Banca Sistema

DISCLOSURE BY INSTITUTIONS ACCORDING TO REGULATION (UE) N.575/2013 "THIRD PILLAR"

31 December 2016

BANCA SISTEMA SPECIALTY FINANCE

INDICE GENERALE

INTRODUCTION

With this document, the Banca Sistema S.p.A. Group (hereinafter the "Bank" or "Banca Sistema") 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 specific disclosure area.

In particular, the public disclosure was prepared considering 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.

This document also takes into consideration the new standards for preparing the public disclosure set out in the document "Guidelines on disclosure requirements under Part Eight of Regulation (EU) N° 575/2013" published on 14 December 2016 by the EBA.

As at 31 December 2016, the scope of the Banca Sistema Group included the Beta Stepstone S.p.A. subsidiary, which was acquired in 2016 and merged by incorporation in January 2017. Consequently, the disclosure includes the qualitative and quantitative information concerning the capital adequacy of Beta Stepstone as at 31 December 2016.

Part Eight (Regulation UE n. 575/2013 of the European Parliament and of the Council of 26 June 2013)		Qualitative Information	Quantitative Information
Section 1	Risk management objective 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 credit 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)	X	X
Section 12	Operational risk (Art. 446)	X	X
Section 13	Exposures in equities not included in the trading book	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 Securitization positions (Art. 449)	X	N/A
Section 16	Remuneration policy (Art. 450)	X	N/A
Section 17	Leverage (Art. 451)	X	X
Section 18	Use of IRB approach to the credit risk (Art. 452)	N/A	N/A
Section 19	Use of credit risk mitigation techniques (Art. 453)	X	X
Section 20	Use of Advanced Measurement Approaches to operational risk (Art. 454)	N/A	N/A
Section 21	Use of Internal Market Risk Models (Art. 455)	N/A	N/A

It should be noted that the information required in sections: 6 “Capital buffers”, 7 “Indicators of global systemic importance”, 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 assumed, 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

The risk culture in Banca Sistema

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.

Starting from 1 January 2014, the Bank has used a reference framework both to identify its own risk appetite and for the internal capital adequacy assessment process. 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 based on the strategic guidelines and regulatory changes.

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 its functions.

In order to supervise the risks of the Bank, and 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 first structures responsible for the risk management process are the operational ones.
- **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.

  The second level controls (risk management, compliance, and the prevention of money laundering) are assigned to the Risk Department and the Compliance and Anti-Money Laundering Department.

- **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 Internal Audit Department performs the third level controls.

Organisational structure

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 08 February 2017, 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
  - Internal Control and Risk Management Committee
  - Nominations 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 and ALM
  - Technical Organisational Committee
  - Credit Committee
  - Crisis Management Committee

Company control functions

- Risk Department
- Compliance and Anti-Money Laundering Function
- Internal Audit Department
- Manager responsible for preparing the Company's financial reports

<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>

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.

Nominations 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 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.

<u>Governance Bodies: CEO and General Manager</u>

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.

The General Manager has the power and the duty to manage, coordinate and supervise all the Departments, Functions, units, offices, and services of the Banking group without prejudice to the mandatory limits imposed by law and the supervisory regulations.

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 and ALM

The Risk Management Committee and ALM, 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. The classification of non-performing loans and related write-downs are defined by the Risk Management Committee and ALM.

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 actions and coordinating new projects, defining the priorities and governing implementation.

Credit Committee

Within the purview of the credit process, it supports the CEO in decisions to take on risks within their area of competence. In particular, during the Credit Committee meetings the granting and renewal of credit lines are evaluated through a review of the analyses received from the various functions involved in the disbursement process.

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 offences envisaged 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:

- The **Risk Department**, which reports directly to the CEO, is tasked with the identification, management, and monitoring of all risks to which the Bank is or may be exposed. It cooperates 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 management process as well as in setting operational limits for the assumption of various types of risk.
- **Compliance and Anti-Money Laundering Function** which reports to the BoD and 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 Department collaborates with other departments of the Bank for the definition of methods for the assessment of compliance risks. It includes the Anti-money laundering Function which is established for the purpose of inspecting with a risk-based approach.
- **Internal Audit Department** reports directly to the Board of Directors and functionally to the CEO. The Department assesses, with a third level, the overall functioning of the internal control system, bringing possible improvements to the attention of the Corporate bodies. The Department 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.
- The **Manager responsible for preparing the Company's financial reports** 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. The manager supervises over the implementation of formalities in accordance with common configurations at the Bank, approved by the Board of Directors.

These Departments/Functions are separated from each other with regard to organisation.

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

In detail:

- The Risk Management Function and the Compliance and Anti-Money Laundering Function present to the Corporate bodies on an annual basis, 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 any deficiencies observed in the inspections, and any newly identified risks;
- Each year, the Internal Audit Function presents an Audit Plan to the corporate bodies 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 management hedging policies

Based on the analysis conducted, the Bank, considering its current and future operations, is exposed to the following risks at 31 December 2016:

I) Pillar 1 risks

- credit and counterparty risk
- market risk;
- operational risk;

l) 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 standard methods that will be described in the following paragraphs.

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.

This is the most significant risk to which the Bank is exposed covering about 80% of the allocated internal capital.

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

a) Acquisition of receivables with and without recourse (factoring);

a) Purchases of loans granted in the form of salary- and pension-backed loans from other intermediaries;

a) Loans to small and medium enterprises, guaranteed by the National Guarantee Fund;

a) Financial instruments held on its own account;

a) Loans to supervised intermediaries.

It should be noted that the Bank's core business is in factoring (especially in the public sector) which has its own unique risk characteristics leveraging a more complex assessment (debtors, assignors and supply contracts) and benefiting from credit rotation.

By virtue of both the control of the transaction being financed and observation of the creditworthiness of the debtors, factoring allows for effective risk mitigation.

Credit risk in factoring transactions also include:

- "dilution" risk, or the possibility that the acquired receivables are no longer completely collectible at the due date because of offsets, allowances, disputes between the debtor and the originator; for this type of risk, the Company has adequately safeguarded itself with specific contractual clauses;
- "revocation" risk. Pursuant to law 52/1991, for transfers in which the debtor is notified, the debtor is nonetheless required to pay the receivables subject to the transfer contract even if the originator files for bankruptcy and the burden of proof regarding knowledge of the factor's state of insolvency lies with the Receiver. If the Receiver were

to prove that the transferee was aware of the originator's state of insolvency at the time of the transfer, the transfer would not be effective and any payments received from the debtor would be returned to the Receiver.

The above-mentioned risks are monitored in the investigation phase with an assessment of the credit worthiness of the counterparty, the debtor, and the underlying assets. The assessment would then be brought to the attention of the Credit Committee which supports the decision-making bodies (CEO, Board of Directors for their areas of responsibility) in the decisions to be made.

Credit process and the involvement of the control function

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.

The process that generates credit risk (disbursement process) is organised in the various steps summarised below:

- Sales contract and preliminary activities: contact with the potential customer and gathering of documentation.
- Investigation: analysis and assessment of the creditworthiness of the customer, debtor and the underlying asset;
- Decision and related activities: approval by the decision-making bodies of the receivables assignment transaction agreed with the customers and the start of the process aimed at completing the transaction.
- Signing and completion of the assignment: signing of the contract and completion of the transaction.
- Disbursement and management of collections: financing the transaction and management of the collection of the acquired receivables.
- Monitoring: continuous monitoring of the position in order to manage any possible actions to take in the event of default (possible legal recovery).

The Risk Department is involved in the investigation process through the verification of compliance with the Major Risks, and the defined Key Risk Indicators, while control of the due diligence activities on the customer is handled by the Anti-Money Laundering and Compliance Department.

