security issues based on the financial soundness and outlook of the companies themselves.
Said assessment is performed by specialised agencies or by the bank based on internal models.

Credit risk
This represent the risk than an unexpected change of the creditworthiness of a counterparty, of the guarantees thereby provided, or even the margins thereby used in case of insolvency, may generate an unexpected change in the bank's credit quality.

Market risk
Risks deriving from the fluctuation of value of the financial instruments traded in markets (shares, bonds, derivatives, securities in foreign currency) and of financial instruments the values of which are linked to the market variables (the rate component of customer loans, deposits in Euro and in foreign currency:, etc.).

Liquidity risk
The possibility that the undertaking is not able to honour its respective payment commitments due to the inability to unfreeze assets or to obtain sufficient funds from the market (funding liquidity risk) or also due to difficulties/the impossibility to easily monetise positions in financial assets without materially and unfavourably influencing it due to inadequate depth of the financial market or to its temporary malfunctioning (market liquidity risk:).

Operational risk
Operational risk is the risk of loss arising from inadequate or dysfunctioning of internal processes, human resources or internal systems, or from external events. Legal risk is included within the scope of operational risk, that is the risk of loss deriving from violations of laws or regulations, from contractual or non-contractual liability, or also from other disputes, ICT risks (Information and
Communication Technology) and the model risk, strategic and reputational risks are instead not included.

GLOSSARY

The definitions of the main technical terms used in the document are provided below.

Risk Management
Activity of acquiring, measuring, assessing, and globally managing the various types of risk and the respective hedges.

RWA (Risk Weighted Assets)
Cash and off-balance sheet assets (derivatives and guarantees) classified and weighted based on various risk related ratios, in accordance with bank regulations enacted by the supervisory authorities for calculating solvency ratios.

Tier 1
Tier 1 capital (tier 1) includes the Common Equity Tier 1 capital (CET1) and the Additional Tier 1 capital (AT1).

Tier 1 ratio
The ratio between Tier 1 capital (tier 1), which includes the(Common Equity Tier 1 capital (CET1) and the Additional Tier 1 capital (AT1), and the total risk-weighted assets.

Tier 2
Tier 2 capital (Tier 2) is mainly composed of the computable subordinated liabilities.

Total capital ratio
Capital ratio referring to the sum of constituent components of Own funds (Tier 1 and Tier 2).