The proposed classification of positions in default is the responsibility of the Risk Department. The Department performs specific assessments based on the information received from the Collections Department (function entrusted with credit collection) and the Underwriting Department (function entrusted with portfolio assessment and monitoring activities), as well as through analysis tools made directly available to it. Based on the assessments, it proposes an appropriate classification of the exposures to be presented to the CEO for decision, who will evaluate the change in status upon hearing the opinion of the Risk Management Committee and ALM.

Finally, the Internal Audit Department, within the purview of credit risk, based on a method that determines the controls to be implemented and their frequency according to a risk based approach, carries out audits that involve the entire factoring process.

The credit risk management and mitigation controls specifically implemented based on the various transaction types are set out below.

a) Acquisition of receivables with and without recourse (factoring): 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 by a direct result of the definitive acquisition of credit from the customer company versus the insolvency of the assigned debtor.

b) Salary- and 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 Companies"), 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.

c) 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.

It should be noted that the Bank, starting in 2016, has decided to suspend the development of this business line following new regulatory developments related to the SME Loan product guaranteed by MCC for which the guarantee percentage will be reduced and thus no longer deemed profitable for the Bank.

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.

Trading in Italian government securities involves credit risk exposure to the Central administrations.

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

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

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.

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.

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"(1). It differs from credit risk by the type of transactions to which it refers; typically, these are 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.

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[(2)].

Market 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 unfavourable 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 book, 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 Department 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 improper functioning of 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.

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.

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

(1) Cf. Supervisory provisions for banks" - Bank of Italy, Circular no. 285 of 17 December 2013, Part II, Chapter 7 as amended.
(2) Cf. EU Regulation 575/2013 Title II, Chapter 4.

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-sectoral concentration risk following the proposed ABI approach. The ABI approach allows the effects on the internal capital caused by changes of sectoral concentration to be assessed. Said effects are calculated using a benchmark with respect to which, by applying a mark-up 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(3). 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(4).

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 Department, the Risk Department, 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 2016, no interest rate risk hedging instruments were used.

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 one's 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 one's 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

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

maturities and conduct.
- Contingency 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 specific Key Risk Indicators (KRI) present in the Risk Appetite Framework (RAF) 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 2016 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.

Always regarding the liquidity KRIs, the Bank continuously monitors the level of readily monetisable assets, or the level of Euro denominated securities issued by the governments within the EMU area, unstructured and accepted as collateral for refinancing transactions with the ECB, as well as cash.

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 Department (first level protection) represents the first protection in liquidity risk management. The function calculates and monitors the risk indicators;
- Every month, the Risk Department (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 Departments, also in connection with the Risk Management Committee meetings.

The Risk Department 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 2016, 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. It is the risk of 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 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.

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.

Reporting system

The Risk Department keeps the management bodies continuously updated on the levels of risk taken on by the Bank though a system of reporting scheduled according to content.

All the analyses the Risk Department 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 and ALM, of the Internal Control and Risk Management Committee, and of the Board of Directors, together with the Board of Statutory Auditors.

The Risk Department also produces different disclosures for both the Department itself and for the other functions. The reports produced, the scope, addressee and the frequency are listed below:

Report/control	Description	Addressee	Frequency
Loan portfolio monitoring	Analysis of potential risks for each portfolio being acquired (i.e. Major Risks, MST, etc.)	Risk Department	Per event
Treasury position	Verification of compliance with the treasury powers delegated to the CEO	Risk Department	Daily
Credit Risk Report	Performance monitoring of the Bank's lending portfolio	Risk Management Committee and ALM	Monthly
RAF	Monitoring of risk indicators set out in the RAF	CEO Committee	Weekly
Risk Reporting	Report containing the Bank's overall level of risk.	CEO Committee / Board of Directors Bank of Italy	Quarterly
Impairment	Generic and specific assessment of the receivables portfolio	Risk Management Committee and ALM	Quarterly
Risk Management Report	Report on the activities carried out, the audits performed, the results obtained, any weaknesses observed, and the actions to be adopted to eliminate them	CEO Committee / Bank of Italy	Annually

In particular, Risk Reporting calls for disclosures with regard to:

- Own Funds and Capital Adequacy
- RWA Trend
- Total Internal Capital
- RAF – Risk Appetite Framework
- Asset Quality
- Total Internal Capital and Stress scenario

With details regarding

- Credit and Counterparty Risk
- Pillar 2 risks
- Liquidity and Contingency Funding Plan

Stress testing

The Risk Department performs stress tests aimed at assessing the impact, including in terms of capital adequacy, generated by a stress scenario.

Stress tests include a series of methods of varying complexity and sophistication aimed at simulating the Bank's sensitivity to exceptional, but plausible, changes in one or more risk factors that could result in a deterioration of the Bank's financial stability.

They consist of the following:

a) sensitivity analysis, used to assess the capital adequacy following the change in a single risk factor;

b) scenario analysis, used to simulate the impact on own capital of a shock that results in a simultaneous change in a set of risk factors.

The Risk Department monitors capital adequacy monthly by also considering the stress scenarios. The results of the stress scenarios are reported to the Company's top management.

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 €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 2016, Banca Sistema Group was composed of the Parent Company Banca Sistema S.p.A., Specialty Finance Trust Holding Limited, a company incorporated under U.K. Law, LASS Immobiliare, and the newly acquired Beta Stepstone, merged by incorporation in January 2017.

SECTION 3 - OWN FUNDS

(Art. 437 CRR)

QUALITATIVE INFORMATION

Own funds, risk weighted assets and solvency ratios as at 31 December 2016 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 (issued in 2013), and the update of Circular no. 154.

Within the above regulatory framework, Own Funds are characterised by a structure based on two tiers:

- Tier 1 Capital in turn composed of:
  - Common Equity Tier 1 Capital, or CET 1;
  - Additional Tier 1 Capital, or AT1
- Tier 2 Capital, or 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				
no.	Characteristics	Ordinary shares	Subordinated Tier 1 bonds	Subordinated lower Tier 2 bonds
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 institution; consolidated; individual institution and consolidated	Individual institution (1)	Individual institution (1)	Individual institution (1)
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

Main characteristics of capital instruments				
no.	Characteristics	Ordinary shares	Subordinated Tier 1 bonds	Subordinated lower Tier 2 bonds
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	Early redemption at the discretion of the issuer subject to prior approval of the Supervisory Authority	No	Yes	No
15	Date and amount of the early redemption	N/A	The Issuer reserves the right to proceed, starting from 18/12/2017, with the full or partial early redemption of the residual par value of the securities. Early redemption clauses associated with taxation and/or regulatory events also exist.	N/A
16	Dates subsequent to early redemption	N/A	Subsequent to the first date of early redemption, the Issuer reserves the right to evaluate whether to proceed with the early redemption on an annual basis	N/A
Coupon/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%	Euribor 6 months + 5.50%
19	Presence of a "dividend stopper" mechanism	No	Yes	No

Main characteristics of capital instruments				
no.	Characteristics	Ordinary shares	Subordinated Tier 1 bonds	Subordinated lower Tier 2 bonds
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, in a "capital event". The term "capital event" means: a) a reduction of the capital ratios below the minimum regulatory level; b) Common Equity Tier 1 coefficient drops below 5.125%. 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	Non-cumulative or cumulative	N/A	Non-cumulative	N/A
23	Convertible or non-convertible	N/A	Non-convertible	Non-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 point 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				
no.	Characteristics	Ordinary shares	Subordinated Tier 1 bonds	Subordinated lower Tier 2 bonds
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

(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 thresholds.

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 Statement of Financial Position 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.

(Amounts in thousands of Euro)

	Equity components	(A) Amount	(B) Reference article of Regulation (EU) no, 575/2013	(C) Amount upon full phase-in
Common Equity Tier 1: instruments and reserves				
1	Capital Instruments and the relevant Share Premium Reserves	49,002,305	26, paragraph 1, 27, 28, 29, ABE list pursuant to art, 26, paragraph 3	49,002,305
2	Retained earnings	39,608,427	26, paragraph 1, letter c)	39,608,427
3	Other comprehensive accumulated income (and other reserves, include the profits and losses not realised pursuant to the applicable accounting regulation)	424,600	26, paragraph 1	424,600
5a	Profit for the period verified by independent personnel net of all foreseeable expenses or dividends	19,200,991	26, paragraph 2	19,200,991
6	Common Equity Tier 1 (CET1) before regulatory adjustments	**108,236,323**		**108,236,323**
Common Equity Tier 1 (CET1)				
8	Intangible assets (net of the relevant tax liabilities)	-1,834,760	36, paragraph 1, letter b), 37, 472, paragraph 4	-1,871,896
16	Direct or indirect holdings by an institution of own Common Equity Tier 1 instruments (negative amount)	-1,477,649	36, paragraph 1, letter f), 42	-1,477,649
26	Regulatory adjustments applied to Common Equity Tier 1 in relation to the amounts subject to pre-CRR treatment	-302,546		0
26a	Regulatory adjustments relative to the unrealised gains and losses pursuant to articles 467 and 468	-302,546		0
	of which unrealised gains relative to exposures with Central Authorities classified in the category "Available-for-sale financial assets" of IAS 39 approved by the EU	-221,177	467	0
	of which a filter for unrealised gains	-146,133	468	0
	of which a filter for unrealised losses	64,764	467	0
28	**Total regulatory adjustments to Common Equity Tier 1 (CET1)**	**-3,614,955**		**-1,871,896**
29	**Total regulatory adjustments to Common Equity Tier 1 (CET1)**	**104,621,368**		**106,364,427**
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	**Additional Tier 1 (AT1) before regulatory adjustments**	**8,000,000**		8,000,000
44	**Capitale aggiuntivo di Classe 1 (AT1)**	**8,000,000**		**8,000,000**

45	**Tier 1 (T1=CET1+AT1)**	**112,621,368**		**114,364,427**
Additional Tier 2 (T2): instruments and provisions				
46	Capital Instruments and the relevant Share Premium Reserves	12,091,680	62.63	12,091,680
51	**Tier 2 (T2) before regulatory adjustments**	**12,091,680**		12,091,680
58	**Tier 2 (T2)**	**12,091,680**		12,091,680
59	**Total Capital (TC = T1 + T2)**	**124,713,048**		**126,456,107**
60	**Total risk weighted assets**	**788,041,077**		**788,041,077**
Capital ratios and Reserves				
61	Common Equity Tier 1 (as a percentage of risk exposure)	13.28%	92, paragrafo 2, lettera a), 465	13.50%
62	Tier 1 capital (as a percentage of risk exposure)	14.29%	92, paragrafo 2, lettera b), 465	14.51%
63	Total capital (as a percentage of risk exposure)	15.83%	92, paragrafo 2, lettera c)	16.05%
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	4.91%	CRD 128, 129, 130	4.91%
65	of which: the capital conservation buffer requirement	2.50%		2.50%

(Amounts in thousands of Euro)

Asset items	Accounting Data	Amount relevant for the purposes of Own Funds	Ref. Transitory model table for the publication of information regarding capital funds
120. Intangible assets	90,329,669	20,091,680	30,32,46
of which: goodwill	20,102,195	20,091,680	30,32,46
of which: other intangible assets	424,600	122,054	3,26,26a
30. Securities issued	679,575	0	26,26a
of which: subordinate instruments subject to transitional provisions	-254,975	122,054	26,26a
140. Valuation reserves	39,608,427	39,608,427	1,2
of which: valuation reserves on securities available for sale	39,351,779	39,351,779	1
of which: other valuation reserves	9,650,526	9,650,526	1
170.Reserves	-52,476	-1,477,649	5a
180. Share premiums	25,312,991	25,312,991	5a
190. Capital	-6,112,000	-6,112,000	5a
200. Treasury shares			
220. Profit (loss) for the period		124,713,048	
of which: profit for the period net of dividend distributed for the year		12,774,791	5a
Total Own Funds at 31 December 2016		**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).

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 regarding 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 a 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 internal anticyclical ratio greater than 2.5%.

The Supervisory Authority, given the state of the economy and of credit in Italy, deemed it expedient to keep the foregoing ratio equal to zero for all of 2016.

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 € 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/Single name
	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 equity 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 Internal Audit and, for approval, to the attention of the Board of Directors.

   The ICAAP having been completed, the Internal Audit Department 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 2016 within 30 April 2017. 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	
	31/12/2016	31/12/2015	31/12/2016	31/12/2015
A. RISK ASSETS	2,469,702	2,234,170	652,999	535,194
A.1 Credit and counterparty risk	**2,469,702**	**2,234,170**	**652,999**	**535,194**
1. Standardised approach	-	-	-	-
2. Internal ratings based approach	-	-	-	-
2.1 Basic	-	-	-	-
2.2 Advanced	-	-	-	-
3. Securitised debt	-	-	-	-
B. MINIMUM REGULATORY REQUIREMENTS				
B.1 Credit and counterparty risk			**52,240**	**42,815**
B.2 Credit assessment adjustment risk			**-**	**-**
B.3 Settlement risk			-	-
B.4 Market risk			368	-
1. Standard approach			368	-
2. Internal models			-	-
3. Concentration risk				
B.5 Operational risk			**10,436**	**8,037**
1. Basic indicator approach			10,436	8,037
2. Standardised approach			-	-
3. Advanced measurement approach			-	-
B.6 Other calculation elements				
B.7 Total capital requirements			**63,043**	**50,853**
C. RISK ASSETS AND CAPITAL RATIOS				
C.1 Risk-weighted assets			788,041	635,658
C.2 CET1 capital/risk-weighted assets (CET1 capital ratio)			13.28%	13.67%
C.3 Tier 1 capital/risk-weighted assets (Tier 1 capital ratio)			14.29%	14.93%
C.4 Total Own Funds/risk-weighted assets (Total Capital Ratio)			15.83%	16.82%

SECTION 5 - EXPOSURE TO COUNTERPARTY CREDIT 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 the 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 31/12/2016, only Repurchase agreements are outstanding with the Compensation and Guarantee Fund.

QUANTITATIVE INFORMATION

OUTSTANDING REPURCHASE AGREEMENTS

(Amounts in thousands of Euro)

Type of instrument	Supervisory trading book	Banking book
Reverse repurchase agreements	-	-
Repurchase agreements	-	295,581

SECTION 8 - CREDIT RISK ADJUSTMENTS
(Art. 442 CRR)

QUALITATIVE INFORMATION

The Banca Sistema Group defined its credit quality policy as a function of the provisions in the Bank of Italy Circular 272 (Accounts matrix), the principle definitions of which are provided on the following pages.

The Supervisory Provisions for Banks assign to intermediaries specific obligations concerning the monitoring and classification of loans:

"The obligations of the operating units in the monitoring phase of the loan granted must be inferable from the internal regulation. The intervention terms and methods must be set in event of irregularity. The measurement, management, and classification criteria for irregular loans, as well as the related responsible units, must be set with resolution of the board of directors, which indicates the methods of coordination among these criteria and the methods required by the supervisory reports. The board of directors must be regularly informed on the performance of the irregular loans and the related recovery procedures."

According to the definitions in the above-mentioned Bank of Italy Circular, financial assets that lie within the categories of the doubtful, unlikely to pay or non-performing past due and/or overdrawn exposures are defined as non-performing.

Exposures whose anomalous situation is attributable to factors relevant to the so-called "country risk" are excluded from "doubtful" financial assets.

The following definitions apply:

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 (art. 5 bankruptcy law). The definition therefore applies regardless of the existence of any collateral (real or private) provided as protection against the exposures.

This class also includes:

a) the exposure to local institutions (municipalities and provinces) in state of financial difficulty for the portion subject to the applicable liquidation procedure;

b) the credits purchased from third parties having doubtful parties as the primary obligor, regardless of the accounting portfolio in which it is allocated.

Unlikely to pay

Classification into this category is first of all the result of the Bank's 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.

Non-performing 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 or unlikely to pay, 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 past due exposure in connection with the factoring operation, the following is specified:

- for "with recourse transactions", the past due exposure, other than that associated with the assignment of future receivables, is determined only if both of the following conditions exist:
- the advance is of an amount equal to or greater than the amount of the receivables 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 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 past due and/or overdrawn exposures at the level of the debtor party.

The regulation also requires the overall exposure to a debtor to be recognised as past due and/or overdrawn if, at the reference date of the report, the relevance threshold of 5% is exceeded.

Forborne exposures

Forborne exposures are defined as the exposures which lie in the categories of "Non-performing exposures with forbearance measures" and "Forborne performing exposures" as defined in the International Technical Standards (ITS).

A forbearance measure represents a concession towards a debtor which faces or is about to face difficulties in fulfilling its financial obligations ("financial difficulties"); a "concession" indicates one of the following actions:

- an amendment of the previous terms and conditions of a contract which the debtor is considered unable to fulfil due to its financial difficulties, that would not have been granted if the debtor was not in financial difficulty;
- a total or partial refinancing operation of a problem loan that would not have been granted if the debtor was not in financial difficulty.

Art. 172 of ITS EBA sets some situations which, if occurring, lead in any case to the presence of forbearance measures, i.e. when:

- an amended contract was classified as non-performing and would have been so in the absence of the amendment;
- the amendment made to the contract implies a partial or total cancellation of the debt;
- the intermediary approves the use of forbearance clauses incorporated in the contract for a debtor classified as non-performing or that would have been so without resorting to these clauses;
- at the same time or close to the additional granting of credit by the intermediary, the debtor makes payments of

capital or interest on another contract with the intermediary that was classified as non-performing or that would have been classified so in the absence of the refinancing.

According to these criteria, forbearance is presumed to have taken place when:

- the amended contract has totally or partially expired for more than 30 days (without being classified as non-performing) at least once during the three months before the amendment or would have been so in the absence of the amendment;
- at the same time or close to the additional granting of credit by the intermediary, the debtor makes payments of capital or interest on another contract with the intermediary that was totally or partially expired for more than 30 days (without being classified as non-performing) at least once during the three months before the amendment or would have been so in the absence of the amendment;
- the intermediary approves the use of forbearance clauses incorporated in the contract for a debtor which has expired for more than 30 days or that would have been so without resorting to these clauses.

QUANTITATIVE INFORMATION

The tables indicated in the following Table were taken from the Financial Statements as at 31 December 2016, Part E of the 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					507,872	507,872
2. Held-to-maturity financial assets						
3. Due from banks					83,493	83,493
4. Loans to customers	22,969	16,163	68,172	240,990	1,000,036	1,348,330
5. Financial assets at fair value through profit and loss						
6. Financial assets held for disposal						
Total 2016	**22,969**	**16,163**	**68,172**	**240,990**	**1,591,401**	**1,939,695**
Total 2015	**13,899**	**5,093**	**65,255**	**258,961**	**2,042,290**	**2,385,468**

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 assets			**Total (net exposure)**
	Gross exposure	Specific adjustments	Net exposure	Gross exposure	Portfolio adjustments	Net exposure	
1. Available-for-sale financial assets				507,872		507,872	507,872
2. Held-to-maturity financial assets							
3. Due from banks				83,493		83,493	83,493
4. Loans to customers	123,760	16,456	107,304	1,246,868	5,842	1,241,025	1,348,330
5. Financial assets at fair value through profit and loss							
6. Financial assets held for disposal							
Total 2016	**123,760**	**16,456**	**107,304**	**1,838,233**	**5,842**	**1,832,390**	**1,939,695**
Total 2015	**91,353**	**7,137**	**84,216**	**2,299,485**	**3,233**	**2,296,252**	**2,380,468**

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

(Amounts in thousands of Euro)

TType of exposures / Values	Gross Exposure					Specific adjustments	Portfolio adjustments	Net exposure
	Non-performing assets				Performing 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	**1**							
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					83,493			83,493
of which: forborne exposures								
TOTAL A								
B. OFF-BALANCE SHEET EXPOSURES					**83,493**			**83,493**
a) Non-performing								
b) Performing								
TOTAL B								
TOTAL (A+B)					**83,493**			**83,493**

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

On-balance sheet credit exposures to banks: dynamics of overall value adjustments: 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					Specific adjustments	Portfolio adjustments	Net exposure
	Non-performing assets				Performing 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	1	62	352	34,816		12,260		22,971
of which: forborne exposures								
b) Unlikely to pay	11,867	2,869	2,063	3,390		4,027		16,163
of which: forborne exposures								
c) Non-performing past due exposures	29,665	8,916	11,100	18,661		170		68,172
of which: forborne exposures								
d) Performing past due exposures					241,350		552	240,798
of which: forborne exposures								
e) Other performing exposures					1,513,390		5,290	1,508,099
of which: forborne exposures								
TOTAL A	**41,533**	**11,847**	**13,515**	**56,867**	**1,754,740**	**16,457**	**5,842**	**1,856,203**
B. OFF-BALANCE SHEET EXPOSURES								
a) Non-performing								
b) Performing					45			45
TOTAL B					**45**			**45**
TOTAL (A+B)	**41,533**	**11,847**	**13,515**	**56,867**	**1,754,785**	**16,457**	**5,842**	**1,856,248**

**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
A. Initial gross exposure	**20,021**	**5,913**	**65,420**
- of which: non-derecognized assigned exposures			
B. Increases	**34,903**	**26,249**	**148,037**
B.1 incoming performing exposures	11,213	13,984	101,309
B.2 transfers from other categories of non-performing exposures	13,964	3,569	
B.3 other increases	9,726	8,251	44,848
Business combinations		445	1,880
C. Decreases	**19,693**	**11,963**	**145,115**
C.1 outgoing performing exposures	4,724		57,386
C.2 derecognitions		10	
C.3 collections	14,969	2,389	79,655
C.4 gains on sales			
C.5 losses from disposal			
C.6 transfers to other categories of non-performing exposures		9,574	6,931
C.7 other decreases			
D. Final gross exposure	**35,231**	**20,189**	**68,342**
- of which: non-derecognized assigned exposures			

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

(Amounts in thousands of Euro)

Causali/Categorie	Doubtful		Unlikely to pay		Non-performing past due exposures		Performing past due exposures		Performing	
	Total	Of which: forborne exposures	Total	Of which: forborne exposures	Total	Of which: forborne exposures	Total	Of which: forborne exposures	Total	Of which: forborne exposures
A. Initial total adjustments	**6,122**	**-**	**820**	**-**	**194**		**-**	**-**	**-**	**-**
- of which: non-derecognized assigned exposures	-	-	-	-	-		-	-	-	-
B. Increases	**8,491**	**-**	**4,071**	**-**	**136**		**-**	**-**	**-**	**-**
B.1 value adjustments	8,690	-	3,771	-	59		-	-	-	-
B.2 losses from disposal	-	-	-	-	-		-	-	-	-
B.3 transfers from other categories of non-performing exposures	722	-	5	-	-		-	-	-	-
B.4 other increases	79	-	45	-	77		-	-	-	-
Business combinations			250							
C. Decreases	**2,353**	**-**	**865**	**-**	**162**		**-**	**-**	**-**	**-**
C.1 valuation write-backs	2,107	-	98	-	110		-	-	-	-
C.2 collection write-backs	1	-	-	-	32		-	-	-	-
C.3 profits from disposals	-	-	-	-	-		-	-	-	-
C.4 derecognitions	-	-	45	-	-		-	-	-	-
C.5 transfers to other categories of non-performing exposures	-	-	722	-	5		-	-	-	-
C.6 other decreases	245	-	-	-	15		-	-	-	-
D. Final total adjustments	**12,260**	**-**	**4,026**	**-**	**168**		**-**	**-**	**-**	**-**
- of which: non-derecognized 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	Specific adjustments	Portfolio adjustments	Net Exposure	Specific adjustments	Portfolio adjustments	Net Exposure	Specific adjustments	Portfolio adjustments	Net exposure	Specific adjustments	Portfolio adjustments	Net Exposure	Specific adjustments	Portfolio adjustments	Net Exposure	Specific adjustments	Portfolio adjustments
A. On-balance sheet exposures																		
A.1 Doubtful	0	0	0	10,240	5,137	0	0	0	0	0	0	0	12,573	6,543	0	156	582	0
- of which: forborne exposures	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
A.2 Unlikely to pay	0	0	0	0	0	0	0	0	0	0	0	0	15,208	4,024	0	955	2	0
- of which: forborne exposures			0			0			0	0	0	0			0			0
A.3 Non-performing past due exposures	736	0	0	49,743	130	0	0	0	0	1	0	0	17,196	38	0	497	1	0
- of which: forborne exposures	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
A.4 4 Performing exposures	744,220	0	108	496,715	0	6,132	2,223	0	0	2	0	0	238,564	0	1,689	267,173	0	641
- of which: forborne exposures																		
Total A	**744,956**		**108**	**556,698**	**5,267**	**6,132**	**2,223**			**3**			**283,540**	**10,605**	**1,689**	**268,781**	**585**	**641**
B. Off-balance sheet exposures																		
B.1 Doubtful																		
B.2 Unlikely to pay																		
B.3 Other non-performing assets																		
B.4 Performing exposures													9			36		
Total B													**9**			**36**		
Total (A+B) 2016	**744,956**		**108**	**556,698**	**5,267**	**6,132**	**2,223**			**3**			**283,549**	**10,605**	**1,689**	**268,817**	**585**	**641**
Total (A+B) 2015	**1,195,995**	**20**	**105**	**563,893**	**4,934**	**1,436**	**198,608**						**291,438**	**1,618**	**1,147**	**129,130**	**562**	**546**

DISTRIBUTION BY GEOGRAPHICAL AREA 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	22,971	12,260	0	0	0	0	0	0	0	0
A.2 Unlikely to pay	16,131	3,817	0	0	0	0	0	0	0	0
A.3 Non-performing past due exposures	68,172	170	0	0	0	0	0	0	0	0
A.4 Other performing exposures	1,737,662	8,540	9,609	25	1,625	5	0	0	0	0
Total A	**1,844,968**	**24,787**	**9,609**	**25**	**1,625**	**5**	**0**	**0**	**0**	**0**
B. Off-balance sheet exposures										
B.1 Doubtful	0	0	0	0	0	0	0	0	0	0
B.2 Unlikely to pay	0	0	0	0	0	0	0	0	0	0
B.3 Other non-performing assets	0	0	0	0	0	0	0	0	0	0
B.4 Other performing exposures	45	0	0	0	0	0	0	0	0	0
Total B	**45**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Total (A+B) 2016	**1,845,013**	**24,787**	**9,606**	**25**	**1,625**	**5**	**0**	**0**	**0**	**0**
Total (A+B) 2015	**2,359,118**	**10,311**	**21,211**	**59**	**0**	**0**	**0**	**0**	**0**	**0**

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 6months	from more than 6 months up to 1 year	from more than 1 years up to 5 years	Over 5 years	indeterminate
On-balance sheet assets	**399,746**	**26,538**	**3,587**	**50,021**	**216,361**	**245,577**	**449,490**	**375,680**	**131,857**	**6,835**
A.1 Government securities					92,042	100,086	295,396	20,018		
A.2 Other debt securities										
A.3 UCI units										
A.4 Loans	399,746	26,538	3,587	50,021	124,319	145,491	154,494	355,662	131,857	6,835
- banks	8,497			11	8	330				6,835
- customers	391,249	26,538	3,587	50,010	124,311	145,161	154,494	355,662	131,857	
On-balance sheet liabilities	**483,513**	**415,619**	**39,183**	**24,126**	**196,318**	**77,489**	**85,836**	**480,811**	**24,741**	
B.1 Deposits and current accounts	481,400	48,040	38,978	22,955	195,291	65,991	65,264	236,904	3,776	
- banks	20,276	45,000	35,000	15,000	150,000					
- customers	461,124	3,040	3,978	7,955	45,291	65,991	65,264	236,904	3,776	
B.2 Debt securities						1,314	1,314	70,000	20,000	
B.3 Other liabilities	2,113	367,579	205	1,171	1,027	10,184	19,258	173,907	965	
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 GEOGRAPHICAL AREA 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	Total Adjustments	Net Exposure	Total Adjustments	Net Exposure	Total Adjustments	Net Exposure	Total Adjustments	Net Exposure	Total Adjustments
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	83,493	-	-	-	-	-	-	-	-	-
Totale A	**83,493**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
B. Off-balance sheet exposures	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
B.1 Doubtful	-	-	-	-	-	-	-	-	-	-
B.2 Unlikely to pay	-	-	-	-	-	-	-	-	-	-
B.3 Other non-performing assets	-	-	-	-	-	-	-	-	-	-
B.4 Other performing exposures		-	-	-	-	-	-	-	-	-
Total B		**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total (A+B) 2016	**83,493**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total (A+B) 2015	**2,121**	**-**		**-**	**-**	**-**	**-**	**-**	**-**	**-**

At 31 December 2016, the Parent Company's Significant exposures (exposures equal to or greater than 10% of the regulatory capital) consist of 18 positions amounting to:

a) Book value € 1,204,797 (in thousands)

b) Weighted value € 89,077 (in thousands)

SECTION 9 - UNENCUMBERED ASSETS
(Art.443 CRR)

QUALITATIVE INFORMATION

The Bank's encumbered assets include Debt securities as guarantees for refinancing transactions with the ECB and debt securities used as collateral in repurchase agreements. The encumbered assets also include trade receivables as security with 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, established, 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 2017 budget.

As at 31/12/2016, the encumbered debt securities amounted to approximately € 296 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 (108 million).

The collateral received by the bank during repurchase 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 repurchase agreements.

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	**403,437**		**1,540,320**	
On demand loans			55,605	
Equity instruments	-	-	7,962	7,962
Debt securities	295,528	295,528	212,344	212,344
Loans other than on demand loans	107,908		1,268,307	
Other assets	107,909		1,320,015	

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	Nominal amount of the collateral received or of own debt securities issued that may not be encumbered
Real collateral received by the reporting institute	-	-	1,026
Equity instruments	-	-	92,2
Debt securities	-	-	933,6
Other collateral received	-	-	-
Own debt securities issued other than originated covered bonds or ABS	-	-	-

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 covered bonds and encumbered ABS
Book value of selected financial liabilities	488,430	403,437

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 lending activities predominantly consist:

- in the purchase with and without recourse of the accounts receivable due from Central Administrations, territorial authorities and in general from Public Administration;
- 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 2016, the Bank availed itself of the ratings issued by the ECAI:

- "Dominion Bond Rating Service" (DBRS), for the exposures to the Central Administrations and Central Banks; the related Supervised Intermediaries, Public sector institutions and Territorial authorities;
- "Fitch Ratings", with regard to exposures to businesses and other entities.

The identification of a reference ECAI does not represent in any way, 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.

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

QUANTITATIVE INFORMATION

(Amounts in thousands of Euro)

Regulatory class	Weighting							Total
	0%	20%	50%	75%	100%	150%	250%	
Central administrations and central banks	820,317	-	-	-	5,169	-	2,324	**827,811**
Territorial Authorities, Public Sector Institutions, Non-profit institutions	-	451,241	27,965	-	5	-	-	**479,211**
Supervised Intermediaries	-	406,929	167	-	-	-	-	**407,096**
Multilateral Development Banks	-	-	-	-	-	-	-	**0**
International Organisations	-	-	-	-	-	-	-	**0**
Businesses and other entities	-	-	-	-	268,579	-	-	**268,579**
Detail	-	-	-	324,004	-	-	-	**324,004**
UCI	-	-	-	-	-	-	-	**0**
Securitised debt	-	-	-	-	-	-	-	**0**
Covered bank bonds	-	-	-	-	-	-	-	**0**
Property-secured exposures	-	-	-	-	-	-	-	**0**
Exposures in equity instruments	-	-	-	-	7,074	-	922	**7,995**
Non-performing exposures	-	-	-	-	25,585	104,720	-	**130,305**
Other exposures	98	-	-	-	-	-	-	**24,701**

SECTION 11 - EXPOSURE TO MARKET RISK
(Art. 445 CRR)

QUALITATIVE INFORMATION

Market risk represents the risk of loss deriving from adverse movements in market prices (share prices, interest rates, exchange rates, commodity prices, risk factor volatility, and so forth) with regard to the trading book for Supervisory purposes (position, settlement and concentration risk) and the financial statements of the Bank (exchange rate and commodities position risks).

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

The regulations identify and regulate the treatment of the different types of market risk with regard to the trading book for supervisory purposes.

As at 31 December 2016 the Bank is marginally exposed to the market risk due to the position in the trading book of a security. The security is in Swedish krona and, therefore, also generates an exchange rate risk which, due to the size, is also limited.

The existing limit system defines a careful and balanced management of the operational autonomy, establishing limits in terms of portfolio amounts and composition by type of security.

QUANTITATIVE INFORMATION

Based on the approach mentioned above, the capital requirement with respect to market risk, as at 31 December 2016 amounted to €0.4 million.

(Amounts in thousands of Euro)

Standardised Approach	Weighted Amounts 12/2016	Requirement 12/2016
Position risk on debt instruments	0	0
Position risk on UCI units	0	0
Position risk on equity instruments	1,993	159
Foreign exchange risk	2,602	208
Position risk on commodities	0	0

SECTION 12 - OPERATIONAL RISK
(Art. 446 CRR)

QUALITATIVE INFORMATION

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

- 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.

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.

QUANTITATIVE INFORMATION

Based on the approach mentioned above, the capital requirement with respect to operational risk, as at 31 December 2016 amounted to € 10.4 million.

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 financial assets".

Available-for-sale financial assets - accounting criteria

- **Classification criteria**

  This category includes the non-derivative financial assets not classified otherwise as "Financial assets held for trading", "Financial assets measured at fair value", "Held-to-maturity financial assets" or "Receivables".

  The investments "available for sale" are financial assets that are intended to be retained for an indefinite period 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 previously mentioned 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 derecognised 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 previously mentioned 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.
  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 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 Profits/Losses and impairment		Unrealised gains/losses recorded in Statement of Financial Position	
			Level 3	Level 1	Level 2	Level 3	Level 1	Profits	Losses	Gains(+)	Losses(-)
Available-for-sale financial assets			6,965	1,965	-	5,000	-	-	-	-	-
Financial assets at fair value through profit and loss			-	-	-	-	-	-	-	-	-
Equity investments			1,030			1,030					
Goodwill	-	-	1,786	-	-	1,786	-	-	-	-	-

The value reported in available-for-sale financial assets mainly represents the purchase of 200 stakes (equal to 0.066%) of the capital of the Bank of Italy, with a total value of € 5 million.

The item Equity investments includes a 10% 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 Gruppo SF Trust of Solvi S.r.l. which was subsequently merged into 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.

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 Department 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 31/12/2016, 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”, except for:

- 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 withdrawal 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 interest rate risk in the banking book, 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 31/12/2016
INTERNAL CAPITAL FOR INTEREST RATE RISK	579
REGULATORY CAPITAL	124,713
RISK INDICATOR	0.5%
THRESHOLD LIMIT DEFINED BY CODE	20%

SECTION 15 - EXPOSURE TO SECURITISATION POSITIONS (ART. 449 CRR)

QUALITATIVE INFORMATION

The securitisation of receivables is a financial technique that transforms illiquid "assets" (receivables, property, other rights) into financial instruments that are traded on the bond market. It is also an instrument for funding and transferring risk.

During 2016, Banca Sistema acted as originator for 2 securitisation transactions (serving also as the Master Servicer) which are described below:

- Quinto Sistema: securitisation of the portfolio of receivables deriving from loans granted that are backed by pensions and salaries.
- Atlantis: securitisation of receivables due from debtors belonging to the "public" category and subject to legal recovery procedures.

Quinto Sistema Objectives

The securitisation of pension- and salary-backed loan transactions has the following objectives:

- Expanding the source of financing by targeting investors that are different from those the Bank normally deals with, such as institutional investors specialised in the senior, mezzanine and junior risk classes.
- Reduction in the cost of funding through the use of ABS as collateral for ECB loans.
- Optimisation of regulatory capital: the creation of an ABS structure (senior, mezzanine and junior), with progressively increasing costs, allows for opportunities to sell higher risk securities on the market to be evaluated, in accordance with the CRR Directive, thus freeing up the desired share of regulatory capital absorbed by the salary-backed loans portfolio.
- Dynamic strategy to maintain the balance between lending (receivables deriving from salary-backed loans) and the banks financing sources (specific funding): typical characteristic of ABS securities when permanently put on the open market, is that they are "self-paying" as the duration of the loan and the funding match perfectly, with no refinancing risk. The contribution of the ABS duration is always proportional to the duration of the sercuritised asset.

Atlantis Objectives

Through this structure, the Bank intends to proceed with the management restructuring and rationalisation of its Factoring portfolio. In line with the organisational changes implemented in 2016 (with the establishment of a Servicing Department) and with the organisational and strategic prospects deriving from the integration of Beta Stepstone, the Bank aims to review its approach for managing receivables that are under legal action. The transaction foresees the securitisation of unopposed enforceable injunctions, hence any injunctions that gradually meet this requirement may be subject to future securitisation. The **benefits** will therefore be "indirect", attributable to the **standardisation of the servicing** of the securitised portfolio, the transparency that will ensue in the management of the securitised positions, and the implementation of a management model that is scalable in relation to the new positions that become "unopposed enforceable injunctions".

Securitisation risks

When speaking of securitisation risks, reference is made to various types of risks that are mainly attributable to three specific roles/circumstances in which Banca Sistema will find itself;

- *Investor* in ABSs deriving from its own securitisation. In the event of portfolio derecognition with some securities maintained in the financial statements, for reporting and prudential purposes the “ABSs” need to be valued and not the “loans”.

- *Servicer* of the securitisation. With the natural operational risks that already exist before the securitisation but that become contractual and regulatory risks.
- *Originator* of the transaction. In addition to the above, there is finally the Bank’s general reputational exposure to the market resulting from the increased transparency that exists regarding the performance of the securitised portfolio (analysed periodically by rating agencies and investors) and the overall performance of the securitisation.

The Bank reports the securitised portfolios in the financial statements and in the supervisory reports as loans, that is, as if the exposures were never securitised.

For these types of exposures, the standardised approach is applied.

The Bank does not hold securitised third party exposures in its portfolios.

ECAI

The rating agencies for Quinto Sistema were Moody’s and DBRS because:

- 2 ratings are necessary for senior ABS to be used in ECB refinancing transactions;
- They are the only two agencies that have a method for assigning a rating to securitised salary-backed loans (the other rating agencies would have to go through a process for preparing the criteria at the expense of the transactions and without any guarantee on the outcome).

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 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, 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 "on full phase-in", i.e. cleansed of the exemptions pursuant to the Transitory measures.

As at 31/12/2016, a leverage indicator equal to 5.6% 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 guarantees 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	31.12.2016
Total assets	**1,998,991**
Items deducted from Own Funds - On full phase-in	-3,312
Items deducted from Own Funds - Transition period	-3,615
repurchase agreement add-ons	
derivative add-ons	0
Off-balance-sheet items	17,832
Overall exposure of leverage ratio - on full phase-in	2,013,564
Overall exposure of leverage ratio - transition period	2,013,261
Tier 1 - Upon full phase-in	112,924
Tier 1 - Transition period	112,621
Leverage - Upon full phase-in	5.61%
Leverage - Transition period	5.59%

SECTION 19 - USE OF CREDIT RISK MITIGATION TECHNIQUES (Art. 453 CRR)

QUALITATIVE INFORMATION

The granting of loans to SMEs 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 Conto! Deposito) converges in particular in the “Retail exposures” segment. The loan granted is guaranteed by the term-encumbered sums.

Moreover, as at 31 December 2016, “current account overdraft facility guaranteed by pledge” transactions were granted for a drawdown equal to approximately € 0.2 million. The value of the exposure is backed by eligible collateral for the purpose of credit risk mitigation[5].

With regard to the exposures deriving from the acquisition of pension-backed loan contracts, the Bank recognises, for credit risk mitigation purposes, the life insurance policies entered into on behalf of the lending entity (following assignment, the Bank becomes the beneficiary of these policies), which contain conditions expressly set out in EU Regulation 575/13, Art. 212 - Requirements for other funded credit protection, paragraph 2.

In order to benefit from unfunded credit protection, the Bank must identify the life insurance policies it intends to make use of to substitute the weighting coefficient of the guarantor with that of the guaranteed party, verifying that the insurance company is authorised to carry out insurance activities and that it has the credit quality rating of an ECAI.

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

QUANTITATIVE INFORMATION

(Amounts in thousands of Euro)

Segment	On-balance sheet exposure	Off-balance sheet exposure	Post CRM on-balance heet exposure	Post CRM off-balance sheet exposure	RWA
Central administrations and central banks	827,811	0	890,183	0	10,980
Territorial authorities	271,306	0	271,306	0	54,265
Public sector institutions	207,905	0	208,117	0	49,988
Supervised intermediaries	25,576	85,992	25,576	0	5,165
Businesses and other entities	199,948	68,631	281,028	45,000	218,849
Detail	319,225	4,779	185,805	0	137,409
Impaired exposures	111,694	18,611	101,095	0	142,351
Exposures in equities	7,995	0	7,995	0	9,377
Other exposures	24,701	0	24,701	0	24,603

CAPITAL ADEQUACY BETA STEPSTONE

QUALITATIVE INFORMATION

a) The following manuals regulate the assumption and monitoring of risk: (i) “Risk Management Policy” approved by the Board of Directors on 24 March 2011, and updated on 29 July 2013), in which the methods to be applied to quantify measurable risks are set out, and (ii) “Credit acquisition and management process” updated on 23 July 2015.

With respect to its business, the Company is generally exposed to the following risks:

- Pillar 1 Risks:
  - Credit risk (quantifiable)
  - Operational risk (quantifiable)
- Pillar 2 Risks:
  - Concentration risk (quantifiable)
  - Interest rate risk in the investment portfolio (quantifiable)
  - Liquidity risk (not quantifiable)
  - Strategic risk (not quantifiable)
  - Reputational risk (not quantifiable)
  - Compliance risk (not quantifiable)

Credit risk

Exposure to credit risk may result from both the quality of the receivables acquired, and the financial and economic standing of the assignor (with recourse transactions) or of the assigned debtor (without recourse transactions); the former are private businesses (especially SMEs) while the latter are almost exclusively entities in the public administration.

In the definitive acquisition of “without recourse” receivables, the risk taken on is with the Public Administration/ public/territorial authority, or the local health authorities or hospitals that financially rely on annual fund allocations from the central Government or the Regions.

In “with recourse” transactions, if the assigned debtor does not fulfil its payment obligation, or if the receivables (originally acquired as “without recourse”) is returned to the assignor because the court determined that all or a part of the receivable is not owed by the debtor, the risk is towards the assignor.

Credit risk also includes:

- dilution risk, or the possibility that the acquired receivables are no longer completely collectible at the due date because of offsets, allowances, disputes between the debtor and the originator; for this type of risk, the Company has adequately safeguarded itself with specific contractual clauses (for example, the disbursement of a second tranche - normally not less than 20% - only upon final collection of the receivable);
- “revocation” risk. Pursuant to law 52/1991, for transfers in which the debtor is notified, the debtor is nonetheless required to pay the receivables subject to the transfer contract even if the assignor files for bankruptcy and the burden of proof regarding knowledge of the factor’s state of insolvency lies with the Receiver. If the Receiver were to prove that the transferee was aware of the assignor’s state of insolvency at the time of the transfer, the transfer would not be effective and any payments received from the debtor would be returned to the Receiver.

The above-mentioned risks are monitored in the investigation phase with an assessment of the assignor’s creditworthiness, even in the case of a purchase “without recourse”.

Being a quantifiable risk, the Company relies on the **standardised approach** set out in the regulations for measurement.

Operational risk

Operational risk is the risk of loss arising from (i) inadequate or improperly functioning procedures and internal systems, (ii) errors made by employees when executing transactions, and (iii) external events. For the regulations, it is considered a “pure” risk in that its assumption is involuntary and inherent in the operations of financial intermediaries.

Being a quantifiable risk, the Company relies on the **Basic Indicator Approach** set out in the regulations for measurement.

Concentration risk

Concentration risk is related to the relevance of some exposures towards a single party with reference to the regulatory capital. It is the most significant risk that the Company is exposed to.

To measure it, the Company uses the approach set out in Bank of Italy’s Circular 263, Title III, Chapter 1, Schedule B for the “business” segment, related to quantifiable risks.

As at 31 December 2016, no exposure exceeds 25% of regulatory capital and, as a result, no additional requirements are applied.

Interest rate risk on the investment portfolio

This risk quantifies the potential impact that unexpected changes in interest rates may have on current profits and on the Company’s shareholders’ equity caused by mismatches in maturities.

Considering that (i) loans are granted with a fixed yield (barring changes in the ECB/legal rate), (ii) the Company has sufficient liquidity and has not made use of advances from intermediaries/banks, interest rate risk is mainly attributable to the trend in the ECB/legal rate.

For measurement, the Company applies the method set out in Attachment C, Title III, Chapter 1, of Circular no. 263.

Liquidity risk

The main risk is funding liquidity risk tied to the inability to fulfil current or prospective financial obligations taken on by the Company. This risk is covered by:

- guaranteed inflows from the collection of receivables in the portfolio;
- cash available in the current bank accounts.

The Company is not exposed to market liquidity risk since it does not have a trading book.

Information on the liquidity reserves at 31.12.2016 and the estimated cash flow changes by maturity interval (maturity ladder) are reported in the following tables:

Liquidity reserves	Book value
Cash and reserves held at central banks	€ 1.762
Deposits held at other banks	€ 14.360.698
Total Cash and cash equivalents	**€ 14.362.460**

Portfolio	1 DAY	2 DAYS	1 WEEK	2 WEEKS	3 WEEKS	1 MONTH	2 MONTHS	3 MONTHS	6 MONTHS	1 YEAR	> 1 YEAR
without recourse				2		215,719		1,862,849	9,737,043	17,460,885	16,898,407
with recourse									11,531,774		
retrocessions	1,106,869										
II without-recourse tranche	- 1,638,690			-1,096,004		- 56,434		- 267,300	- 4,910,580	- 8,220,705	- 4,621,255
Net position	**- 531,821**	**-**	**-**	**-1,096,002**	**-**	**159,285**	**-**	**1,595,548**	**16,358,237**	**9,240,180**	**12,277,152**

Strategic Risk

Strategic risk, which is considered material, may derive from unpredictable changes in profits/margins tied to volatility in volumes or regulatory changes that, in the absence of adequate counter measures by the Company, may result in drastic decreases in business and revenues with consequent losses in the financial statements.

This risk is mitigated through suitable organisational measures.

Reputational Risk

Reputational risk is often connected to other types of risk (especially operational risk), that give rise to or transform themselves into reputational risks.

Since it is not quantifiable, suitable preventive and control measures have been implemented. In particular, the Complaints Office conducted a daily survey of the complaints/grievances received from customers and perform a review of the merits, to verify if they are justified, the outcome of which is constantly reported to the Governing Bodies for the appropriate assessments and the adoption of measures that may be necessary.

Compliance Risk

This is the risk of non-compliance with the internal and external regulations that govern the Company's operations. Since a valid method for measuring it has not yet been identified, the Company has implemented suitable organisational measures for their management and monitoring.

Rischi non rilevanti

The Company is not exposed to the following risks:

- Market risk, as it does not have a trading book;
- Securitisation risk, as it has not entered into securitisation transactions;
- Counterparty risk on derivative transactions, as it does not have derivatives in its portfolio;
- Off-balance sheet risk, as it does not have any off-balance sheet assets;
- Residual risk, as it has not identified any mitigation techniques that are valid for the prudential regulation.

Adequacy of internal capital to support current and future activities

The Company determines Total Internal Capital in accordance with the regulations and based on the principle of proportionality, using the “building block” approach, summing the regulatory requirements for Pillar I risks to the internal capital necessary for the relevant measurable risks in Pillar II.

Since the Company ceased operations following the merger into Banca Sistema, no audits on the prospective adequacy of the capital on an individual level were done.

b) Capital requirement with respect to Credit Risk

For the weighting of the receivables portfolio the Company applies the standardised approach using the rating issued by Moody's for sovereign risk, with a focus on entities in the public sector.

With regard to the Baa2 rating (creditworthiness class 3) assigned by Moody's, the weighting for entities in the public administration is equal to 100% (except for territorial authorities which are weighted at 20% and the Central Administrations which are weighted at 0%). Unrated exposures are weighted according to the regulations, at 100%.

In the prudential supervisory reports performed at 31/12/2016, the requirements for credit risk were **€4,123,742** as set out in the following table:

Credit risk requirement	Information as at 31/12/2016	Information as at 31/12/2015	Δ 2016-2015
Credit risk (standard approach)	€ 4,123,742	€ 4,753,307	-13%
Additional requirements for positions exceeding the individual limits	-	-	na
Total	**€ 4,123,742**	**€ 4,753,307**	**-13%**

c) Capital requirement with respect to market risk

The Company does not have a trading book. As a result, specific measurement was not performed.

d) Capital requirement with respect to operational risks

The capital requirement with respect to operational risk is **€861,627**. The following table illustrates change over the three-year period in correlation to the trend in net interest and other banking income.

Year	2016	2015	2014	Δ 2016-2015
Net interest and other banking income	€ 5,757,606	€ 4,813,247	€ 6,661,680	20%
Average last three years	€ 5,744,178	€ 6,606,064	€ 7,359,627	-13%
Weighting	15%	15%	15%	Na
Internal Capital	**€ 861,627**	**€ 990,910**	**€ 1,103,944**	**-13%**

The **total Pillar I capital requirements** (credit/market/operational risks) are decreasing with respect to the previous year following the contraction in the receivables portfolio.

Risk	2016 regulatory requirements	2015 regulatory requirements	Δ 2016-2015
Credit risk	€ 4,123,742	€ 4,753,307	-13%
Additional requirement for exceeding the individual limits	€ 0	€ 0	na
Operational risk	€ 861,627	€ 990,910	-13%
Total Pillar I	**€ 4,985,369**	**€ 5,744,217**	**-13%**

e) Regulatory Capital

The total capital for supervisory purposes at 31/12/2016 amounts to **€61,696,859** as illustrated in the following table:

Capital item	2016	2015	Δ 2016-2015
Tier 1 capital	**€ 61,696,859**	**€ 58,998,476**	**5%**
Paid-in share capital	€ 47,000,000	€ 47,000,000	0%
Reserves (statutory and profit carried forward)	€ 11,975,633	€ 11,882,124	1%
Profit for the period	€ 2,734,882	€ 140,080	1,852%
Intangible assets	-€ 13,656	-€ 23,728	-42%
Tier 2 capital	**€ 0**	**€ 16,144,658**	**-100%**
Subordinated liabilities (max 50% of Tier I capital)	€ 0	€ 16,144,658	-100%
Total Regulatory Capital	**€ 61,696,859**	**€ 75,143,134**	**-18%**

i. Tier 1 capital, equal to **€61,696,859** consists of the share capital, the reserves and income for the period;

ii. Tier 2 capital was zeroed following repayment of the subordinated loan from the former single shareholder in 2016, upon receiving authorisation from the Bank of Italy.

f) Total and Tier 1 capital ratios

As illustrated in the following tables, the **Tier 1 ratio** is equal to **74.3%** (Tier 1 capital/risk weighted assets) and corresponds to the **total capital ratio** as there is no Tier 2 capital.

Information as at 31/12/2016	Credit Risk	Operational risk	Total
RWA (requirement * reciprocal 6%)	€ 68,729,036	€ 14,360,444	€ 83,089,481
Tier 1 capital	€ 61,696,859	€ 61,696,859	€ 61,696,859
Regulatory Capital	€ 61,696,859	€ 61,696,859	€ 61,696,859
Tier I ratio (Tier I capital / RWA)	**90%**	**430%**	**74.30%**

g) Total 3rd level regulatory capital

The company does not have 3rd level regulatory capital.

DECLARATION BY THE MANAGER RESPONSIBLE FOR PREPARING THE COMPANY'S FINANCIAL REPORTS

The Manager responsible for preparing the company's financial reports, 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 Institutions according to Regulation (EU) 575/2013 - 31 December 2016" corresponds to the company's documents, books and accounting records.

Margherita Mapelli
Manager responsible for preparing
the company's financial reports

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; held-to-maturity assets, 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 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 of Common Equity Tier 1 capital (CET1) to total risk-weighted assets.

CRM
Credit Risk Mitigation.

Default
It identifies the condition of stated impossibility to honour one's 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
An evaluation of the quality of a company or of its bond issues, based on the company's financial strength and outlook.
Said assessment is performed by specialised agencies or by the bank based on internal models.

Credit risk
This represents 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 improperly functioning internal processes, human resources, or internal systems, or from external events. Operational risk includes legal risk or the risk of loss deriving from legal or regulatory violations, contractual or non-contractual liabilities or other disputes, ICT risks (Information and Communication Technology) and model risk; strategic and reputational risks are not included.

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

RWA (Risk Weighted Assets)
On- and off-balance sheet assets (derivatives and guarantees) classified and weighted based on various

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

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 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).